Agenda Item

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Shetland Islands Council

Shetland Islands Council	**3 December 2014**
Pension Fund Consultative Panel	**11 December 2014**

Pension Fund Annual Report on the 2013/14 Audit	
F-061-F	
Report Presented by Executive Manager – Finance	**Corporate Services**

1.0 Summary

1.1 The purpose of this report is to receive Audit Scotland's Annual Report on the 2013/14 Audit.

2.0 Decision Required

2.1 The Council:

a) NOTE Audit Scotland's Annual Report on the 2013/14 Audit.
b) APPROVE the Action Plan.

3.0 Detail

3.1 The Annual Audit Plan requires the Council to receive the Annual Report of the Pension Fund by December 2014. This is included at Appendix 1. The accounts for 2013/14 have received an unqualified audit opinion.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities – The preparation and presentation of the Pension Fund Accounts is a key element of the Council's overall governance and reporting arrangements.

4.2 Community /Stakeholder Issues – NONE.

4.3 Policy And/Or Delegated Authority – The Pension Fund Consultative Panel has an overview of the management of the local government pension scheme. Receiving the audited accounts of the Council and related certificates and reports is a matter reserved by the Council.

4.4 Risk Management – The Annual Report is enclosed as Appendix 1 to this Report. There were 7 risk areas identified.

An Action Plan to address these issues has been drawn up and is included as Appendix B: Action Plan (part of Appendix 1). The Action Plan is realistic and achievable within the timescales set.

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 The Council is required to prepare and publish a set of Accounts in respect of the Pension Fund, within a set timescale. The accounts are then subject to external audit and currently Audit Scotland is the Council's nominated auditors. Audit Scotland has now certified the accounts as being a true and fair statement of the Pension Fund's financial position at 31 March 2014. Audit Scotland has provided an Annual Report of the 2013/14 accounts and have identified 7 risk areas. An Action Plan has been agreed to ensure that those risks are well managed and resolved, within a reasonable timeframe.

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11 November 2014

List of Appendices

Appendix 1: Pension Fund Annual Report on 2013/14 Accounts by Audit Scotland

Background documents:

NONE.

END

AUDIT SCOTLAND

Shetland Islands Council Pension Fund

Annual report on the 2013/14 audit

Prepared for the members of Shetland Islands Council as administering body for Shetland Islands Council Pension Fund and the Controller of Audit

October 2014

Contents

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Key messages

Financial statements	• We have given an unqualified opinion on the financial statements of Shetland Islands Council Pension Fund for 2013/14.
Financial position	• The Fund had net assets of £333 million as at 31 March 2014. The actuarial value of promised retirement benefits at the accounting date has been estimated by the actuary as £478 million, giving a net liability of £145 million as at 31 March 2014.
Governance & accountability	• The Shetland Islands Council Pensions Fund has governance arrangements that include a Pensions Fund Consultative Panel which is advised by relevant officers of the council as appropriate.
Best Value, use of resources & performance	• Investment returns were slightly below the benchmark target for 2013/14 and the 3 and 5 year benchmarks.
Outlook	• The uncertainty in the global financial markets and the consequent effect on the stock market means that the pension fund will require to remain vigilant and continue to assess the risk exposure. • New governance arrangements come into force on 1 April 2015 as a result of the Public Services Pensions Act 2013. • The administration of a career average scheme and auto-enrolment for staff may mean changes to the pension fund's processes.

Financial Statements

1. We have given an unqualified audit opinion that the financial statements of Shetland Islands Council Pension Fund for 2013/14 give a true and fair view of the state of the financial transactions of the fund during the year ended 31 March 2014 and of the amount and disposition at that date of their assets and liabilities.

Financial position

2. The Fund had net assets of £333 million as at 31 March 2014. The actuarial value of promised retirement benefits at the accounting date has been estimated by the actuary as £478 million, giving a net liability of £145 million as at 31 March 2014 (£126 million as at 31 March 2013).

Funding position

3. The most recent triennial valuation was reported in February 2012. The report highlighted that the fund's assets valued at 31 March 2011 (£251 million) were sufficient to meet 91% of its liabilities accrued up to that date, resulting in a funding shortfall of £25 million. This represented an improved position from the previous triennial valuation that reported a funding position of 88% (a funding shortfall of £26 million).

4. However, the interim funding position disclosed in the accounts at 31 March 2014 is somewhat weaker with funds falling to 70% of estimated future benefits, reflecting volatility in the stock markets.

5. The triennial valuation at 31 March 2014 which will set the employer contribution rates for the next three years starting from 1 April 2015 will be reported in February 2015.

6. The Public Services Pensions Act 2013 will introduce changes to ensure the sustainability of the Local Government Pension Scheme. Notably, the ‘employer cost cap’ will move some of the risk of future rises in scheme costs away from the Fund and onto members.

Governance and accountability

7. The Shetland Islands Council Pension Fund has governance arrangements which include a Pensions Fund Consultative Panel advised by relevant officers of the council as appropriate. The Panel meets approximately twice per year.

8. Our audit work indicates that the Pension Fund has adequate internal controls and satisfactory arrangements for the prevention and detection of fraud and corruption.

Best Value and performance

9. Investment performance is monitored by officers on both a quarterly and an annual basis against a benchmark return for fund managers. For the year to 31 March 2014, the Fund had

a return of 6.5%, a shortfall of 0.2% on the Fund's benchmark return of 6.7%.

Outlook

10. Global financial markets in 2013/14 faced a combination of political tensions across the world, prospects of monetary policy tightening in the US and a loss of economic momentum in some emerging economies. With investment performance key to the funding position of the Local Government Pension Scheme, this may impact on employer contributions in the longer term.

11. The Public Services Pensions Act 2013 passed by the UK parliament will mean changes to the way Local Government Pension Funds operate and pension benefits are accrued by members. Changes to meet the new Act are required to be implemented by 6 April 2015.

Introduction

12. This report is a summary of our findings arising from the 2013/14 audit of the Shetland Islands Council Pension Fund. The purpose of the annual audit report is to summarise the auditor's opinions and conclusions, and to report any significant issues arising from the audit. The report is divided into sections which reflect our public sector audit model.

13. Our responsibility, as the external auditor of Shetland Islands Council Pension Fund, is to undertake our audit in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.

14. The management of Shetland Islands Council Pension Fund is responsible for:

    - preparing financial statements which give a true and fair view
    - implementing appropriate internal control systems
    - putting in place proper arrangements for the conduct of its affairs
    - ensuring that the financial position is soundly based.

15. This report is addressed to the members of Shetland Islands Council, as administering body for the Pension Fund and the Controller of Audit. It should be made available to the public and other stakeholders. Audit is an essential element of accountability and the process of public reporting.

16. This report will be published on our website after it has been considered by those charged with governance. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

17. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. Local reports and relevant national reports are summarised at Appendix I. We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of Shetland Islands Council Pension Fund.

18. The concept of audit risk is of key importance to the audit process. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements. We set out in our annual audit plan the related sources of assurance and the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix II sets out the significant audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

19. Appendix III is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response".

20. We recognise that not all risks can be eliminated or even minimised. What is important is that Shetland Islands Council Pension Fund understands its risks and has arrangements in place to manage these risks. The council and the Proper Officer should ensure that they are satisfied with proposed management action and have a mechanism in place to assess progress and monitor outcomes.

21. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures. Consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

Acknowledgement

22. The co-operation and assistance given to us by officers during the conduct of our audit is gratefully acknowledged.

Financial statements

Performance	Net Assets	Investments	Funding Level
Return on investments 6.5%	Increase in Net assets £26.7m	Change in market value £26.7m	Net Assets £332.9m Value of promised retirement benefits £478m Funding Position 70%
Benchmark 6.7%	Net assets £332.9m	Investment Income £0.9m	

Audit opinion

23. We have given an unqualified opinion that the financial statements of Shetland Islands Council Pension Fund for 2013/14 give a true and fair view of the financial transactions of the fund during the year to 31 March 2014 and of the amount and disposition at that date of their assets and liabilities.

Other information published with the financial statements

24. Auditors review and report on other information published with the financial statements, including the explanatory foreword and the annual governance compliance statement. We have nothing to report in respect of these statements.

Legality

25. Through our planned audit work we consider the legality of the pension fund's financial transactions. In addition, the Executive Manager - Finance has confirmed that, to the best of his knowledge and belief, the financial transactions of the pension fund are in accordance with relevant legislation and regulations. There are no legality issues arising from our audit which require to be brought to the attention of those charged with governance.

Accounting issues arising

Presentational and monetary adjustments

26. A number of presentational adjustments were identified during the course of the audit. These were discussed and agreed with management who agreed to amend the unaudited financial statements.

27. Local authority bodies in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and the Service Reporting Code of Practice 2013/14 supported by International Financial Reporting Standards (IFRS). We concluded that the financial statements have been prepared in accordance with extant guidance.

Report to those charged with governance

28. We presented our report to those charged with governance (ISA 260) to the council's Audit Committee on 23 September. The primary purpose of that report is to communicate the significant findings arising from our audit prior to finalisation of the independent auditor's report. There were no significant issues identified from our audit.

Outlook

29. The financial statements of the Fund are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The main new standards to be adopted in 2014/15 include:

- IFRS 13 Fair value measurement
- IAS 32 Financial Instruments: Presentation
- Annual improvements to IFRSs 2009-2011 cycle

30. The revised Local Authority Accounts (Scotland) Regulations 2014 apply to financial years 2014/15 onwards. The regulations set out in more detail what is required in respect of financial management and internal control, and the content of the annual accounts. The significant requirements in relation to the financial statements include:

- the requirement for the unaudited accounts to be considered by a governance committee. This can take place following submission to the auditor and up to 31 August if necessary. In addition, the audited accounts must be considered and approved for signature by a governance committee by 30 September with publication on the administering authority's website by 31 October.

31. The Pension Fund should ensure that arrangements are put in place to comply with the requirements of the revised Local Authority Accounts (Scotland) Regulations 2014.

Refer to action plan point no.1

Financial position

32. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.

33. Auditors consider whether audited bodies have established adequate arrangements and examine:

    - financial performance in the period under audit
    - compliance with any statutory financial requirements and financial targets
    - ability to meet known or contingent, statutory and other financial obligations
    - responses to developments which may have an impact on the financial position
    - financial plans for future periods.

34. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the Fund.

Financial results

Budgetary control

35. The pension fund prepared an annual budget for the first time in 2013/14. A mid-year review is reported to the council's Policy & Resources Committee and the Pension Fund Consultative Panel to monitor the financial performance of the Pension Fund to ensure that expenditure incurred and income generated has been delivered within the approved budget.

Financial position

36. The overall position at 31 March 2014 is that the fund has net assets of £333 million. The financial statements do not take account of the obligations to pay pensions and other benefits which fall due after the end of the year. The actuarial position of the scheme, which does take account of such obligations, is disclosed in Note 18 to the Accounts. When taking into account these obligations (£478 million) the overall funding position of the fund is 70%.

Funding position

37. The most recent triennial valuation was reported in January 2012. The report highlighted that the fund's assets valued at 31 March 2011 were sufficient to meet 91% of its liabilities accrued up to that date, resulting in a funding shortfall of £25 million. This represents an improved position from the previous triennial valuation (as at March 2008) which reported a funding position of 86% (a funding shortfall of £26 million).

38. Since this time, the funding position has seen a significant downward movement. This is monitored on a regular basis as part of the administering authority's risk management

programme. The interim funding position as at 31 March 2014 has reduced to 70%, reflecting market volatility. This is an area of concern for the Fund and management should take appropriate action to address the reasons for the shortfall.

Refer to action plan point no.2

39. The movement in valuations is summarised in Table 1 below, updated with fund values as determined by the actuary for the year ended March 2014:

Table 1: Movement in valuations 2008 to 2014

Fund Details	2008 £ million	2011 £million	2014 £million
Assets	200	251	333
Liabilities	(226)	(276)	(478)
Net Liability	(26)	(25)	(145)
Funding Level	86%	91%	70%

Source: actuary's valuations at 31 March 2014

40. The actuarial value of promised retirement benefits at the accounting date has been estimated by the fund actuary as £478 million (2012/13 £432 million), giving a net liability of £145 million as at 31 March 2014 (2012/13 £126 million). There has been a significant increase in the net liability year on year since the last triennial valuation in 2011 and this is mainly attributed to the reduction in the real discount rate (the nominal discount rate net of inflation) and real bond yields, which have fallen considerably.

41. The Public Services Pensions Act 2013 is designed to ensure the continued sustainability of the Local Government Pension Scheme. In particular, the employer cost cap measures will move some of the risk of the future rises in scheme costs from the Fund onto members.

42. Actuarial assumptions include retirement rates, numbers and age of members within their valuations, and although the position is challenging, the fund reviews its position on a regular basis.

Outlook

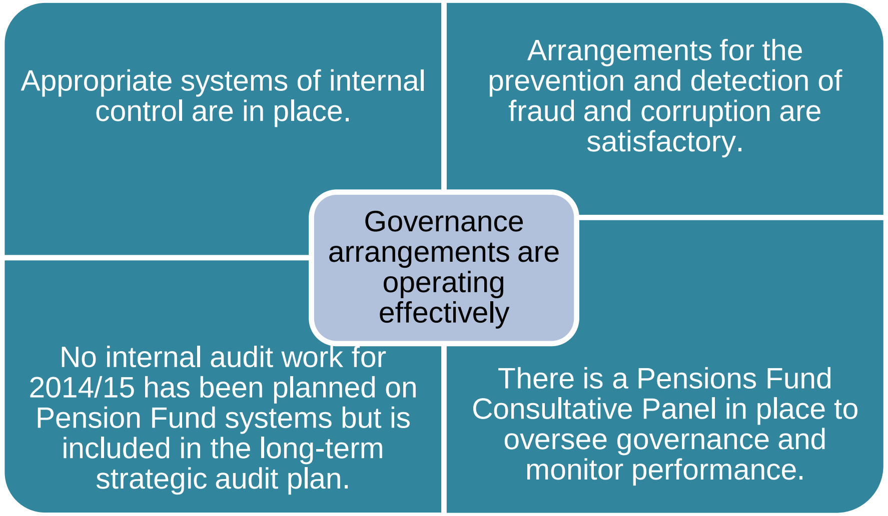
43. Looking ahead, it is clear that the outlook for public spending remains very challenging as significant budget reductions are required in future years. Spending constraints are set to continue and pressures on the fund will increase as scheduled and admitted bodies seek to deliver efficiencies through reductions in staffing levels.

44. Pension Fund membership increased during the financial year from 5,557 to 5,805 and is likely to increase further as other employers progress through the auto-enrolment process. This is an area for management to monitor closely to ensure the

fund remains sustainable.

45. The volatility in the global financial markets makes it important for pension funds to have a wide range of investment vehicles including hedging against currency fluctuations. The Pension fund will have to remain vigilant and ensure the risk exposure is at an acceptable level.

Governance and accountability



46. Members of the council and the Proper Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of Shetland Islands Council Pension Fund and for monitoring the adequacy and effectiveness of these arrangements.

Corporate governance

47. Shetland Island Council, as the administering authority for the Pension Fund, manages the Fund in terms of the Local Government Pension Scheme (Scotland) Regulations 2008. There is a Pension Fund Consultative Panel and the Policy and Resources Committee of the council has an overview of the activities of the fund.

48. Based on our observations and audit work, our overall conclusion is that the governance arrangements within Shetland Islands Council Pension Fund are operating effectively. The fund should continue to monitor arrangements to ensure compliance with legislation.

Governance processes and committees

49. Shetland Islands Council acts as the administering authority for the Pension Fund. It is responsible for managing and administering the scheme for scheduled and admitted bodies.

50. The current arrangements are that all pension fund issues are reviewed by the full council. The Policy and Resources Committee has the responsibility of reviewing the performance of the pension fund. In addition, there is a Pension Fund Consultative Panel in place which meets approximately twice per year. The role of this panel is to involve a wider range of stakeholders in overseeing the pension fund.

51. The Pension Fund commissioned Hymans Robertson, as investment adviser to the Fund, to conduct a review of its investment strategy. A new investment strategy was recently

approved by the Fund with the aim of achieving a fully funded pension scheme by 2027. As a result of the new investment strategy, a number of changes are to be made to the fund manager and investment structure to achieve better returns on investments whilst reducing risk. The Pension Fund will need to ensure that all changes to fund manager and investment structure comply with the new investment strategy and The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.

Refer to action plan point no.3

52. The Pension Fund will require to review its governance arrangements as a result of the Public Services Pensions Act 2013. The Act requires, at a national level, the establishment of a Scheme Advisory Board to provide advice and guidance with regard to the management and administration of the Local Government Pension Scheme. In addition, with the introduction of career average pensions, there will be a requirement to maintain pension records for each individual which will lead to an increased administrative workload for the pensions section.

53. At a local level, the Act requires a Scheme Manager and the establishment of a Pensions Board (from 1 April 2015) to support the manager. The Pensions Board must contain an equal number of employer and member representatives.

54. In addition, a Heads of Agreement on governance matters has been concluded between COSLA and the trade unions. However, the statutory regulations underpinning the new governance requirements will not be available until early 2015. This tight deadline presents a number of challenges to the pension fund and there is a risk that the Fund will not have appropriate arrangements in place by 1 April 2015.

Refer to action plan point no.4

Governance Compliance Statement

55. Pensions administration regulations require an administering authority to prepare and publish a governance compliance statement to measure the pension fund's governance arrangements against the standards set out in the guidance issued by Scottish Ministers. Having reviewed the governance compliance statement in the 2013/14 financial statements, we are satisfied that it complies with the guidance issued by the Scottish Ministers.

56. The governance compliance statement is designed to set out the areas of compliance and non-compliance with Scottish Government guidance. There were no areas of non-compliance reported by the Shetland Islands Council Pension Fund.

Internal control

57. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work is also informed by an assessment of risk and the activities of internal audit.

58. As part of our work we took assurance from key controls within the fund's systems. Our review of these financial systems did not identify any significant issues.

59. Shetland Islands Council acts as the Administering Authority, responsible for managing and administering the scheme for scheduled and admitted bodies. The Council plans to update its General Ledger system in 2014/15. Currently a number of reconciliations between the General Ledger System and the Pension Fund are performed. It is important that these controls are maintained and that the new system is tested prior to introduction.

Refer to action plan point no.5

60. In our 2012/13 audit report, we raised an action point highlighting that the internal controls reports provided by the external auditors of the Investment Managers and the Custodian are not reviewed. This action point is still to be addressed and there is a risk that weaknesses already identified by the auditors of the Investment Managers may not be addressed by the fund. We will continue to monitor progress in this area.

Refer to action plan point no.6

Internal audit

61. Internal audit is an important element of the fund's governance structure. The internal audit service is provided by the council's internal audit section. We reviewed the work of internal audit in terms of ISA 610 and concluded that they operated in accordance with the Public Sector Internal Audit Standards.

Arrangements for the prevention and detection of fraud

62. The Shetland Islands Council Pension Fund complies with the relevant fraud and irregularity policies of Shetland Islands Council and these have been reviewed as part of the council wide audit. Overall, we concluded that arrangements for the prevention and detection of fraud are adequate and there are no issues which we require to include in this report.

63. Shetland Islands Council as the administering authority for the pension fund participates in the National Fraud Initiative (NFI). The NFI uses electronic data analysis techniques to compare

information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error.

64. As part of our local audit work we monitor the council's approach to participation in NFI both in terms of the submission of the required datasets and strategies for investigating the subsequent data matches. We are satisfied that officers are proactive in investigating data matches. No areas of fraud were identified in 2013/14.

Outlook

65. There are a number of challenges for the Fund including the revised governance arrangements as a result of the Local Authority Accounts (Scotland) Regulations 2014 and the Public Services Pensions Act 2013. In addition, the move to pensions on a career average basis may have significant implications for the Fund in relation to the transition to and administration of a new scheme, as well as impacts on the Fund's assets, liabilities and future funding requirements.

66. The revised Local Authority Accounts (Scotland) Regulations 2014 apply to financial years 2014/15 onwards. The regulations set out in more detail what is required in respect of financial management and internal control, and the content of the annual accounts. The significant requirements in relation to governance include:

- the regulations require an annual review of the effectiveness of a local authority's system of internal control. The findings of that review are to be considered at a meeting of elected members.
- the regulations require a local authority to assess the efficiency and effectiveness of internal audit.

67. The Pension Fund should ensure that arrangements are put in place to comply with the requirements of the revised Local Authority Accounts (Scotland) Regulations 2014.

Refer to action plan point no.1

68. Auto-enrolment of employees is now being implemented by employers who are members of Shetland Islands Council Pension Fund. This will inevitably have an impact on administrative workloads, and early preparation for the changes is required to ensure continuing compliance with guidance. We will continue to keep this area under review in 2014/15.

69. Preparations are required for the introduction of career average pensions. There will be a requirement to maintain pension records for each individual bringing together a range of entitlements arising from benefits built up under different pension regimes. This will not only increase administrative workload initially, but may also generate more queries and enquiries from fund members seeking clarification on their

benefits on an ongoing basis.

70. It is important, that the training needs of members are kept under review during this period of significant pension reform to ensure that the key developments and their potential impact are understood and that members continue to be able to exercise their scrutiny role effectively.

Best value, performance and use of resources

Best Value

71. The pension fund has not been subject to a Best Value review however, it is covered by the overall Best Value arrangements of the administering authority.

Performance

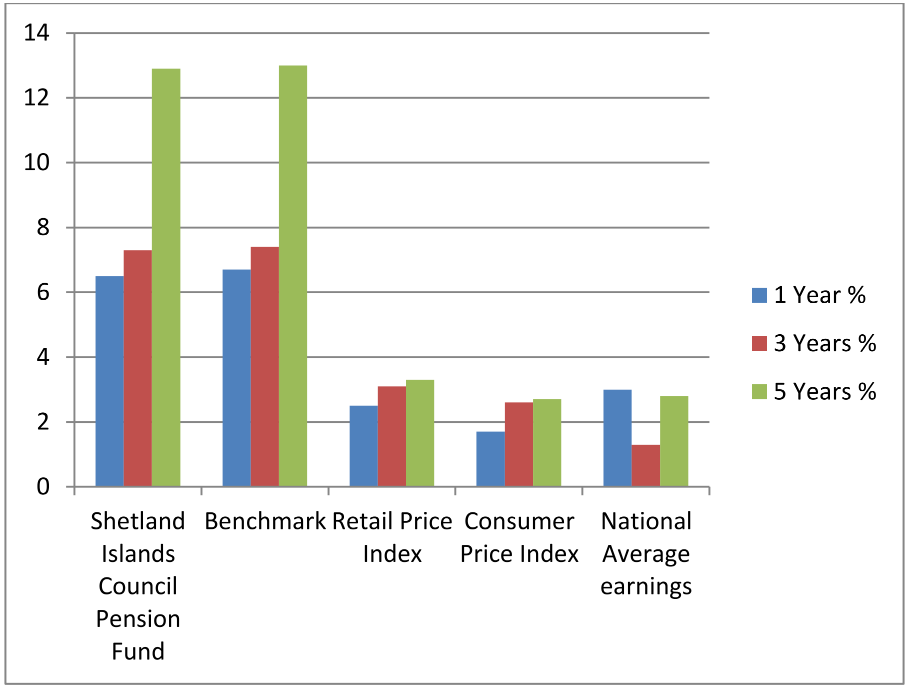
Investment Performance

72. The main mechanism for measuring investment performance is through an analysis of the returns achieved by each of the fund's external fund managers. The manager's performance, in terms of achieving benchmarks, is subject to independent verification by an independent investment adviser (WM Company). Mid year and year end performance is reported to the Policy & Resources Committee and the Pension Fund Consultative Panel.

73. Over the long term, the overall level of investment return achieved by the fund is expected to exceed the rate of return assumed by the actuary in valuing the Fund. Investment returns of Shetland Islands Council Pension Fund were slightly below the benchmark target for 2013/14 and the 3 and 5 year benchmarks.

74. Recent investment performance of the Fund is highlighted in table 2 below:

Table 2: Investment Performance



Source: Shetland Islands Council Pension Fund Annual Report & Accounts 2013/14

75. The table shows that over a period of one, three and five years,

the pension fund has outperformed National Average Earnings, the Consumer Price index and the Retail Price Index. However, as stated earlier the Fund is slightly below the benchmark target for 2013/14 and is still slightly below the 3 and 5 year benchmarks. Fund manager performance should continue to be closely monitored in the future to help ensure that benchmark returns are achieved.

Administration performance

76. An administrative strategy was approved by the Pension Fund Consultative Panel and the Council's Executive Committee in January 2012.

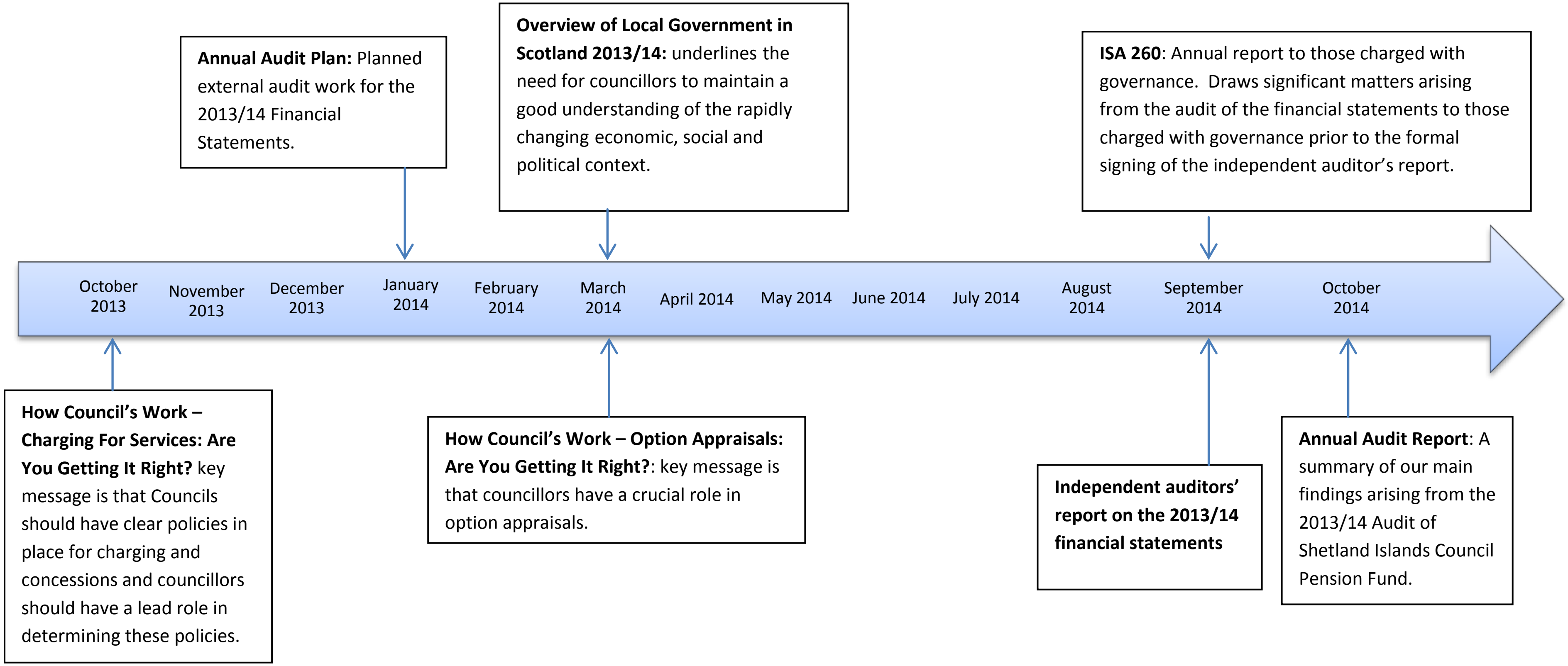
77. In our 2011/12 audit report, we raised an action point highlighting that service standards had been developed by the Pensions Section to monitor administrative performance and that there were plans to report these in 2012/13. However, these service standards are still not reported to committee and there is a risk that those charged with governance are not made aware of performance against service targets.

Refer to action plan point no.7

National Performance reports

78. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest are included in Appendix 1 along with locally produced audit reports.

Appendix I –Shetland Islands Council Pension Fund local audit and National reports 2013/14



Appendix II – Significant audit risks

The table below sets out the key audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure
Investment Performance	
Investment Strategy In the absence of a more focussed strategy, there is a risk that the pension fund may not achieve the required returns on investments and reach full funding before the fund reaches maturity.	• Monitored progress throughout the year. • Reviewed minutes. • Reviewed updated Investment Strategy implemented on the 26th March 2014.
Internal Controls There is a risk that appropriate action is not taken by management to address any weaknesses identified in the control systems of the pension fund investment managers.	• Monitored progress throughout the year. • Internal controls reports of independent service auditors are still not submitted to the Policy & Resources Committee or the Pension Fund Consultative Panel.
Pension Fund Administration	
Non-compliance with legislation There is a risk that management and investment regulations for permitted investments are not monitored on	• Monitored progress throughout the year. • Updated Investment Strategy outlines new proposed investments.

Audit Risk	Assurance procedure
an on-going basis and investments are not held in accordance with legislation.	
Public Service Pension Reform	
Pension Reform – Administration There is a risk that the pension fund may not prepare for and implement the required changes to comply with the Public Pensions Services Act.	• Monitored progress throughout the year. • Reviewed administration arrangements through monitoring of reports and minutes of committee meetings.
Pension Reform – Governance There is a risk that the governance arrangements of the pension fund do not comply with the changes introduced by the Public Services Pensions Act 2013.	• Monitored progress throughout the year. • Reviewed governance arrangements through monitoring of reports and minutes of committee meetings.
Pension Reform – Governance There is a risk that members will not be able to perform the scrutiny function effectively without appropriate training for the changes brought about by the Public Services Pensions Act 2013.	• Monitored progress throughout the year. • Reviewed governance arrangements through monitoring of reports and minutes of committee meetings. .

Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
1/31 and 67	**Local Authority Accounts (Scotland) Regulations 2014 – Financial Statements** The revised Local Authority Accounts (Scotland) Regulations 2014 requires a number of significant changes in respect of financial management, internal control and in the content of the financial statements. **Risk** The fund may not comply with legislation. **Recommendation** The Pension Fund should put arrangements in place to ensure compliance with legislation.	The Finance Service is aware of the changes that will be taking place as a result of the regulations and is providing necessary training and implementing necessary changes to ensure that the SIC Pension Fund is compliant with legislation.	Section 95 Officer	31 March 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
2/38	**Funding Position** The most recent triennial valuation reported in February 2012 highlighted that the fund had sufficient assets to meet 91% of its liabilities. However, the interim funding position as at 31 March 2014 has significantly fallen to 70% representing an area of concern for the fund. **Risk** The fund may not be able to meet all of its long term liabilities. **Recommendation** The Pension Fund should take appropriate action to address the reasons for the shortfall.	The Council approved a new Pensions Fund Investment Strategy in 2014 which is designed to ensure that the Pension Fund is 100% funded by the estimated time that it reaches maturity in 2027. This has meant the Pension Fund taking a more active management approach towards its investment portfolio, requiring new Fund Managers. The Pension Fund is currently going through a procurement exercise to award 3 new Investment Mandates which should be concluded in November 2014, with funds transferred to the new managers before the end of 2014. The new strategy will be monitored each year to ensure the investments are generating the expected returns. With regard to scheme liabilities, there is little that the Council can do as it does not have control over pension benefits. However, it is hoped that the new LGPS coming in from April 2015 will help to ensure that the scheme remains affordable for its member bodies.	Section 95 Officer	31 December 2014

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
3/51	**Investment Strategy** A new investment strategy was recently approved by the Fund with the aim of achieving a fully funded pension scheme by 2027. As a result of the new investment strategy, a number of changes are to be made to the fund manager and investment structure to achieve better returns on investments whilst reducing risk. **Risk** The fund may not comply with legislation. **Recommendation** The Pension Fund should put arrangements in place to ensure compliance with the new investment strategy and The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.	As part of the investment strategy review, due consideration was given to the 2010 regulations. The new arrangements will be in place by the end of December 2014 to ensure that the funds are invested in line with the agreed strategy. This position will be maintained into the future as net contributions are added to the funds in the years up to 2027.	Section 95 Officer	31 December 2014

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
4/54	**Public Services Pension Act 2013** The Public Service Pensions Act 2013 requires changes to public service pensions in line with the Government's objectives and the recommendations of the Independent Public Service Pensions Commission. **Risk** There is a risk that the pension fund may not comply with the Public Services Pensions Act 2013. **Recommendation** The Pension Fund should put arrangements in place to ensure compliance with legislation.	The relevant staff have attended national meetings and training courses to ensure that there is a local understanding of the changes that are coming into place from April 2015. Arrangements are currently being put in place to ensure that IT Systems will be able to meet the requirements of the new CARE scheme, and then ensuring that existing data is successfully migrated to the new system. This work is being managed through a project which has a timetable in place to ensure that the new arrangements are in place for April 2015.	Section 95 Officer	31 March 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
5/59	**General Ledger System** The General Ledger system of Shetland Islands Council who acts as the Administering Authority for the pension fund is to be updated during 2014/15. Currently a number of reconciliations between the General Ledger System and the Pension Fund are required to be performed. The updating may have an adverse impact on the Pension Fund if internal controls are not maintained and tested prior to the system update. **Risk** There is a risk of accounting mis-statement or financial loss for the Pension Fund if internal controls are not robust. **Recommendation** Changes to the General Ledger system should be tested to ensure that there is no adverse impact on the financial controls.	The Finance Service's in-house Systems Officer will ensure that any changes to the General Ledger System do not negatively impact upon the internal controls of the Pensions Fund.	Section 95 Officer	31 March 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
6/60	**Investment Assurances** The internal controls reports provided by the external auditors of the Investment Managers and the Custodian are not being reviewed. **Risk** There is a risk that weaknesses may not be identified and that appropriate action is not taken. **Recommendation** All reports should be reviewed and reported to committee with appropriate action taken to address any weaknesses.	These reports will be reviewed and reported to the appropriate committee as they become available with immediate effect.	Section 95 Officer	31 March 2015

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
7/77	**Administrative Performance** Service standards for administrative performance are not reported to those charged with governance. **Risk** There is a risk that corrective action is not put in place to address areas of weakness in administrative performance. **Recommendation** The Pension Fund should put arrangements in place to ensure that administrative performance is reported to the appropriate committee.	Appropriate arrangements will be developed for the 2014-15 Annual Performance Review of the Pension Fund and included in that report.	Section 95 Officer	31 March 2015

Agenda Item

E

Shetland Islands Council

Shetland Islands Council **3 December 2014**

Annual Report on the Audit 2013/14	
F-060-F	
Report Presented by Executive Manager – Finance	**Corporate Services**

1.0 Summary

1.1 The purpose of this report is to receive Audit Scotland's Annual Report on the 2013/14 Audit.

2.0 Decision Required

2.1 Shetland Islands Council is asked to:

a) NOTE Audit Scotland's Annual Report on the 2013/14 Audit.
b) APPROVE the Action Plan.

3.0 Detail

3.1 The Annual Audit Plan requires the Council to receive the Annual Report by December 2014.

3.2 The accounts were issued with an unqualified audit opinion meaning that Audit Scotland has concluded that they give a true and fair view of the financial position and income and expenditure of the council and its group for the year (2013/14).

3.3 The 2013/14 Annual Report from Audit Scotland contains a number of risks that require to be addressed. The Annual Report is enclosed as Appendix 1 to this Report.

3.4 An Action Plan to address these issues has been drawn up and is included as Appendix B: Action Plan (part of Appendix 1). The Action Plan is realistic and achievable within the timescales identified.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities – The preparation and presentation of the Accounts is a key element of the Council's overall governance and reporting arrangements.

4.2 Community /Stakeholder Issues – NONE.

4.3 Policy And/Or Delegated Authority – Receiving the unaudited and audited accounts of the Council and related certificates and reports is a matter reserved to the Council.

4.4 Risk Management – The Annual Report from Audit Scotland includes the identification of key financial risks and internal control arrangements in place to manage those risks, together with any improvement actions required.

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 The Council is required to prepare and publish a set of Accounts, within a set timescale. The accounts are then subject to external audit and currently Audit Scotland is the Council's nominated auditors. Audit Scotland has now certified the accounts as being a true and fair statement of the Council's financial position at 31 March 2014. Audit Scotland has provided an Annual Report of the 2013/14 accounts and has identified several areas of risk which require to be addressed. An Action Plan has been agreed to ensure that those risks are well managed and resolved, within a reasonable timeframe.

For further information please contact:
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11 November 2014

List of Appendices

Appendix 1: Annual Report on 2013/14 Accounts by Audit Scotland

Background documents:

NONE

END

Shetland Islands Council

Annual report on the 2013/14 audit

Prepared for the members of Shetland Islands Council and the Controller of Audit

October 2014

Contents

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Key messages

Financial statements	•Unqualified auditor's report on the 2013/14 financial statements.
Financial position	•The actual draw on reserves for 2013/14 was £14.9 million which was £11.7 million less than budgeted. •Usable reserves have increased by £18.1 million to £240.9 million. •The General Fund balance has increased by £10.3 million to £13.9 million. •Financial management remains strong with a robust budget setting process in place.
Governance & accountability	•The council had sound governance arrangements in place. •Systems of internal control operated effectively.
Best Value, use of resources & performance	•The council continues to develop its arrangements for monitoring and reporting performance against strategic priorities. •Substantial progress has been made towards delivering the objectives set out in its Corporate Plan.
Outlook	•Councils face rising demands for services and continued funding pressures alongside managing major reforms in welfare and health and social care. •Effective partnership working will be essential to make the best use of available resources as well as continued strong governance and leadership.

Financial Statements

1. We have given an unqualified audit opinion that the 2013/14 financial statements of Shetland Islands Council give a true and fair view of the state of the affairs of the council and its group as at 31 March 2014 and of the income and expenditure for the year then ended.
2. We have also given an unqualified audit opinion on the 2013/14 financial statements of Zetland Educational Trust registered by Shetland Islands Council and audited under the provisions of the Charities Accounts (Scotland) Regulations 2006 (the 2006 Regulations).
3. Overall, the council's 2013/14 draw on reserves was £14.9 million which was £11.7 million less than budgeted.
4. The General Fund budget included a requirement to achieve savings of £12.6 million from service reviews, efficiency initiatives and one-off savings. The council achieved a total savings figure of £20.3 million which was £7.7 million more than planned. The additional savings were mainly due to a drive across all services to reduce expenditure.
5. As a result of slippage, capital expenditure of £13 million was £2.8 million less than budget.
6. Financial management remains strong with close budget monitoring and regular reporting to members.

Financial position

7. The closing balance of usable reserves at 31 March 2014 was £240.9 million, representing a net increase of £18.1 million from 2012/13. The council's mid-term financial policy is to maintain a minimum reserves level of £150 million.
8. The net movement in the General Fund balance for 2013/14 was £10.3 million, increasing the general fund balance to £13.9 million as at 31 March 2014. This is made up of earmarked commitments of £1.1 million and an unallocated balance of £12.8 million.
9. The net movement in capital reserves was £31.7 million in 2013/14, decreasing the balance to £71.8 million at 31 March 2014.
10. Other Revenue and Statutory Funds increased by £37.6 million to £153.3 million.
11. The council's 2014/15 budget requires cost savings of £6.5 million (6% of 13/14 budget). The council aims to deliver these savings through a combination of increased or new charges, service re-designs and efficiencies.

Governance and accountability

12. Overall, in 2013/14, the council had sound governance arrangements which included a number of standing

committees overseeing key aspects of governance. The council had an effective system of internal control.

13. In their 2012/13 annual report, internal audit highlighted compliance with Council Standing Orders for Tenders and Contracts and Small Contracts Procedures as a specific area of concern. In their 2013/14 annual report, internal audit highlighted that there are *'still substantial issues of concern notably in Ferries and Ports & Harbours'.* The council's Standing Orders for Tenders and Contracts and Small Contracts Procedures have been revised and improvements have been made within Infrastructure Services to address this issue.

14. In July 2014, Shetland NHS Board and the council approved the Body Corporate as the preferred model for Health and Social Care Integration in Shetland. A steering group exists to deliver the Transition Programme required to implement the chosen model. It will be challenging for the council to have the appropriate governance arrangements in place by the government deadline of 1 April 2015.

Best Value, use of resources and performance

15. The council continues to develop its Planning and Performance Management Framework which sets out its arrangements for monitoring and reporting performance against the council's priorities.

16. In May 2014, the council reported substantial progress towards delivering the objectives set out in its corporate plan.

Outlook

17. Demands on services and resources continue to increase and these need to be managed alongside major reforms in the welfare system and health and social care. This underlines the need for strong governance, leadership and decision making based on good cost and performance information. Effective working with partners will be required to make the best use of available resources as well as innovation and vision to design and deliver the services needed to serve the future needs of citizens.

18. In May 2014 the council agreed to proposals to revise its governance arrangements. This included changes to the names and remits of a number of committees.

Introduction

19. This report is a summary of our findings arising from the 2013/14 audit of Shetland Islands Council. The purpose of the annual audit report is to summarise the auditor's opinions and conclusions, and to report any significant issues arising from the audit. The report is divided into sections which reflect our public sector audit model.

20. Our responsibility, as the external auditor of Shetland Islands

Council, is to undertake our audit in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.

21. The management of Shetland Islands Council is responsible for:

- preparing financial statements which give a true and fair view
- implementing appropriate internal control systems
- putting in place proper arrangements for the conduct of its affairs
- ensuring that the financial position is soundly based.

22. This report is addressed to the members of Shetland Islands Council and the Controller of Audit and should form the basis of discussions with the council as soon as possible after it has been issued. Reports should be made available to stakeholders and the public, as audit is an essential element of accountability and the process of public reporting.

23. This report will be published on our website after it has been considered by the council. The information in this report may be used for the Account's Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

24. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports, shown at Appendices I and II, include recommendations for improvements. We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of Shetland Islands Council.

25. The concept of audit risk is of key importance to the audit process. During the planning stage of our audit, we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements. In our annual audit plan, we set out the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix III sets out the significant audit risks identified at the planning stage and how we addressed these in arriving at our opinion on the financial statements.

26. Appendix IV is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response".

27. We recognise that not all risks can be eliminated or even minimised. What is important is that Shetland Islands Council understands its risks and has arrangements in place to manage these risks. The council and the Proper Officer should ensure that they are satisfied with proposed management action and have a mechanism in place to assess progress and

monitor outcomes.

28. In this report we have included only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

29. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Financial statements

Budgeted Revenue Draw on Reserves £23.5m

Actual Revenue Draw on Reserves £12.9m

Revenue Underspend £10.6m

Budgeted Capital Draw on Reserves £3.1m

Actual Capital Draw on Reserves £2m

Capital Underspend £1.1m

Planned Minimum Usable Reserve Balance £150m

Actual Usable Reserve Balance £240.9m

Movement in usable reserves £18.1m

Savings Target £12.6m

Savings achieved £20.3m

Audit opinion

30. We have given an unqualified opinion that the financial statements of Shetland Islands Council for 2013/14 give a true and fair view of the state of the affairs of the council and its group as at 31 March 2014 and of the income and expenditure for the year then ended.

Other information published with the financial statements

31. Auditors review and report on other information published with the financial statements, including the explanatory foreword, annual governance statement and the remuneration report. We have nothing to report in respect of these statements.

Legality

32. Through our planned audit work we consider the legality of the council's financial transactions. This includes obtaining written assurances from the Proper Officer. There are no legality issues arising from our audit which require to be reported.

The audit of charities financial statements

33. The Charities Accounts (Scotland) Regulations 2006 (the 2006 Regulations) sets out the accounting and auditing rules for Scottish charities. These required, for the first time in 2013/14, a full audit of all registered charities accounts where a local authority or some members are the sole trustees.

34. We have given an unqualified opinion on these matters with respect to the 2013/14 financial statements of Zetland Educational Trust.

Group accounts

35. Local authorities are required to prepare group accounts in addition to their own council's accounts where they have a material interest in other organisations.

36. Shetland Islands Council has accounted for the financial results of two subsidiaries and two associates in its group accounts for 2013/14. The overall effect of consolidating these balances on the group balance sheet is to increase total reserves and net assets by £117.1 million.

37. The net assets of the group at 31 March 2014 totalled £597 million, compared to a net asset position of £541.3 million in 2012/13. The positive movement in the closing net worth balance is partially due to the transfer of Police and Fire functions to the new authorities from 1 April 2013 and the removal of the £31.3 million pension liabilities of Police and Fire from the group accounts.

Accounting issues arising

Presentational and monetary adjustments

38. A number of presentational adjustments were identified in the financial statements during the course of our audit. These were discussed with management who agreed to amend the unaudited financial statements. There were no monetary adjustments made to the financial statements as a result of our audit.

39. There was one unadjusted error of £11,000 identified during the course of the audit, but there would have been no material effect on the financial statements if the adjustment had been made.

Whole of government accounts

40. The whole of government accounts are the consolidated financial statements for all branches of government in the UK. The council submitted the consolidation pack for audit by the

deadline. This has been audited and the audited return submitted to the Scottish Government.

Report to those charged with governance

41. On 23 September 2014 we presented our report to those charged with governance (ISA 260) to the Audit Committee. The primary purpose of that report is to communicate the significant findings arising from our audit prior to finalisation of the independent auditor's report. There were no significant issues identified.

Outlook

42. The financial statements of the council are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The main new standards required to be adopted in 2014/15 include :

- IFRS 10 Consolidated financial statements
- IFRS 11 Joint arrangements
- IFRS 12 Disclosures of interests in other entities
- IAS 28 Investments in associates and joint ventures.

43. These standards affect the group financial statements and include a change to the definition of control. This is likely to require a reassessment of the group boundary and potentially further consolidations and disclosures.

44. The revised Local Authority Accounts (Scotland) Regulations 2014 apply for financial years 2014/15 onwards. The regulations set out in more detail what is required in respect of financial management and internal control, and in respect of the annual accounts themselves. Some of the changes include the requirement for the unaudited accounts to be considered by the Audit committee. This can take place following submission to the auditor and up to 31 August if necessary. In addition the audited accounts must be considered and approved for signature by the council by 30 September with publication on the council's website by 31 October.

45. Highways assets (roads and street lighting) are currently carried within infrastructure assets in the balance sheet at depreciated historic cost of £71.8 million. The 2016/17 Code requires highways to be measured for the first time on a depreciated replacement cost basis. This represents a change in accounting policy from 1 April 2016 which will require a revised opening balance sheet as at 1 April 2015 and comparative information in respect of 2015/16. This is a major change in the valuation basis for highways and will require the availability of complete and accurate management information on highway assets. The council should ensure it is planning ahead to allow full compliance with the Code.

46. We understand that there will be staff changes within Finance Services during 2014/15 and, in particular, a change to the Section 95 officer. This is a key position within the council for

ensuring that effective financial planning and management arrangements are in place. The Section 95 officer also has an obligation to ensure that the council's financial statements are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom. There is risk that good quality draft financial statements and working papers may not be submitted for audit as a result of changes within Finance Services.

Refer Action Point 1

47. Major updates to the General Ledger system are planned during 2014/15 (for example changes to authorisation and reporting processes). It is important that these updates are properly managed and tested to ensure that the key internal controls of the council's financial systems continue to operate effectively.

Financial position

48. The council reported a surplus of £32 million on the provision of services in 2013/14. Adjusting this balance to remove the accounting entries required by the Code, the council increased its general fund balance by £10.3 million.

49. The 2013/14 budget, approved by the council on 11 December 2013, had a planned total draw on reserves of £26.5 million that included £12.6 million of budgeted savings. As the council secured higher than expected levels of savings of £20.3 million, the actual total draw on reserves was £14.9 million.

50. The council's draw on reserves for revenue purposes was £10.6 million less than budgeted. This was as a result of

- An underspend across services of £7.7 million
- Housing Revenue Account underspend of £1.0 million
- Harbour Account exceeded surplus of £1.9 million.

51. As a result of slippage in the capital programme the council's draw on reserves for capital purposes was £1.1 million less than budgeted.

The council's strategic financial management plans require, in the medium term, a minimum usable reserve balance of £150 million. As shown in Exhibit 1, the overall level of usable reserves held by the council increased by £18.1 million compared to the previous year and totalled £240.9 million.

Exhibit 1: Usable reserves

Description	*31 March 2013 £ million*	*31 March 2014 £million*
General Fund	*3.6*	*13.9*
Capital Reserve Fund	*103.5*	*71.8*
Capital Grants Unapplied	*0.0*	*1.9*
Other Funds	*115.7*	*153.3*
Total Usable Reserves	***222.8***	***240.9***

Source: Shetland Islands Council 2013/14 financial statements

52. The movements in the reserves includes

- £10 million draw on HRA debt contingency
- £15 million transfer to the Equalisation Fund
- £11 million transfer to the Development Loans Fund
- £15 million draw on reserves for revenue and capital spend
- £11 million of investment income.

53. The closing usable reserve balance at 31 March 2014 is made up of a number of earmarked commitments. The main commitments include

- Capital Fund of £62.2 million
- Repairs & Renewals Fund of £45.7 million
- Harbour Contingency of £41.6 million.

Capital investment and performance 2013/14

54. Total capital expenditure for 2013/14 was £13 million. The most significant capital spends included
    - £2.8 million for Phase 3 of Shetland College
    - £1.0 million for Walls Pier
    - £0.5 million for vehicles and plant
    - £0.5 million for broadband provision for remote council premises.

55. The council reported a total underspend of £2.8 million against the planned level of capital expenditure (17.6% of the total programme for 2013/14). The main reasons for this slippage were underspends in the following areas:
    - Economic Development – £390k
    - Shetland College - £416k
    - HRA –£653k
    - Harbour Account – £874k

56. A certain level of slippage on capital projects can often occur, particularly in complex projects. However significant delays may have an impact on the council's Medium Term Financial Plan (MTFP) and on the council's ability to meet its objectives and deliver services.

Refer Action Point 2

Treasury Management

57. As at 31 March 2014, the council did not have any external borrowings. Funds held for investment at 31 March 2014 were £203.5 million (£205.7 million at 31 March 2013). Realised gains on investments due to de-recognition and revaluation amounted to £43.7 million (£28.9 million in 2012/13). The movement in realised gains reflects the decision by the council to change its investment strategy during 2013/14 which resulted in a higher level of disposals required in order to transfer funds between fund managers.

58. In June 2013 the council agreed the Investment Strategy 2013 - 18 that is intended to
    - support the council's Medium Term Financial Plan
    - reduce fund manager fees
    - lower the risk of large negative returns whilst maintaining similar levels of return to that achieved in recent years.

59. The new Investment Strategy required changes to the way the council's funds are invested. An active equity mandate was

replaced with a passive equity mandate and a diversified growth fund mandate was added to the strategy. There have also been changes to the council's fund managers.

60. Audit Scotland has, on behalf of the Accounts Commission, recently completed a national review of borrowing and treasury management in councils. This involved discussions with members and officers as well as audit visits to a number of selected fieldwork councils, including Shetland Islands Council. The review focused on the affordability and sustainability of borrowing and governance arrangements and considered how councils demonstrate best value in their treasury management functions. The national report is planned for publication in December 2014.

Outlook

2014/15

61. The revised 2014/15 budget of £130.3 million requires a revised total draw on reserves of £20.7 million. This is a lower draw on reserves than was budgeted in 2013/14, but is still higher than the actual draw on reserves during the year of £14.9 million. The financial position of the council remains challenging in the current year.

62. In August 2014, the council's projected 2014/15 outturn position was a total underspend of £4.2m against the revised budget. This includes underspends of £1.4 million on revenue, £2.1 million on capital and £0.7 million on spend to save initiatives.

Medium Term Financial Plan (MTFP)

63. The council will continue to operate in a funding environment which is subject to sustained pressure to deliver more with less. The level of flexibility within expenditure budgets is considerably reduced by the realisation of cost savings in previous years.

64. The council updated its MTFP in July 2014. The MTFP sets out its five year plan to deliver a budget with a sustainable draw on reserves and will require

- savings of £10.5 million to be made over the next three years
- a possible net draw on reserves of over £8.2 million over the next five years (total draw of £72.2 million and expected income of £64.0 million).

Refer Action Point 3

External Borrowing

65. The council has not had any external borrowing for 20 years and has had a policy to fund all capital expenditure from its reserves. However, in December 2013, the council agreed a new Borrowing Policy and Strategy in order to

- secure best value in the financing of capital expenditure

- maintain reserve levels.

66. The two capital projects currently proposed by the council for external borrowing are the Anderson High School (expected cost of £42 million) and Housing Revenue Account historical internal borrowing (debt of £16 million as at 31 March 2014). There is a risk that best value is not achieved through external borrowing.

Refer Action Point 4

Governance and accountability

Financial systems had appropriate systems of internal control in place during 2013/14

Arrangements for the prevention and detection of fraud and irregularities are satisfactory

Governance arrangements are operating effectively

Arrangements for maintaining standards of conduct and the prevention and detection of corruption are satisfactory

Committees of the council are effective in overseeing governance and performance monitoring

67. Members of the council and the Proper Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of Shetland Islands Council and for monitoring the adequacy and effectiveness of these arrangements.

Corporate governance

68. In May 2014, the council agreed to proposals to improve its corporate governance arrangements and this will result in changes to the role and remit of some committees. These changes have yet to be agreed. The committees affected by these changes are

- Policy and Resources Committee
- Audit Committee
- Social Services Committee
- Assets and Treasury Sub-committee
- Shetland College Board.

69. Within Shetland Islands Council the corporate governance arrangements are supported by the following standing committees:

Policy and Resources Committee

Audit Committee

Planning Committee

Licensing Committee

Harbour Board

Shetland College Board

Appeals Committee

70. The council also has the following functional committees:

Education and Families

Social Services

Development

Environment and Transport

71. Based on our observations and audit work, our overall conclusion is that the governance arrangements within Shetland Islands Council are operating effectively.

Internal control

72. As part of our audit we reviewed the high level controls in a number of the council's systems that impact on the financial statements. This audit work covered payroll, general ledger, cash and banking, trade payables, trade receivables, capital accounting, non-domestic rates, council tax and treasury. Our overall conclusion was that the council's financial systems had appropriate systems of internal control in place during 2013/14.

73. In our 2012/13 report we highlighted that compliance with Standing Orders for Tenders and Contracts and Small Contracts Procedures was a specific area of concern for the council. The council has reported that this continued to be a problem area during 2013/14.

74. The council has revised its Standing Orders for Tenders and Contracts and Small Contracts Procedures and improvements have been made within Infrastructure Services. This includes incorporating compliance with standing orders within the performance measures that are regularly reported to committee. The council also reviewed procurement of goods, work and services within Ferries and Ports and action plans have been established to ensure future compliance. We will continue to monitor the council's progress in this area.

Refer Action Point 5

Internal audit

75. Internal audit provides members of the council and the Proper Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where appropriate

76. Our review of internal audit concluded that the internal audit service operates satisfactorily. The 2013/14 internal Audit

annual report stated that Internal Audit substantially complies with the Public Sector Internal Audit Standards.

ICT audit

77. For the first time in 2012/13, councils had to apply to connect to the Public Services Network (PSN) to allow the sharing of electronic data with other public bodies, such as the Department of Works and Pensions. The application and approval process is subject to annual review and could result in a disruption to operations and service delivery if there were any non-compliance issues. The council obtained a compliance certificate in October 2013 which we understand will be valid until the next compliance deadline of January 2015.

78. The new security requirements have had an impact on some of the council's working arrangements. While no services have been removed there have been some changes to how they are delivered. For instance, employees are now less likely to use remote access systems or use their own mobile devices for service delivery.

79. The time and resources spent on ensuring PSN compliance has delayed and/or reduced other planned ICT projects (e.g. Absence Management System and electronic payslips).

80. Following a review of ICT stock control arrangements in August 2013, Internal Audit reported that *'the current manual stock control system is insufficient to ensure the security and correct record of assets held at ICT'.* An action plan has been put in place to address the issues raised by Internal Audit including revised stock control procedures. We will continue to monitor the council's arrangements for stock control.

Arrangements for the prevention and detection of fraud

81. The council's arrangements in relation to the prevention and detection of fraud and irregularities were satisfactory.

82. Shetland Islands Council participates in the National Fraud Initiative (NFI). The NFI uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error.

83. Overall, we concluded that the council has satisfactory arrangements in place for investigating and reporting data matches identified by the NFI.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

84. The arrangements for the prevention and detection of corruption in Shetland Islands Council are satisfactory and we

are not aware of any specific issues that we need to record in this report.

Integration of adult health and social care

85. The Public Bodies (Joint Working) (Scotland) Act received royal assent on 1 April 2014. The Act provides the framework for the integration of health and social care services in Scotland. The Act offers some flexibility on the partnership arrangements for the governance and oversight of integrated health and social care services. The integration will be complex and challenging and the council will need to engage at the highest level with the relevant health bodies in its area to ensure that integration is delivered within the required timescales and that the arrangements are functional and fit for purpose.

86. In July 2014 Shetland NHS Board and the council approved the Body Corporate as the model for Health and Social Care Integration in Shetland.

87. A steering group was established to deliver the Transition Programme and to coordinate and link the projects and work streams required to implement Shetland's chosen model for health and social care integration.

88. The priority for the Transition Programme is to prepare reports for the Council and the Health Board by December 2014 seeking approval of an Integration Scheme including:

- the budgets for 2015/16 and the budget allocations for the Body Corporate
- the functions to be delegated to the Body Corporate
- the governance arrangements for the Body Corporate
- the localities model of integration for Shetland.

89. In addition, work has begun on developing a Joint Strategic Planning Process to deliver a Joint Commissioning Strategy and Strategic Plan for the new Health and Social Care Partnership. This will build on the existing arrangements established under Shetland's Community Health and Care Partnership.

90. On 1 October 2014 the council reported that the main risk to the delivery of the Body Corporate model by 1 April 2015 is the challenging timescale for delivering the Integration Scheme, particularly in relation to the delegated functions and associated budgets and the localities model.

Refer Action Point 6

Welfare Reform

91. The council recognises the impact that the changes to the UK welfare system could have on resources and service provision. 2013/14 was a period of significant change with council tax benefits being replaced by the new Council Tax Reduction Scheme and the introduction of the Scottish Welfare Fund. Councils continue to face uncertainties over the roll out of the

Universal Credit and there is the potential for further reforms after the recent Scottish independence referendum.

92. The council has been monitoring and planning ahead to mitigate against the impact of the reforms. The council is represented on the Shetland Financial Resilience Welfare Reform sub-group which considers the impact of welfare reform changes.

93. Since the introduction of the “Spare Room Subsidy” in April 2013 there have been 173 households in Shetland that have been affected by the change. However due to Discretionary Housing Payment, no households in Shetland have suffered any financial impact from under occupancy.

94. The council reported rent arrears of £161,000 as at 31 March 2014 (2013: £137,000) relating to 319 properties (2013: 306).

Housing and council tax benefits performance audit

95. In June 2014, an Audit Scotland report on behalf of the Accounts Commission identified some risks relating to the performance of benefit services across councils and their ability to deliver improvements going forward. Key risks identified were:

- Having sufficient, experienced staff is a significant issue for a number of councils. Experienced officers have left many benefit services and councils have had difficulty in some instances in replacing these officers. Where staff members have been replaced, the incoming officers have required significant training before becoming fully effective.
- A lack of effective planning and management of major projects such as IT system implementations. In particular, not planning effectively for the disruption to normal service levels and returning to target service performance levels.

96. These are relevant risks to the council and present a significant challenge to the delivery of improvements in this area.

Refer Action Point 7

Outlook

97. Councils continue to face rising demands for services alongside managing major reforms in welfare and health and social care. There is now a greater need than ever for strong governance and leadership. The integration of health and social care is a complex and challenging process and the council will need to continue to engage at the highest level with partners to ensure that the unified service is in place by the statutory date of 1 April 2016.

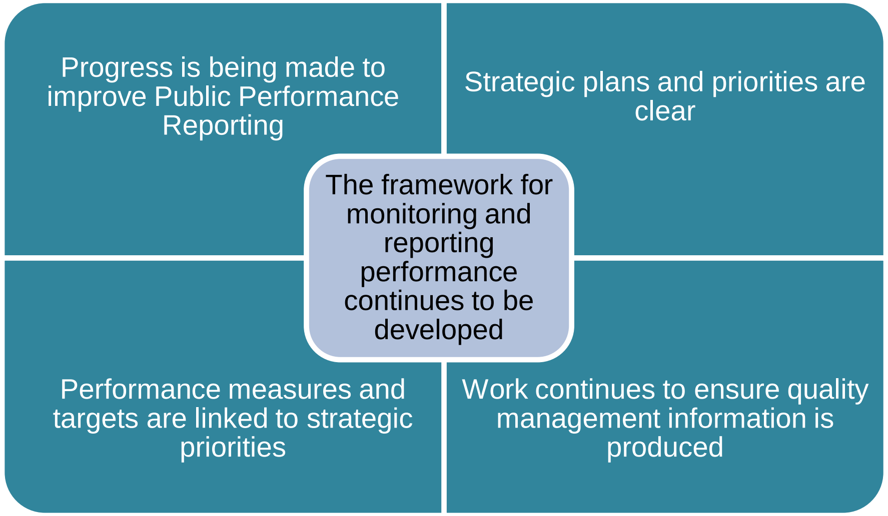
98. There are to be major changes in councils’ responsibilities for

the investigation of fraud. The new Single Fraud Investigation Service (SFIS) is a national fraud investigation service within the Department for Works and Pensions which will take over the responsibility for the investigation of housing benefit frauds. The investigation of the Local Council Tax Reduction Scheme and corporate frauds will remain within councils. The SFIS will be implemented across councils on a phased basis during the period July 2014 and March 2016 and will see the transfer of staff from councils to the DWP. There is a risk that council arrangements for the prevention and detection of fraud may be weakened due to the loss of experienced investigators to the SFIS.

99. Due to its small size the council's benefits team does not include any fraud officers. The benefits team refers cases to the DWP Fraud Investigation Team for investigation or makes referrals direct to the police. As such there will be no officers from the benefits team transferred to the DWP.

100. The political context in 2014 has been particularly challenging with the referendum on Scottish independence. Following the referendum there is the potential for even further change and discussions are likely on local services, governance and accountability.

Best value, use of resources and performance



101. Local authorities have a statutory duty to provide best value in those services they provide directly as well as those provided through agreements with Arms Length External Organisations. This requires continuous improvement while maintaining a balance between quality and cost and having regard to value for money, equal opportunities and sustainability. There is also the duty to report performance publicly so that local people and other stakeholders know what quality of service is being delivered and what they can expect in the future.

Arrangements for securing Best Value

102. The council's arrangements for securing best value are set out in its Best Value framework that forms part of its overall Planning and Performance Management Framework.

103. The Best Value framework is linked to the council's Corporate Plan and the Change Programme which are linked to Directorate plans. The framework sets out the council's best value principles and aligns these principles to strategic objectives and improvement outcomes.

104. In recent years the council has made significant progress in establishing arrangements to deliver best value. The council continues to work to improve these arrangements.

Use of resources

Asset Management

105. In December 2013 the council agreed its five year Asset Investment Plan 2014-19 which is aligned with its Medium Term Financial Plan. The focus of the Asset Investment Plan is on the maintenance of existing assets rather than the creation of new assets. The main exception to this is the new Anderson High School.

106. Each year, as part of the annual budgeting process, an annual asset investment plan is agreed. Quarterly monitoring reports on capital expenditure are submitted to committee, detailing the progress of capital projects within the current financial year.

Workforce Management Plan

107. The council continues to develop arrangements to manage its staff and has a number of policies and procedures in place covering staff development, performance management and attendance. However the council does not have a documented workforce strategy in place. The development of a workforce strategy is one of the objectives of the Corporate Plan and it is intended that a strategy is in place by the end of 2014.

Refer Action Point 8

Risk Management

108. A Corporate Risk register is now in place and work is ongoing to ensure risk registers are up to date. On 31 July 2014 the responsibility for risk management was transferred to Internal Audit. Further work is required to develop and improve risk management arrangements to ensure that risk management is fully embedded across the council and that it forms an integral part of performance and improvement. Such arrangements should include the monitoring and managing of strategic and operational risks.

109. Internal Audit's 2013/14 annual plan highlighted that *'there are a number of areas in relation to risk management that still require to be improved corporately*.'

Refer Action Point 9

Procurement

110. In 2009, the Scottish Government introduced an annual evidence based assessment, the procurement capability assessment (PCA), to monitor public bodies' adoption of good purchasing practice and as a basis for sharing best practice. In May 2014, the council reported a 2013 PCA assessment as 35% (33% in 2012) against the average score across Scottish councils of 56%. The council has established a PCA Improvement Plan to help deliver further improvement.

Refer Action Point 10

Performance management

111. The council is committed to having a strong framework in place for monitoring and reporting performance. The Planning and Performance Management Framework (PPMF) is regularly updated as the council's arrangements for improving performance continue to be developed. The latest update in May 2014 was made to clarify

- the integration of Financial and Service Planning timetables
- the link between planning and risk management.

112. The PPMF sets out the arrangements for delivering corporate objectives including the planning, monitoring and reporting arrangements. It shows how operational objectives are linked to strategic objectives, who has accountability for each plan and who has responsibility for each process.

113. We are pleased to note the council's progress towards developing robust and effective performance management arrangements. Effective arrangements are important to the delivery of the council's strategic and operational objectives. The council should continue to work to improve its performance management arrangements.

Overview of performance targets in 2013/14

114. The Corporate Plan sets out ambitious objectives for the council. To help achieve these objectives, the council agreed a Change Programme that includes the key projects for 2013/14.

115. In May 2014, the council reported substantial progress against delivery of its Change Programme. Of the 32 agreed Change Programme actions, only one was reported as not achieved and this related to an overspend of £372,000 within Social Services.

116. In September 2014, the council reported progress against performance indicators which have been submitted to the Improvement Service as part of the Local Government Benchmarking Framework. In comparison to 2012/13, nine indicators have improved and five have declined. Areas of improvement include non-teacher sickness absence and the cost of collection of council tax. Areas that have declined include teachers' sickness absence and attendance at pools and other sports and leisure facilities.

Statutory performance indicators

117. The Accounts Commission has a statutory power to define performance information that councils must publish locally and it does this through its annual Statutory Performance Information Direction. Since its 2008 Direction, the Accounts Commission has moved away from specifying individual indicators and has focused on public performance reporting and the requirement for councils to take responsibility for the performance information they report.

118. The review of Statutory Performance Indicators in 2013/14 is a two stage process. The first stage requires auditors to ascertain and appraise councils' arrangements for public performance reporting and the completion of the Local Government Benchmarking Framework indicators. This focuses on three statutory performance indicators (SPIs) namely :

- SPI 1: covers a range of information relating to areas of corporate management such as employees, assets and equalities and diversity
- SPI 2: covers a range of information relating to service

performance

- SPI 3: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.

119. The second stage involves an assessment of the quality of the information being reported by the council to the public. An evaluation of all Scottish Local Authorities' approaches to public performance reporting (PPR) has been carried out by Audit Scotland's Performance Audit and Best Value section, the results of which were reported to the Accounts Commission in June 2014. Individual assessments were also reported to councils' Chief Executives, Leaders and Chairs of Audit Committees. These highlighted the extent to which their PPR material met the criteria used in the evaluation. The results for Shetland Islands Council were 0% fully, 76% partially and 24% not meeting the criteria. A further evaluation of councils' approaches to PPR is due to be carried out by Audit Scotland in spring 2015.

Refer Action Point 11

120. During 2013/14, the local audit team reviewed the council's PPR arrangements. Overall, we found that the council was committed to improving its arrangements and has plans in place to do so. There is room for improvement in the Council's arrangements for collecting, reporting and publishing performance information that the community would like to see.

Assurance and Improvement Plan 2014-17

121. The Assurance and Improvement Plan (AIP) covering the period 2014 to 2017 is the fifth AIP for Shetland Islands Council prepared by the Local Area Network of scrutiny partners for the council since the introduction of the shared risk assessment process. This has been published on Audit Scotland's website and was submitted to the council on 2 July 2014.

122. No areas were identified where further scrutiny was required. Areas identified where further information was required were:

- leadership and direction
- community engagement and empowerment
- asset management
- procurement
- risk management
- housing and homelessness.

123. We will revisit these areas as part of the Shared Risk Assessment process for 2014/15.

Local performance audit reports

124. During 2013/14, we carried out a review of the impact of two of our national reports - 'Health inequalities in Scotland' (report published December 2012) and 'Major capital investment in

councils' (published March 2013). In both cases we found that the council had satisfactorily dealt with the issues raised in our reports.

National performance audit reports

125. In August 2014, the council agreed revised arrangements to improve the way it deals with our national performance reports. All Audit Scotland reports will be considered by the relevant service committee and an action plan will be drawn up to address any recommendations. The Audit Committee will consider each report and action plan. Thereafter, the lead officer will confirm implementation of all agreed actions. Reports will be presented to the Audit Committee to monitor progress against action plans.

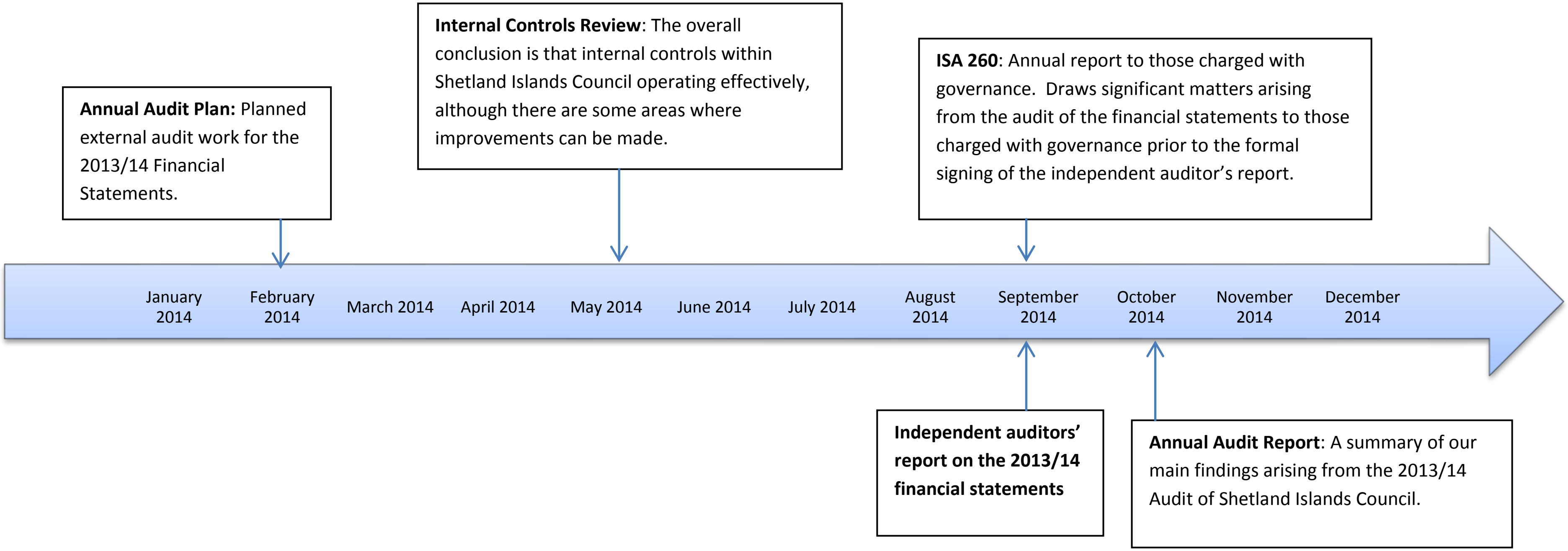
126. A summary of national performance audit reports, along with local audit reports, is included in Appendices I and II.

Outlook

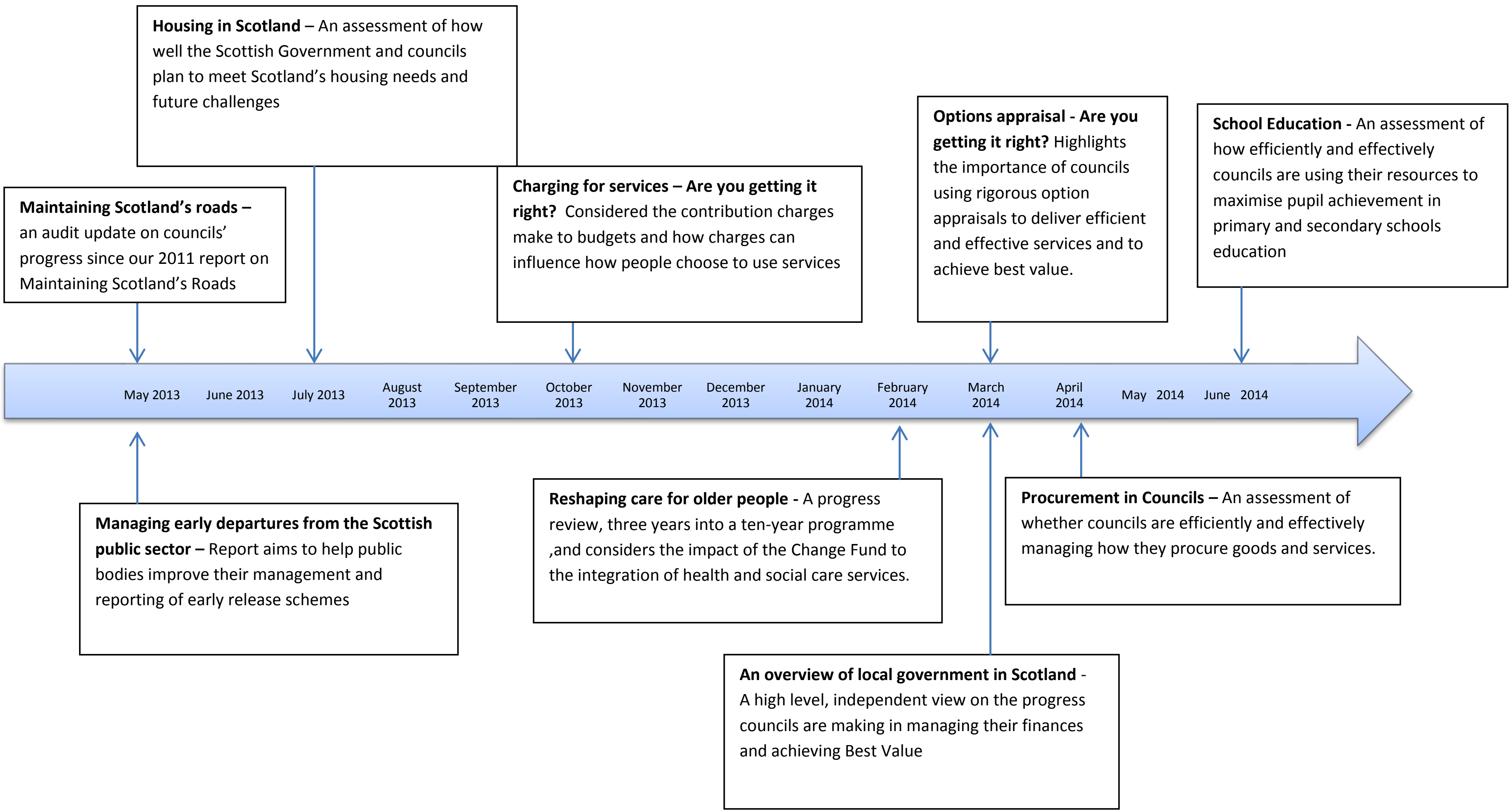
127. In common with other councils, Shetland Islands Council faces the key challenges of reducing budgets, an aging population with higher levels of need and the public expectation of high quality services. The council has made significant savings in recent years and this has been accompanied by a reduction in the workforce.

128. In order to deliver its Medium Term Financial Plan, decisions faced by the council will become increasingly difficult, and the council will have to focus on making the best use of all available resources and to challenge existing ways of doing things. A strong and effective performance management framework will be critical to the success of the council achieving its key priorities.

Appendix I – Summary of Shetland Islands Council local audit reports 2013/14



Appendix II – Summary of Audit Scotland national reports 2013/14



Appendix III – Significant audit risks

The table below sets out the key audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure
Medium Term Financial Plan There is a risk that the council fails to successfully delivery it's MTFP and draws on reserves cannot be sustained.	• Reviewed financial management arrangements through monitoring of committee reports and attendance at council meetings • Audit of the 2013/14 financial statements
Housing Revenue Account If the HRA debt is not properly managed this may have an adverse impact on rents and capital investment in housing.	• Reviewed financial management arrangements through monitoring of committee reports and attendance at council meetings • Audit of the 2013/14 financial statements
Change Programme If the Change Programme is not properly managed the council may not be able to deliver its corporate plan.	• Reviewed performance management arrangements through monitoring of committee reports and attendance at council meetings • Audit of the 2013/14 financial statements
Standing Orders There is an ongoing risk of non-compliance with EU regulations and council's standing orders for contracts.	• Reviewed the work of Internal Audit • Reviewed governance arrangements through monitoring of committee reports and attendance at council meetings

Audit Risk	Assurance procedure
Tendering Exercises If tender exercises do not result in affordable tenders the council may not meet its financial plans.	• Reviewed the work of Internal Audit • Reviewed governance arrangements through monitoring of committee reports and attendance at council meetings
Risk Management Until risk management arrangements are fully embedded the council cannot effectively manage its risks.	• Reviewed risk management arrangements through monitoring of committee reports and attendance at council meetings • Reviewed corporate risk register
Corporate Risk Register In the absence of a corporate risk register, strategic and operational decisions do not take account of appropriate risks.	• Reviewed risk management arrangements through monitoring of committee reports and attendance at council meetings • Reviewed corporate risk register
Performance Management Until effective performance management arrangements are fully embedded across the council the expected quality of services may not be delivered.	• Reviewed performance management arrangements through monitoring of committee reports and attendance at council meetings • Reviewed progress against targets through monitoring of committee reports and attendance at council meetings

Audit Risk	Assurance procedure
Welfare Reform The council may not be adequately prepared for the impact Welfare Reform may have on service provision.	• Monitored progress through monitoring of committee reports and attendance at council meetings • Liaised with Policy Manager and obtained regular updates on the council's arrangements for addressing the impact of Welfare Reform
Partnership Working There is a risk that the council cannot deliver its challenging and ambitious community plans and therefore fails to meet its corporate objectives are not met.	• Monitored partnership working arrangements, in particular Health and Social Care Integration, through monitoring of committee reports and attendance at council meetings.
Workforce Management If the workforce is not effectively managed there is a risk that the council does not deliver its strategic or operational objectives.	• Monitored progress through committee reports and attendance at council meetings.
New Anderson High School The new AHS is not designed and built on time, within budget and to the agreed specification.	• Monitored progress committee reports and attendance at council meetings.
Group Accounts The group accounts disclosures in the financial statements do not include financial information for SCT	• Early planning of audit of 2013/14 financial statements with Finance • Audit of the 2013/14 financial statements

Appendix IV – Action plan

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
1/46	**Changes to Finance Services** There will be changes to the Finance Service during 2014/15, with a new Section 95 Officer to be appointed. **Risks** The council's financial statements are not prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom. **Recommendation** The council should ensure that changes within Finance Services are managed to ensure that the council's 2014/15 financial statements are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom.	Work is currently underway to ensure that arrangements are put in place to replace the current Section 95 Officer. Management is acutely aware of the need to put strong arrangements in place to ensure that the finance service continues to improve. With this in mind, the Director of Corporate Services will be reporting to Council in November 2014 on proposals to fill this key post.	Director of Corporate Services	31 December 2014

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
2/56	**Capital Slippage** There was a 17.6% slippage in the 2013/14 capital programme. **Risk** Delays in the capital programme impact on the council's ability to deliver its objectives. **Recommendation** Reasons for capital slippage should be investigated and appropriate action taken to minimise the risk of future delays with capital projects. This should include learning lessons from past delays.	Most of the slippage referred to was as a result of delays experienced on a small number of projects, all of which will be complete by the end of 14/15. The reasons behind these delays have been investigated and are now well understood. The lessons learnt will inform the preparation of the Council's Asset Investment Plan for 2015-20, currently underway.	Executive Manager – Capital Programme.	April 2015
3/64	**Medium Term Financial Plan** The council's Medium Term Financial Plan requires significant savings to be delivered over the next three years. **Risk** Savings are not achieved and there is a larger draw on reserves than planned. **Recommendation** Progress against planned savings targets continues to be monitored and corrective action taken to address any significant variances.	The Council is currently well on track to deliver the 2014-15 budget and has developed a draft budget for 2015-16 which will be presented to the Council in December 2014 for approval. If agreed, this will be a sustainable budget which requires an affordable draw on reserves. Work is already underway within services to identify savings proposals for 2016-17 and subsequent years.	Section 95 Officer	Continuous

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
4/66	**Borrowing** The council will consider funding capital expenditure through external borrowing rather than using its reserves if this secures best value. **Risk** Best value is not achieved by funding capital projects through external borrowing. **Recommendation** In advance of any external borrowing, thorough options appraisals are carried out to determine whether best value for the council is achieved.	The Council will work with its Treasury advisors to determine whether Best Value is secured by borrowing from external markets, or from borrowing internally from reserves. This will be an ongoing process, but at present the only project that is increasing the Council's Capital Financing Requirement is the new Eric Gray Resource Centre.	Section 95 Officer	Ongoing

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
5/74	**Standing Orders for Tenders and Contracts and Small Contracts Procedures** Non-compliance with procurement guidance and regulations continues to be a concern for the council. **Risk** The council suffers significant financial loss. **Recommendation** The council closely monitors the award of tenders and contracts to ensure compliance with guidance and legislation.	Following the introduction of revised Contract Standing Orders in September 2013, the Procurement team have carried out a programme of awareness sessions with all Executive Managers across the Council to explain the processes to be followed and the monetary thresholds that apply. In addition, they will continue to monitor the award of tenders and contracts to ensure compliance with Contract Standing Orders and procurement legislation.	Executive Manager – Capital Programme	April 2015

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
6/90	**Health & Social Care Integration** There are significant challenges for delivering the Integration Scheme by December 2014. **Risk** If there are no agreed governance or financial management arrangements in place by 1 April 2015 for Health and Social Care Integration in Shetland the council may not meet the requirements of the Public Bodies (Joint Working) (Scotland) Act 2014. **Recommendation** Progress on the Integration Scheme should be closely monitored and appropriate action taken where necessary to ensure expected outcomes are delivered.	Project governance and management arrangements have been put in place to ensure that all work packages relating to Health and Social Care Integration are completed by 31 March 2015. A Local Partnership Finance Group consisting of representatives from the Council and NHS Board is in place to lead on the development of the financial aspects of the legislative changes.	Director of Corporate Services	31 March 2015

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
7/96	**Benefits Service** The Benefits Service's ability to deliver continuous improvement could be adversely affected by • not having sufficient levels of experienced staff • not planning effectively for the disruption to normal service levels due to the implementation of significant IT projects. **Risk** The benefits section cannot deliver expected service improvements **Recommendation** Arrangements are put in place to ensure benefits services have sufficient resources to implement expected improvement	As part of the Finance Service's workforce planning and succession planning arrangements a number of staff have been enrolled to study for their IRRV qualification. In addition, 2 new posts will be created in Revenues and Benefits at a higher level to ensure that there are staff in the pipeline who will eventually be well placed to succeed the current Team Leader. Whilst the Revenues and Benefits team is small, it has a level of in-built flexibility that allows staff to be moved to the areas of demand as they occur. These arrangements should be sufficient to meet the requirements placed on the Council with regard to Welfare Reform.	Section 95 Officer	Ongoing

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
8/107	**Workforce Management** The council does not yet have an approved workforce management strategy in place. **Risk** The council cannot deliver its agreed objectives if resources are not strategically managed. **Recommendation** The council approves a workforce strategy by the end of 2014	The Executive Manager – HR is leading on this piece of work and it will be progressed throughout the remainder of 2014-15. This will result in a Workforce Management Strategy being represented to Council in February 2015.	Executive Manager – HR	31/3/2015
9/109	**Risk Management** Risk Management arrangements are not yet fully embedded across the council. **Risk** Corporate objectives are not achieved if risks are not effectively managed. **Recommendation** The council should continue to develop its risk management arrangements. This should include effective monitoring of identified risks.	An independent review of risk management within the Council is currently ongoing. This will help to inform what further actions the Council will take. A risk management workshop has been arranged with CMT for 9/12/14 and a SMART action plan will be presented to CMT and Audit Committee once the final report on the risk management review has been agreed.	Executive Manager – Audit, Risk and Improvement	31/3/15

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
10/110	**Procurement** The council's 2013 PCA assessment as 35% is significantly lower than the average score across Scottish councils of 56%. **Risk** The council's procurement arrangements do not deliver best value. **Recommendation** The procurement improvement plan should be properly monitored to ensure the expected progress against agreed improvement actions is achieved.	The Council's PCA assessment for 2014 has resulted in an improved score of 40%. It is understood that the assessment regime will change for future years. The Council is committed to demonstrating year on year improvement in this area, but with greatest priority applied to measures that will generate cash savings. This approach is described in the Council's Procurement Strategy and associated Action Plan, which is reviewed on a regular basis.	Executive Manager – Capital Programme	April 2015

Action plan point/ para ref	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
11/119	**Public Performance Reporting** Improvements are required in the council's approach to public performance reporting. **Risk** Without the required performance information stakeholders cannot challenge the council on its performance to ensure council objectives are delivered. **Recommendation** The council continues to develop its public performance reporting arrangements This should include identifying and reporting/publishing appropriate performance information.	Meetings have been held with relevant Council officers to explain what PPR requirements are. PPR Information is to be submitted by 31 December 2014 to Audit, Risk & Improvement and work is underway to develop different means of communication. E.g. Posters in public places and a dedicated webpage by 31 March 2015. A Performance Management strategy will be developed by August 2015.	Executive Manager – Audit, Risk and Improvement	August 2015

Agenda Item

1

Shetland Islands Council

Policy & Resources Committee **26 November 2014**
Shetland Islands Council **3 December 2014**

SIC Overall Management Accounts **2014-15 Projected Outturn at Quarter 2**	
F-073-F	
Report Presented by Executive Manager - Finance	**Corporate Services**

1.0 Summary

1.1 The purpose of this report is to enable the Policy & Resources Committee to monitor the financial performance of all Council services to ensure that Members are aware of the forecast income and expenditure and the impact that this will have with regard to delivering the approved budget. This allows the Committee the opportunity to provide early instruction to officers to address any forecast overspends in order that the budget is delivered by the year-end.

1.2 This report discusses the projected outturn position for the 2014/15 year as at the end of the second quarter for revenue and capital. The forecasts have been determined by Finance Services after consultation with the relevant Budget Responsible officers for the services. This report shows the impact this has on the draw on reserves for 2014/15.

1.3 The projected outturn position for the Council are underspends of £3.388m on revenue, £1.449m on capital plus £0.032m CFCR, and £1.005m on Spend to Save (unallocated). A total underspend of £5.874m.

2.0 Decision Required

2.1 The Policy & Resources Committee recommend that the Council RESOLVE to:

- review the Management Accounts showing the projected outturn position at quarter 2.

3.0 Detail

3.1 On 11 December 2013 (SIC Min Ref: 109/13) the Council approved the 2014/15 revenue and capital budgets for the Council (including the General Fund, Harbour Account, Housing Revenue Account and Spend to Save) requiring a draw from reserves of £14.793m. This is still at an unsustainably high level and therefore it is vital to the economic wellbeing of the organisation that the budget is delivered, as any overspends will result in a further draw on reserves.

3.2 The table below sets out the projected outturn position against the revised budget. There is a total projected underspend against the revised budget of £5.874m.

Type of Spending	*Original Budget £m*	Revised Budget £m	Projected Outturn £m	Variance (over)/ underspend £m
Revenue	*106.401*	109.393	106.005	3.388
Capital	*10.606*	15.720	14.271	1.499
Spend to Save (unallocated)	*1.500*	1.681	0.676	1.005
Remove CFCR included in Capital above	*(1.090)*	(1.547)	(1.579)	0.032
TOTAL	***117.417***	**125.247**	**119.373**	**5.874**

3.3 The impact on the reserves of the projected outturn, set out in section 3.2 above, is that the draw on reserves for 2014-15 is to reduce by £7.074m against the revised budget. More of the underspend relates to spending funded by the Council's reserves than that funded by other sources on the Capital programme.

2014-15 Draw on Reserves	*Original Budgeted Draw £m*	Revised Budgeted Draw £m	Projected Outturn Draw £m	Variance (over)/ underspend £m
Annual All Funds	*14.793*	20.278	13.204	7.074

3.4 The projected outturn draw on reserves equates to £36k per day as can be seen from the table below.

2014-15 Draw on Reserves	*Original Budgeted Draw £000*	Revised Budgeted Draw £000	Projected Outturn Draw £000	Variance (over)/ underspend £000
Amount per Day	*41*	55	36	19

Variances shown in Appendices

3.5 Appendix 1 shows the revenue projected outturn position for the second quarter for the Council by service area and fund. Detailed reports on spending variances have been presented to individual committees.

3.6 There is a projected underspend of £3.031m on the General Fund against the revised budget. This underspend is a combination of projected underspends and overspends across directorates, the largest projected underspends are in Community Care (staffing costs) and Development (grant schemes) and the cost pressures and contingency is unlikely to be spent.

3.7 There is a projected increased surplus of £419k on the Harbour Account, which is mainly due to additional income.

3.8 There is a projected reduced surplus of £62k on the Housing Revenue Account due mainly to the restructuring and externalising of historic debt in 2014/15. The outstanding debt is to be paid over a shorter period, which is more efficient for the HRA over the longer term.

3.9 There is a projected underspend of £1.005m on the Spend to Save Reserve (unallocated).

3.10 Appendix 2 shows the capital projected outturn position for the first quarter for the Council. There is an anticipated underspend of £1.449m against the revised budget mainly due to delays on to the New Scalloway Health Centre Conversion, Phase 2 of the ET & Taing Conversion, Clickimin Roundabout/Access Road, Rolling Bridge Replacements, Town Hall Conservation project and Terminal Life Extensions. This is offset by an increase in spending on the new AHS school fees.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities
There is a specific objective within the Corporate Plan to ensure that the Council is "living within our means" with a range of measures which will enable the Council to achieve financial sustainability over the next four years, and line up spending with priorities and continue to have significant reserves.

The Medium Term Financial Plan also includes a stated objective to achieve financial sustainability over the lifetime of the Council.

4.2 Community /Stakeholder Issues – None.

4.3 Policy And/Or Delegated Authority

Section 2.1.2(3) of the Council's Scheme of Administration and Delegations states that the Committee may exercise and perform all powers and duties of the Council in relation to any function, matter, service or undertaking delegated to it by the Council. The Council approved both revenue and capital budgets for the 2014/15 financial year. The Policy & Resources Committee has delegated authority for securing the co-ordination, control and proper management of the financial affairs of the Council.

4.4 Risk Management

There is a risk that revenue services and capital projects will not be delivered within the approved 2014/15 budget resulting in an additional draw on reserves, which is unsustainable. Failure to deliver the 2014/15 budgets may result in the Council failing to deliver its Corporate Plan and Medium Term Financial Plan.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial

The 2014/15 Council budget is not sustainable because it requires a draw on reserves in excess of the returns that the fund managers can make on average in a year.

For every £1m of reserves spend (in excess of the sustainable level) it will mean that the Council will have to make additional savings of £50,000 each year in the future as a result of not being able to invest that £1m with fund managers to make a return.

It is therefore vital that the Council delivers its 2014/15 budget, as any overspend will result in a further unsustainable draw on reserves which will have the long term consequences as explained above.

Revenue (GF/Harbour/HRA/Spend to Save)

The projected outturn position shows a net underspend of £3.388m. This underspend is made up of General Fund underspend of £3.031m, a decrease in surplus income on the Housing Revenue Account of £0.062m, an increase on the surplus on the Harbour Account of £0.419m.

Capital (GF/Harbour/HRA/Spend to Save)

The projected outturn position shows a net underspend of £1.449m. This is made up of General Fund underspend of £0.730m and Harbour Account overspend of £15k, Spend to Save underspend of £0.735m and the Housing Revenue Account is expected to overspend by £0.001m.

Spend to Save Budget Unallocated Budget

The projected outturn position shows a net underspend of £1.005m.

Reserves
The projected outturn draw on reserves is £13.204m (or £36k per day) which is £7.074m (or £19k per day) less than the revised budget.

4.8 Legal – None.

4.9 Human Resources – None.

4.10 Assets And Property – None.

5.0 Conclusions

5.1 The revenue outturn position for the combined General Fund, Harbour Account, Housing Revenue Account and Spend to Save is projected to be under budget by £3.388m.

5.2 The capital outturn position for the combined General fund, Harbour Account, Housing Revenue Account and Spend to Save is projected to be under budget by £1.449m.

5.3 The outturn position for the Spend to Save (unallocated) budget is projected to be under budget by £1.005m.

5.4 The projected draw from reserves is to decrease by £7.074m against the revised budget.

For further information please contact:
James Gray,
01595 744607
James C. Gray@shetland.go.uk

List of Appendices
Appendix 1 – Overall SIC Projected Revenue Outturn Position for 2014/15
Appendix 2 - Overall SIC Projected Capital Outturn Position for 2014/15

Background documents:
SIC Budget Book 2014-15, SIC 11 December 2013
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=15444

END

Shetland Islands Council

1. Revenue Projected Outturn Position for 2014/15

General/Support/Recharged Description	Revised Budget 2014/15 £000	Projected Outturn 2014/15 £000	Budget v Proj. Outturn Variance £000
Chief Executive	1,682	1,681	1
Children's Services	41,702	41,609	93
Community Care	20,238	19,573	664
Corporate Services	9,961	9,829	132
Development	13,724	13,240	484
Infrastructure	20,810	20,680	129
Fund Managers Fees	600	768	(168)
Contingencies & Budget Pressures	5,141	3,445	1,696
Net Recharges to Other Fund	(1,911)	(1,911)	0
Total Costs	**111,946**	**108,915**	**3,031**
Funded by:			
Government Grants	(85,732)	(86,096)	364
Council Tax	(8,686)	(8,348)	(338)
Unsustainable Draw on Reserves	(17,528)	(14,471)	(3,057)
Total Funding	**(111,946)**	**(108,915)**	**(3,031)**
Balanced Budget	**0**	**0**	**0**

Harbour Account	Revised Budget 2014/15 £000	Projected Outturn 2014/15 £000	Budget v Proj. Outturn Variance £000
Harbour Account	(2,224)	(2,643)	419
Funded by : Marine Fund (Reserve)	(138)	(138)	0
Contribution to Reserve Fund (Reserve)	2,362	2,781	(419)
Balanced Budget	**0**	**0**	**0**

Housing Revenue Account	Revised Budget 2014/15 £000	Projected Outturn 2014/15 £000	Budget v Proj. Outturn Variance £000
Housing Revenue Account	(192)	(129)	(62)
Funded by: Contribution to HRA R&R fund (Reserve)	192	129	62
Balanced Budget	**0**	**0**	**0**

Spend to Save	Revised Budget 2014/15 £000	Projected Outturn 2014/15 £000	Budget v Proj. Outturn Variance £000
Spend to Save Unallocated	1,681	676	1,005
Funded by: Spend to Save (Reserve)	(1,681)	(676)	(1,005)
Balanced Budget	**0**	**0**	**0**

Shetland Islands Council

2. Capital Projected Outturn Position for 2014/15

Service Area Description	Revised Budget 2014/15 £000	Projected Outturn 2014/15 £000	Budget v Proj. Outturn Variance £000
Children's Services	1,488	2,886	(1,398)
Community Care	3,793	2,602	1,191
Corporate Services	777	777	0
Development	702	768	(66)
Infrastructure (incl. Harbour Account)	6,872	5,149	1,723
Development (HRA)	2,087	2,088	(1)
Total Costs	**15,720**	**14,271**	**1,449**
Funded by:			
General Capital Grant	(6,996)	(6,996)	0
Other Government Grants	(495)	(495)	0
Capital Fund Reserve	(1,447)	473	(1,920)
Spend to Save Reserve	(1,650)	(915)	(735)
ERDF Grant	0	(106)	106
Capital Receipts	(500)	(836)	336
General Fund CFCR	(388)	(388)	0
CFCR (HRA)	(1,337)	(1,338)	1
Capital Receipts (HRA)	(750)	(750)	0
CFCR (Harbour Account)	(210)	(210)	0
Debt Charges (Harbour Account)	(16)	(31)	15
External Borrowing	(1,931)	(2,680)	748
Total Funding & Financing	**(15,720)**	**(14,271)**	**(1,449)**
Balanced Budget	**0**	**0**	**0**

Appendix
2

Shetland Islands Council

Shetland Islands Council **3 December 2014**

Chair's Report – Policy and Resources Committee 26 November 2014– Review of Community Grants
Report No. SIC-0312-P&R-DV045

1.0 Summary

1.1 The purpose of this report is to consider recommendations from the Chair of the Policy and Resources Committee in relation to a report requiring a Council decision.

2.0 Decision Required

2.1 That the Council **RESOLVES** to approve the recommendations from the Policy and Resources Committee, namely to:

2.1.1 Extend the current transitionary period of the Support Grant Aid Scheme and Grounds Maintenance Scheme for another year, with a further 25% reduction applied to the level of grant awarded;

2.1.2 Close the Support Grant Aid Scheme and Grounds Maintenance Scheme on 31 March 2016; and

2.1.3 Agree that as part of the budget proposals for 2015/16, that the level of funding for community grants be retained at the 2014/15 level, with the amount to be found from existing contingencies.

3.0 Report

3.1 The report to Committee concluded that the Community Grants review has identified that closing a number of grant aid schemes in March 2014 is impacting on community groups across Shetland. The reduction in funding to the remaining two schemes in financial year 2014/15 is also impacting on community groups. The consultation process has confirmed that removal of the remaining two schemes will have significant impacts on many community groups going forward.

3.2 Community consultation has illustrated that community groups are working on ways to address the planned closure of the remaining schemes. Many groups are seeking to increase income through increased charges and/or fundraising, with other groups looking to bring in external funding. Other measures highlighted were finding internal efficiencies, sharing equipment or premises and exploring possible mergers to achieve economies of scale. However throughout the consultation process, and following discussions with community groups and stakeholders, it has been identified that community groups are at different stages of progressing the changes necessary to become financially self sufficient. Our findings indicate that some groups are well organised and already moving away from the reliance on grant aid, whereas a number of other community groups have made very little progress and are in need of more support to become financially independent.

3.3 It is the intention of CP&D to move away from annual revenue grants and introduce a more targeted "one off" project type funding linked to achieving agreed outcomes. However the Community grants review has flagged up that a significant number of community groups would benefit from another transition year. This would provide more time for community groups to prepare and budget for their activities without annual Support or Grounds Maintenance grants. It would also provide CP&D staff with more information and time to analyse what gaps exist. This will ensure that new grant aid criteria and budgets are targeted as effectively as possible going forward.

3.4 Copies of the report have been previously circulated or can be accessed via the Council's website at the link shown below, or by contacting Committee Services.

3.5 The Chair will present any further information to the Committee as to the debate or issues that the Committee considered.

4.0 Implications

4.1 Detailed information concerning the proposals was contained within the report already circulated to Members, including the strategic and resources implications for the Council.

4.2 There are no additional implications to be considered by the Council, other than those set out in the report.

For further information please contact:

Mr G Robinson, Leader and Chair of Policy and Resources Committee
26 November 2014

List of Appendices
None

Background documents:
Policy and Resources Committee – 26 November 2014
http://www.shetland.gov.uk/coins/agenda.asp?meetingid=4553

END

Appendix

3

Shetland Islands Council

Shetland Islands Council **3 December 2014**

Chair's Reports – Policy and Resources Committee – 26 November 2014
2015-16 Budget and Charging Proposals – All Committees; HRA; and Asset Investment Plan
Report No. SIC-0312

1.0 Summary

1.1 The purpose of this report is to consider the recommendations from the Policy and Resource Committee, in relation to recommendations from all the Council's Committees, Harbour Board and College Board, regarding their 2015-16 Budget and Charging proposals, all of which require a Council decision.

2.0 Decision Required

2.1 That the Council **RESOLVES** to approve the recommendations from the Policy and Resources Committee, highlighted in Section 3 below, as part of the SIC Budget 20156-16

3.0 Report

3.1 **Policy and Resources Committee – Budget and Charging Proposals**

The summary budget proposals for the services under the remit of Policy and Resources Committee are £9.785m, split by service area as follows:

Service	2015-16 Proposed Budget £000
Executive Services	1,213
Council Members	619
Chief Executive Sub-total	**1,832**
Director of Corporate Services	210
Capital Programmes	801
Finance	2,173
Governance & Law	1,000
Human Resources	1,458

Service *(continued from previous page)*	**2015-16 Proposed Budget £000**
ICT	1,415
Audit, Risk and Improvement	437
Valuation Joint Board	284
Corporate Sub-total	**7,779**
TOTAL Chief Executive and Corporate	**9,611**
Community Councils	174
TOTAL Development	**174**
TOTAL	**9,785**
Fund Manager Fees	**700**

3.1.1 The Committee agreed to recommend that the Council **RESOLVES** to approve the budget proposals and the proposed charging for 2015-16, subject to clarification being given to Members on the proposal not to increase Town Hall charges for 2015/16.

3.2 **Housing Revenue Account 2015-16 Budget and Charging Proposals**

The table below sets out the proposed 2015-16 budget for the HRA:

Description	**2015-16 Proposed Budget (£000)**
Expenditure:	
Supervision & Management	803
Repair & Maintenance	2,474
Void Rents & Charges	181
Garages	26
Capital Funded from Current Revenue	978
Debt Charges - Dwellings	1,827
Total: Expenditure	**6,289**
Income:	
Interest on Revenue Balances	(4)
Rents - Dwellings	(6,526)
Rents - Other ie garages/sites etc	(177)
Total: Income	**(6,707)**
Total Surplus	**(418)**
Contribution (from) / to Housing R & R Fund	418
Balanced HRA	**0**

3.2.1 The Committee agreed to recommend that the Council **RESOLVES** to approve the budget proposals, the rent levels and proposed charging for 2015-16.

3.3 **Proposed 5 Year Asset Investment Plan 2015-20**

The proposed 2015-20 budget for capital is summarised in the table below.

Description	2015-16 Budget £000	Total Plan 2015-2020 Budget £000
New Developments	17,143	51,919
Maintenance of Existing Assets	7,045	33,570
Spend to Save Projects	70	70
Housing Revenue Account Projects	1,728	6,528
Capital Contingency	2,500	2,500
Total: Expenditure	**28,486**	**94,587**
Scottish Government General Capital Grant	(7,363)	(31,363)
Capital Receipts (General Fund & HRA)	(1,150)	(1,550)
External Funding (General Fund)	(982)	(32,926)
Funded from Revenue (GF/Harbour/HRA)	(1,278)	(6,958)
Draw on Reserves – Spend to Save Projects	(70)	(70)
Draw from Reserves - 2nd Homes Council Tax	(100)	(100)
External Borrowing	(17,543)	(21,620)
Total: Funding	**(28,486)**	**(94,587)**
Balanced Asset Investment Plan	**0**	**0**

3.3.1 The Committee agreed to recommend that the Council **RESOLVES** to:

- approve the capital budget proposals for 2015/16; and
- adopt this as the Council's 5-year Asset Investment Plan 2015-20, subject to any requirements of the Council's 'gateway' process, the resolution of any issues relating to external funding and any variation in the level of government grants.

3.4 **<u>Social Services Committee – Chair's Report</u>**

The summary budget proposals for the services under the remit of the Social Services Committee are £23.6m, split by service area as follows:

Service	2015-16 Proposed Budget £000
Directorate	800
Adult Services	6,095
Community Care resources	9,715
Criminal Justice	10
Mental Health	1,748
Occupational Therapy	1,375
Total Community Care Services	**19,743**
Community Planning and Development	766
Housing	1,766
Total Development Services	**2,532**
Sports & Leisure	1,296
Total Children's Services	**1,296**
OVERALL TOTAL	**23,572**

3.4.1 The Committee agreed to recommend that the Council **RESOLVES** to approve the budget proposals and charging proposals for 2015-16 from the Social Services Committee, as part of the overall budget setting exercise; and that the level of funding for community grants be retained at the 2014/15 level, with the amount to be found from existing contingencies. The Committee also noted that the 2015/16 draft budget proposals for Community Care and the NHS are relevant for the Integrated Joint Board that will become operational from 1 April 2015.

3.5 **<u>Development Committee – Chair's Report</u>**

The summary budget proposals for services under the remit of Development Committee are £4.852m, split by service area as follows:

Service	2015-16 Proposed Budget £000
Director of Development	812
Economic Development	2,800
Planning	1,240
TOTAL	**4,852**

3.5.1 The Committee agreed to recommend that the Council **RESOLVES** to approve the budget proposals and charging proposals for 2015-16 from the Development Committee, as part of the overall budget setting exercise.

3.6 **Education and Families Committee – Chair's Report**

The summary budget proposals for the services under the remit of the Education & Families Committee are £38.801m, split by service area as follows:

Service	2015-16 Proposed Budget £000
Director of Children's Services	1,833
Children & Families	1026
Children's Resources	3,390
Quality Improvement/Schools	30,916
Library	962
Total Children's Services	**38,127**
Community Planning & Development	326
Train Shetland	348
Total Development Services	**674**
OVERALL TOTAL	**38,801**

3.6.1 The Committee agreed to recommend that the Council **RESOLVES** to approve the budget proposals and charging proposals for 2015-16 from the Education and Families Committee, as part of the overall budget setting exercise.

3.7 **Environment and Transport Committee – Chair's Report**

The summary budget proposals for the services under the remit of Environment & Transport Committee are £25.920m, split by service area as follows:

Service	2015-16 Proposed Budget £000
Infrastructure Directorate	938
Environmental Services	3,169
Estate Operations	988
Ferry Operations	11,470
Roads	3,986
Total Infrastructure Services	**20,551**
Transport Planning	5,369
Total Development Services	**5,369**
OVERALL TOTAL	**25,920**

3.7.1 The Committee agreed to recommend that the Council **RESOLVES** to approve the budget proposals and charging proposals for 2015-16 from the Environment and Transport Committee, as part of the overall budget setting exercise. The Committee also asked that a further report on fuel consumption costs be presented to it, in due course.

3.8 **Harbour Board – Chair's Report**

The summary budget proposals for the services under the remit of the Harbour Board is a surplus of £6.382m on harbour activity and £1.3m from the Total Gas Plant, split by activity area as follows:

Service	2015-16 Proposed Budget £000
Ports Management & Engineering	170
Sullom Voe	10,328
Scalloway	689
Terminals	804
Other Piers	371
Jetties & Spur Booms	2,294
Total Expenditure	**14,656**
Harbour Fees & Charges	(15,538)
Terminal Charges	(3,206)
Jetties & Spur Booms	(2,294)
Total Income	**(21,038)**
Net Surplus	**(6,382)**
Contribution from the Marine Fund	(138)
Contribution to the Reserve Fund	6,520
Balanced Budget	**0**

Service	2015-16 Proposed Budget £000
Total Gas Plant contribution	**(1,349)**

3.8.1 The Committee agreed to recommend that the Council **RESOLVES** to approve the budget proposals for 2015-16 from the Harbour Board, including the Table of Dues, as part of the overall budget setting exercise, on the proviso that Officers review the charging of all harbour users in an equal process by the end of September 2015 and that the proposals are presented to the industry on the charging structure that deals equitably with all harbour users with an implementation date being open to debate.

3.9 **Shetland College Board – Chair's Report**

The summary budget proposals for Shetland College (Controllable and Non Controllable) are:

Shetland College	2015-16 Proposed Budget £000
Income:	
Scottish Further Education Funding Council	1,872
Tuition Fees, Contracts & Grants	444
Other Income	241
TOTAL INCOME	**2,557**
***Expenditure*:**	
Employee Costs	1,989
Premises Costs	496
Operating Costs	421
Grants to Individuals	4
Professional Fees/Recharges	95
Travel/Vehicle Expenses	9
TOTAL EXPENDITURE	**3,014**
TOTAL DEFICIT	**(457)**
SIC Contribution	296
Remaining Deficit*	**161**

*A provision for this deficit has been made under contingencies, in the Council Budget Book 2015-16.

3.9.1 The Committee agreed to recommend that the Council **RESOLVES** to approve the budget proposals for 2015-16 from the Shetland College Board, as part of the overall budget setting exercise.

3.10 **Policy and Resources Committee – 2015-16 Budget Book**

The Committee considered a report by the Executive Manager – Finance, and agreed to accept the recommendation in the report, without amendment. This report is the next item on the Council's agenda.

3.11 Copies of each of the above reports have been previously circulated or can be accessed via the Council's website at the link shown, or by contacting Committee Services.

3.12 **The Leader or Chairs will present any information to the Council as to the debate or the issues that the Committees considered.**

4.0 Implications

4.1 Detailed information concerning the proposals was contained within the report already circulated to Members, including the strategic and resources implications for the Council.

4.2 The impact of the recommendations presented by the Policy and Resources Committee are contained in the SIC Budget 2015-16 report on the agenda today.

For further information please contact:

Mr G Robinson, Leader and Chair of Policy and Resources Committee
26 November 2014

List of Appendices
None.

Background documents:
Policy and Resources Committee – 26 November 2014
http://www.shetland.gov.uk/coins/agenda.asp?meetingid=4553

END

Agenda Item

4

Shetland Islands Council

Policy & Resources Committee **26 November 2014**
Shetland Islands Council **3 December 2014**

Shetland Islands Council Budget Book 2015-16	
F-072-F	
Report Presented by Executive Manager – Finance	**Corporate Services**

1.0 Summary

1.1 The purpose of the Council Budget Book 2015-16 is to set out the spending plans for Shetland Islands Council in the next financial year.

1.2 The budget adheres to the Medium Term Financial Plan and therefore contributes towards the strategic aim of realigning more available resources towards Children's Services and Community Care so that a larger percentage of the Council's budget will be spent in those areas by the end of the Council term.

1.3 The 2015-16 budget is a financially sustainable budget.

2.0 Decision Required

The Council RESOLVES to approve the 2015-16 budget by:

2.1 Approving the Council Budget Book 2015-16 (Appendix 1);

2.2 Adopt the Formal Resolutions (Appendix 2);

2.3 Agree to freeze the Council Tax at the current level, in line with the Concordat between the Council and the Scottish Government;

3.0 Detail

3.1 The detailed Council Budget Book 2015-16 and the Formal Resolution is attached as Appendix 1and 2 respectively to this report.

3.2 The Council Tax Band D for 2015/16 will remain at £1,053. This budget assumes a 98.5% in year collection rate.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities
The 2015-16 budget will contribute towards delivering the Medium Term Financial Plan. The Target Operating Budgets proposed within this budget are aligned with the priorities in the Council's Single Outcome Agreement.

4.2 Community/Stakeholder Issues
Each individual service will be responsible for addressing community/stakeholder issues prior to making any changes to the existing level of service delivery.

4.3 Policy And/Or Delegated Authority
The Policy & Resources Committee is required to make recommendations to the Council as to the estimates of capital and revenue expenditure. The decisions required in this report may only be determined by the Council, in accordance with Section 2.1.3 of the SIC Scheme of Administration and Delegations, including the power to fix the Council Tax.

The budget fits within the policies included in the Medium Term Financial Plan. The Chief Executive and Directors will deliver the Council's budget in accordance with the Scheme of Delegations and Financial Regulations.

4.4 Risk Management
There are a number of assumptions around cost pressures (section 5.10) within the budget that are based on the best information available to date.

The budget contains budget savings of £3.326m, there is a risk that should savings not be achieved it will result in an increased draw on reserves.

The 2015-16 budget will require a draw on reserves of £6.946m.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial
For the first time since the 1990s the Council is setting a sustainable budget that requires a draw on reserves of £6.946m which is an affordable amount, and will protect the capital value of reserves. This represents an 80% decrease on the position that the current Council

inherited, which required a £36m draw on reserves to balance the 2011-12 budget. This has been achieved despite significant reductions in government funding and rising costs.

It is possible for Shetland Islands Council to have a higher level of service than mainland councils because of the reserves at its disposal, and this budget seeks to ensure that the real value of the reserves is protected during 2015-16.

It is important that the Council now continues this responsible budgeting approach into the future and avoid returning back to budgets with unsustainable draws on reserves which have been so damaging to the Council. Previous decisions to spend 60% of the Council's Reserves between 2000 and 2012 mean that today's 2015-16 budget is deprived of £15m of extra spending on services that would have been affordable had a sustainable approach been taken over those 12 years.

Any decision to recommend changes to the budget proposals in this report will result in an increased or decreased draw on the reserves. This will require a formal amendment and be fully quantified in the Committee decision.

4.8 Legal
Each individual service will be responsible for addressing legal issues prior to making any changes to the existing level of service delivery.

4.9 Human Resources
Each individual service will be responsible for addressing human resource issues prior to making any changes to the existing level of service delivery.

4.10 Assets And Property
A key part of the 2015-16 budget is the financing of the new Anderson High School, new Eric Gray Resource Centre and Ferry Vessel Life Extensions. This will create an ongoing revenue pressure of an estimated £1.428m for the next 25 years.

5.0 Conclusions

5.1 By adopting this 2015-16 budget Members will have set a sustainable budget.

For further information please contact:
James Gray, Executive Manager - Finance
01595 744607
james.gray2@shetland.gov.uk
18 November 2014

List of Appendices
Appendix 1 – The Council Budget Book 2015-16
Appendix 2 – Formal Resolution

Shetland Islands Council

The Council Budget Book

2015-16

Securing the Best for Shetland

Contents

Executive Summary

1.01 Shetland Islands Council's 2015-16 budget will ensure that public services in Shetland continue to be better funded than any other local authority in Scotland. This is because the Council will top up its Council Tax income and core Scottish Government grant with an additional £15.095m, which is affordable as a result of the budgeted Harbour Account surplus, budgeted income from the TOTAL gas plant and expected investment returns.

1.02 For the first time since the 1990s the Council is setting a sustainable budget that requires a draw on reserves of £6.946m which is an affordable amount, and will protect the capital value of reserves. This represents an 80% decrease on the position that the current Council inherited, which required a £36m draw on reserves to balance the 2011-12 budget. This has been achieved despite significant reductions in government funding and rising costs.

1.03 It is possible for Shetland Islands Council to have a higher level of service than mainland councils because of the reserves at its disposal, and this budget seeks to ensure that the real value of the reserves is protected during 2015-16.

1.04 It is important that the Council now continues this responsible budgeting approach into the future and avoids returning back to budgets with unsustainable draws on reserves which have been so damaging to the Council. Previous decisions to spend 60% of the Council's reserves between 2000 and 2012 mean that today's 2015-16 budget is deprived of £15m of extra spending on services that would have been affordable had a sustainable approach been taken over those 12 years.

1.05 The 2015-16 Budget adheres to the Medium Term Financial Plan, by delivering the required savings of £2.145m and contributing towards the strategic aim of realigning more available resources towards Children's Services and Community Care in particular.

1.06 This is demonstrated by the progress made in re-allocating resources between the directorates to meet these priority areas as shown in the table below:

Directorate	2012-13	2015-16	Change
	%	%	%
Children's Services	37.18	39.53	2.35
Corporate & Executive	10.98	9.64	-1.34
Community Care	18.79	19.80	1.01
Development Services	14.41	13.64	-0.77
Infrastructure Services	18.64	17.39	-1.25

1.07 Further information on how the 2015-16 Budget will support the delivery of the Council's Corporate Plan is set out in Section 4 of this report.

1.08 Financial sustainability is a journey and not a destination and therefore Members will need to continue to set future budgets in line with the Medium Term Financial Plan to ensure that the good work to reach this position continues into the future.

Progress to Date & Future challenges

1.09 The Council can take comfort with regard to the deliverability of the 2015-16 Budget. At present it is currently on course to deliver its 2014-15 Budget which included £6.539m of savings. When added to the £12.5m of savings delivered in 2013-14, the £15m in 2012-13 and £11.5m in 2011-12, the Council is demonstrating a track record of budget delivery.

1.10 However, it is anticipated that there will be further reductions in the core revenue grant from the Scottish Government over the forthcoming years, and simultaneously the Council will have to manage an ever increasing demand for Council services, such as in Community Care, and having to manage cost pressures such as pay awards.

1.11 This Budget will keep the Council on track to manage these significant challenges.

Draw on Reserves

1.12 The Council is asked to approve an affordable and sustainable draw on reserves to balance the 2015-16 Budget:

Draw on Reserves	Budgeted Draw on/ (contribution to) Reserves (£m)
General Fund	12.982
General fund Carry Forward from 14-15 to meet Contingency Requirements	1.943
Asset Investment Plan	0.170
Harbour Account Surplus	(6.382)
TOTAL Gas Plant	(1.349)
Housing Revenue Account	(0.418)
TOTAL BUDGETED DRAW ON RESERVES 2015-16	**6.946**

Key Budget Messages

1.13 Some of the most significant Budget proposals are as follows:

- The Council is freezing Council Tax for the eighth consecutive year so a Band D property continues to incur an annual charge of £1,053. This means that Shetland Islands Council continues to charge the 4th lowest level of Council Tax out of the 32 local authorities in Scotland whilst providing the best funded services.

- The budget contains total savings of £3.326m, exceeding the General Fund savings target of £2.145m as set out in the Medium Term Financial Plan. This has largely been achieved through service efficiencies and focussing on eradicating historic over-budgeting for risk items. The over-achievement of budget reductions by each directorate this year will be used to reduce their savings targets for 2016-17 in the Medium Term Financial Plan.

- The budget includes cost pressures and contingencies totalling £6.774m which is significantly higher than in previous years. The reason for this is to ensure that there will be sufficient budget to absorb any unplanned expenditure, as services were asked not to carry risk/contingency budgets in their proposals. At the end of 2015-16 the approach to contingency budgeting will be reviewed to identify whether it is possible to reduce the size of the corporate contingency budget in order to offer up more savings for the Council.

- The TOTAL gas plant is due to come on stream in 2015-16 and it has been estimated that there will be income of £1.349m during the year. This is a welcome new income stream for the Council and it is anticipated that this, and future income, will be utilised to supplement current expenditure on Council services.

- The Housing Revenue Account budget seeks to increase overall rental income by 0.86% in 2015-16 by simplifying the rents charging policy which will eradicate price differences between properties based on attributes such as whether the house has double glazing or central heating. This is possible because all houses will have these attributes in place by next year in order to meet the 2015 housing quality standard.

- The ambitious Asset Investment Plan budget seeks significant investment in the Council's infrastructure and will require borrowing of £17.544m in 2015-16 to meet the funding shortfall. The borrowing is required to finance the new Anderson High School, the Eric Gray Resource Centre and Ferry Vessel Life Extensions.

- It is estimated that the Council will have to forego spending of £1.428m per year on providing day to day services for the next 25 years to fund the costs associated with this borrowing.

Introduction to the Budget Report

Medium Term Financial Plan

2.01 The Medium Term Financial Plan is the Council's strategic finance document which focuses on the five year period of the current Council term. The key strategic objectives included within the plan are –

- To maintain the reserves by ensuring expenditure remains at a level that can be met from all available resources so as not to erode the capital value of the reserves;
- Achieving a level of spending that is financially sustainable during the course of the current Council term and beyond, thus safeguarding the future economic viability of Shetland Islands Council;
- To offer a level of protection for day to day revenue services by cutting the draw on reserves for capital expenditure, so that more can be affordably spent on revenue services;
- The Target Operating Budgets set for each Directorate reflect the priorities of the Council. This means that by the end of the 5 year plan, the Children's Services, Community Care Services and Infrastructure Services directorates will each have a larger percentage of the budget than they currently do, whilst Development Services, Corporate Services and Executive Services will each have a smaller share of the budget as a consequence; and
- The Medium Term Financial Plan will be updated annually to reflect external developments and changes in the Council's policy direction.

The 2015-16 Budget

2.02 The 2015-16 Council Budget is a tactical financial plan that complements the strategic Medium Term Financial Plan and will ensure that the Council moves towards delivering its strategic financial objectives.

2.03 The Budget encapsulates all aspects of the Council's business; the General Fund, the Housing Revenue Account, the Harbour Account and the Capital Programme. This means it is clearer for Members to see the full impact that the spending proposals will have on the Council's reserves during the financial year.

The Approach to Setting the Budget

2.04 The Council has a rolling programme for selecting one directorate to use a zero-based budgeting approach each year while the remainder of directorates use traditional incremental budgeting. This year the directorate chosen to do zero-based budgeting was Children's Services (with the exception of the schools service), and Community Care voluntarily chose to adopt zero-based budgeting.

2.05 The outcome of this budgeting exercise is that the aggregated budget proposals put forward by directorates are under the budget reduction targets that were set within the Medium Term Financial Plan, and those proposals are aligned to the Council's priorities insofar as possible.

Other Aspects of the Budget Report

2.06 The objective of the Overall Council Budget 2015-16 Report is to provide a high level summary of the proposals and their contribution towards delivering the Medium Term Financial Plan, and their impacts on the Council's reserves.

2.07 The detailed budget proposals for each area of the Council are set out in separate reports which were presented to Special Committee Meetings during November 2014. This report guides Members to those other reports where more detailed information can be found on the General Fund committees' services, the Harbour Account, the Housing Revenue Account and the Asset Investment Plan.

The 2015-16 Budgeted Draw on Reserves

3.01 The 2015-16 budgeted draw on reserves is proposed as follows:

Draw on Reserves	Budgeted Draw on/ (contribution to) Reserves (£m)
General Fund	12.982
General fund Carry Forward from 14-15 to meet Contingency Requirements	1.943
Asset Investment Plan	0.170
Harbour Account Surplus	(6.382)
TOTAL Gas Plant	(1.349)
Housing Revenue Account	(0.418)
TOTAL BUDGETED DRAW ON RESERVES 2015-16	**6.946**

3.02 The total budgeted draw on reserves for 2015-16 is £6.946m. This is both affordable and sustainable, but further work will be required in future years to ensure that the Council remains on track with regard to setting sustainable budgets.

Spend to Save Budget

3.03 Only £0.070m of new Spend to Save funding has been proposed for 2015-16 to complete the ET and Taing project in the Asset Investment Plan. It is forecast that there will be an under-spend of nearly £0.7m on the Spend to Save budget in 2014-15 and it is proposed that this is carried forward to fund Spend to Save projects in 2015-16.

3.04 The purpose of the Spend to Save scheme is to provide up front funding to a service in order to effect a change that will result in recurring savings in the future. Given the requirement to make significant savings over the forthcoming years it is important that ring-fenced funds are available to enable changes to take place that will result in future savings.

3.05 In order for a directorate/service to qualify for Spend to Save funding, the following criteria must be met –

- The up-front investment of Spend to Save funds must be recouped from recurring savings within 3 years;
- The budget savings generated by a directorate/service are offered up as a Council saving and not re-invested in other areas of the directorate/service unless agreed by Council;
- The Spend to Save application is signed off as competent by the Executive Manager – Finance.

Linking the 2015-16 Budget to the Council's Corporate Plan

4.01 The 2015-16 General Fund Budget proposes to incur net expenditure of £109.660m on services to the people of Shetland during the next financial year.

4.02 Although budgets have reduced to get the Council to a position where it is now on a sustainable footing, Shetland Islands Council is still able to provide the best funded services to the public of any local authority in Scotland.

4.03 In order to maximise the potential impact of the available funding for services it will be targeted towards achieving the priorities in the Council's Corporate Plan which are –

- Supporting adults to be independent;
- Providing the best possible start for every child;
- Providing the transport services we need most;
- Supporting a healthy economy – strong communities;
- Supporting vulnerable and disadvantaged people;
- Working with partners and communities;
- Being a properly led and well managed council;
- Dealing with challenges effectively; and
- Living within our means.

4.04 Further detail on how these priorities will be delivered in the 2015-16 financial year can be found in the 5 Directorate Plans. These set out how the budgets of each directorate will be used to contribute towards the delivery of the Corporate Plan. These reports were presented to the Special Service Committee meetings:

Community Health & Social Care Directorate	**CC-035-F** Community Health & Social Care Directorate Plan 2015-16 http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=16913

Development Services Directorate	**DV-047-F** Development Services Directorate Plan 2015 http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=

Children's Services Directorate	**CS-031-F** Children's Services Directorate Plan 2015-16 http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=16919

Infrastructure Services Directorate	**ISD-021-F** Infrastructure Services Directorate Plan 2015-16 http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=16942

Corporate & Chief Executive Directorates	**CRP-021-F** Corporate and Chief Executive's Directorate Plan 2015-16 http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=

The 2015-16 General Fund Budget

5.01 The 2015-16 General Fund budget is set out in the table below:

Line No.	Description	2015-16 £000s	2015-16 £000s
1	Chief Executive & Cost of Democracy	1,832	
2	Children's Services	39,423	
3	Community Care Services	19,743	
4	Development Services	13,601	
5	Infrastructure Services	20,551	
6	Corporate Services	7,779	
7	Corporate Services (Fund Manager Fees)	700	
8	**GENERAL FUND SERVICES NET EXPENDITURE (equals lines 1-7)**		**103,629**
9	Contingencies and Budget Pressures	6,774	
10	Borrowing Support Costs funded corporately for AHS Replacement	1,256	
11	Recharges Out (to Harbour Account , HRA and Capital)	(1,999)	
12	**TOTAL NET GENERAL FUND EXPENDITURE (equals line 8 plus lines 9-11)**		**109,660**
	Funded by -		
13	GRG/NNDR (Scottish Government Allocation)	(86,314)	
14	Council Tax	(8,421)	
15	**TOTAL CORE FUNDING (equals lines 13-14)**		**(94,735)**
	Deficit to be funded from Reserves		
16	Draw on Reserves – Core Expenditure General Fund 2015-16	(5,251)	
17	Draw on Reserves – Equivalent to Harbour Account Surplus	(6,382)	
18	Draw on Reserves – Carry Forward from 2014-15 to meet Contingency Requirements	(1,943)	
19	TOTAL Gas Plant Contribution	(1,349)	
20	**TOTAL FUNDING FROM RESERVES (equals lines 16-19)**		**(14,925)**
21	**TOTAL FUNDING (equals line 15 plus line 20)**		**(109,660)**
22	**Balanced budget (line 12 plus line 21)**		**0**

5.02 The proposals in the 2015-16 General Fund budget fall within the agreed directorate Target Operating Budgets as agreed by Members in the Medium Term Financial Plan 2014-2019.

5.03 The table below shows directorate proposals compared to revised Target Operating Budgets:

	2015-16 Target £000s	Transfers £000s	Cost Pressures £000s	2015-16 Revised Target £000s	2015-16 Actual Budget £000s	Variance £000s
Corporate & Chief Executive Services	10,629	(963)	0	9,666	9,611	55
Children's Services	39,769	343	104	40,216	39,423	793
Community Care Services	19,551	138	55	19,744	19,743	1
Development Services	12,725	712	500	13,937	13,601	336
Infrastructure Services	20,281	350	(84)	20,547	20,551	(4)
Total directorate budgets	**102,955**	**580**	**575**	**104,110**	**102,929**	**1,181**

Expenditure

5.04 The General Fund Services Net Expenditure is budgeted to be £103.629m in 2015-16 as shown at Line 8 in the table above which represents the spending on day to day Council services. The table below shows how the directorate Target Operating Budgets reconcile to the detailed budget proposal reports that have been through the five Special Committee meetings in November 2014:

Directorate	Development Committee £000	Social Services Committee £000	Education & Families Committee £000	Environment & Transport Committee £000	Policy & Resources Committee £000	Total £000
Executive & Corporate Services					9,611	**9,611**
Children's Services		1,296	38,127			**39,423**
Community Care		19,743				**19,743**
Development	4,852	2,532	674	5,369	174	**13,601**
Infrastructure				20,551		**20,551**
TOTAL	**4,852**	**23,571**	**38,801**	**25,920**	**9,785**	**102,929**

5.05 The detailed General Fund budgetary information which underpins this section of the budget report can be found in the following Budget Proposals Reports (including appendices) which were presented to Special Service Committee Meetings:

Special Development Committee 24 November 2014	**F-066-F** 2015-16 Budget and Charging Proposals Development Committee http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=16940

Special Education & Families Committee 24 November 2014	**F-070-F** 2015-16 Budget & Charging Proposals Education and Families Committee http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=16922

Social Services Committee 25 November 2014	**F-067-F** 2015-16 Budget and Charging Proposals Social Services Committee http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=16916

Special Environment & Transport Committee 25 November 2014	**F-059-F** 2015-16 Budget and Charging Proposals Environment and Transport Committee http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=16945

Shetland College Board 26 November 2014	**F-071-F** 2015-16 Budget Proposals for Shetland College http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=

Policy & Resources Committee 26 November 2014	**F-056-F** 2015-16 Budget and Charging Proposals Policy & Resources Committee http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=

Contingencies and Cost Pressures

5.06 A figure of £6.774m has been included in the General Fund budget to cover contingencies and cost pressures (as set out in Line 9 of the table at 5.01). This figure has been calculated based on the best information known as at November 2014. The Medium Term Financial Plan allowed for cost pressures and contingencies of £4.831m. To fund the remaining £1.943m, the Council is being asked to approve carry forward of the 2014-15 contingency which is projected to be no longer required. This will be removed from the 2014-15 on approval of this report.

5.07 This budget line covers Council-wide issues and therefore will be held centrally by the Executive Manager – Finance. It will only be released when the Executive Manager – Finance is satisfied that the cost pressure has materialised or the conditions exist to legitimately release contingency monies.

5.08 The following tables show how the figure of £6.774m (£3,162k for cost pressures and £3,612k for contingencies) has been calculated:

Cost Pressures	Description	Allowance for Cost Pressure in 2015-16 budget (£000)
Pay Award	Estimated provision to meet a 2% pay award. There is no agreement with COSLA on pay awards as yet.	1,751
Holiday Pay	This is to meet the cost of holiday pay relating to overtime and additional hours.	300
Free School Meals	The Government has introduced free school meals for primary 1-3. This is to meet the loss of income plus additional food costs.	253
Nursery Places for 2 year olds	The Government has introduced nursery places for some 2 year olds who qualify. There will be additional staff costs in nurseries depending on eligibility and uptake.	110
Demographics Pressures	Based on Shetland's ageing population, it is anticipated that there will be extra demand on Community Care resources in 2015-16.	301
Health & Social Care Integration	To take account of any additional costs as a result of the new Health and Social Care Integration Board.	15
Social Care Workers	To meet the cost of an additional 2 social care workers required to delivery children and family services.	92
Bus & Air Contract Inflation	To cover the cost of inflationary increases in contracts for bus and air services.	120
Rent Review and Legal Fees	To meet the cost the annual rent review for North Ness and to cover legal fees.	80
IT Licences	This is for the additional cost of IT licence fees.	140
TOTAL COST PRESSURES		**3,162**

Cost Pressures	Description	Allowance for Cost Pressure in 2015-16 budget (£000)
Funded by:	Allowance in Medium Term Financial Plan	(2,643)
	Carry Forward from 2014/15 Cost Pressures and Contingency	(519)
TOTAL FUNDING		**(3,162)**

Contingencies	Description	Allowance for Contingencies in 2015-16 budget (£000)
Off-Island Placements (Community Care/ Children's Svs)	The need for off-island placements varies significantly from year to year. It is an unpredictable demand led activity.	1,000
Children's Resources	To meet contingent demand across Children's Resources as requested by the service which cannot be met from within budget.	200
Schools/Quality Improvement	To meet contingent demand across Schools/QI as requested by the service which cannot be met from within budget.	140
Supply Teachers/ Reliefs in Schools	The need for supply teachers/reliefs varies year to year. This is to meet any additional demand which cannot be met from within budget.	258
Community Care Income	To meet any shortfall in income as a result of changes to COSLA's charging policy for Community Care services. The Council may not be able to charge at the current level.	150
Ferry Vessel Fuel & Biennial Drydocking	Cost pressure arising from anticipated increases in the price of fuel (6p per litre), and to meet the additional biennial drydocking costs.	252
Electricians for Street Light Maintenance	There may be a need to attract agency electricians to do essential street light maintenance.	105
Infrastructure Equipment Failure	To meet unexpected high cost equipment failure throughout Infrastructure Services.	300
Winter Maintenance	Contingency to meet any unforeseen costs due to a severe winter.	110
Ferry Fare Income	To meet any shortfall in fare income should income levels not be achieved.	80

Contingencies	Description	Allowance for Contingencies in 2015-16 budget (£000)
Infrastructure Staffing Costs from Shortages	Building Maintenance and Ferry staff shortages arising from the buoyant employment position in Shetland at the moment. There may be a need to employ agency staff or mainland contractors.	300
Organisational Change Fund	There is still a need for organisational change to bring the Council into a financially sustainable position over the term of the Council. This may result in the need to supplement the capacity of management with the temporary use of external specialists.	500
External Recruitment for Senior Officers	To meet the cost of a number of senior posts for which recruitment is anticipated to be required in 2015-16.	150
Corporate Training	To meet any additional training requirements to ensure Council services can continue to be provided.	181
CIPFA Trainee Programme	The programme has been put into contingency to use only that required.	70
Valuation Joint Board	There has been a proposed restructuring of the staff within the Board; the full cost of this is not yet agreed.	40
ERVR - Housing	Housing Support Services are to be reviewed which may result in ERVR costs.	50
Homeless Accommodation Costs Inflation	The price of accommodation for homelessness is currently inflated and may require additional resources until prices return to normal levels.	60
Insurance cost for NAFC/SSQC	This is a one off cost in 2015-16 until the Tertiary Review has been carried out.	50
Tertiary Education Shortfall	Until the review is complete there is likely to be a Tertiary Education budget shortfall.	300
3rd Sector Funding Shortfall	Contingency to meet possible 3rd Sector funding shortfalls in 2015/16.	50
TOTAL CONTINGENCIES		**4,346**
	Reduction based on risk of events occurring - 17%	(734)
REVISED TOTAL CONTINGENCIES		**3,612**
Funded by:	Allowance in Medium Term Financial Plan	(2,188)
	Carry Forward from 2014/15 Cost Pressures and Contingency Budget	(1,124)
	Carry Forward from 2014/15 Development Department Budget	(300)
TOTAL FUNDING		**(3,612)**

Funding

5.09 The Scottish Government will provide £86.314m of funding for General Fund services to Shetland Islands Council in 2015-16 which is in line with expectations. This funding represents the Council's General Revenue Grant and the level of income that the Council will receive from the National Non-Domestic Rates Pool.

5.10 The Council is freezing Council Tax for the eighth consecutive year so a Band D property will incur an annual charge of £1,053. This means that Shetland Islands Council continues to charge the 4th lowest level of Council tax out of the 32 local authorities in Scotland whilst providing the best funded services. At this rate of taxation it is expected that the Council will generate £8.4m from Council Tax during 2015-16.

5.11 The remainder of the funding required to balance the General Fund will come from the Council's reserves. This is budgeted to total £14.925m in 2015-16 (Line 20 in the table at 5.01).

The 2015-16 Harbour Account Budget

6.01 The Proposed budgeted surplus for the Harbour Account as follows:

Line No.	Description	2015-16 £000s
	Expenditure	
1	Ports Management & Engineering	170
2	Sullom Voe	10,328
3	Scalloway	689
4	Terminals	804
5	Other Piers	371
6	Jetties & Spur Booms	2,294
7	**TOTAL EXPENDITURE (equals lines 1-6)**	**14,656**
	Income	
9	Harbour Fees & Charges	(15,538)
10	Terminal Charges	(3,206)
11	Jetties & Spur Booms	(2,294)
12	**TOTAL EXPENDITURE (equals lines 9-11)**	**(21,038)**
13	**TOTAL SURPLUS (equals line 8 plus line 12)**	**(6,382)**
	Surplus to contribute to Reserves	
14	Contribution from the Marine Fund	(138)
15	Contribution to the Reserve Fund	6,520
16	**Balanced HA budget (line 13 plus lines 14 and 15)**	**0**

6.02 The terminal operator still requires a 24 Hour, 7 day per week Harbour operation to facilitate tanker movements. From the point of view of the Council, this means that there is a requirement to continue to incur a high level of expenditure to maintain this level of service against reducing tanker numbers and therefore charges have had to increase by 6% to cover these costs.

6.03 This has allowed the Council to budget for the surplus on Harbour activities that it required in the Medium Term Financial Plan (after contributing £1.6m to the Pension Fund to cover the towage pension liability). It is proposed to increase all other charges by 3%. The increase on other charges has been raised by 3% to increase the contribution to the maintenance and future investment in piers/equipment.

6.04 The shore based ferry terminal assets have been transferred to Ports and Harbours with a charge for inter-island ferries introduced on a "per berthing" basis. The net income from that charge is £3.206m.

6.05 Income from the Total Gas Plant throughput activity is anticipated to by £1.349m over and above the surplus identified in the Harbour Account budget for 2015-16.

6.06 The detailed Harbour Account budgetary information which underpins this section of the budget report can be found in the following Budget Proposals Report (including appendices) which was presented to the Harbour Board on 26 November 2014:

Harbour Board 26 November 2014	**F-062-F** 2015-16 Budget and Charging Proposals Harbour Board http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=15275

The 2015-16 Housing Revenue Account Budget

7.01 The 2015-16 Housing Revenue Account budget is set out in the table below:

Line No.	Description	2015-16 £000s
	Expenditure	
1	Supervision & Management	803
2	Repairs & Maintenance	2,474
3	Void Rents & Charges	181
4	Garages	26
5	Capital Funded from Current Revenue	978
6	Capital Charges - Dwellings	1,827
7	**TOTAL EXPENDITURE (equals lines 1-6)**	**6,289**
	Income	
8	Interest on Revenue Balances	(4)
9	Rents - Dwellings	(6,526)
10	Rents - Other ie garages/sites etc	(177)
11	**TOTAL INCOME (equals lines 8-10)**	**(6,707)**
12	**TOTAL SURPLUS (line 7 plus line 11)**	**(418)**
	Surplus to contribute to Reserves	
13	Contribution to Housing Repairs & Renewals Fund (Reserves)	418
14	**Balanced HRA budget (line 12 plus line 13)**	**0**

7.02 The objective of the 2015-16 Housing Revenue Account (HRA) budget is to deliver a sustainable position and minimise rent increases for the year. The budget is a one-off stand alone budget whilst the 30 year HRA business plan is under development. It is anticipated that the 2016-17 budget will be prepared in line with the proposals in the 30 year plan.

7.03 The proposal on rents is to remove the disparity in rents between similar properties of the same size and location group as property attributes are no longer valid as a result of stock meeting the Scottish Housing Quality Standards. This will generate an increase in rental income of 0.86%. Properties that are unaffected by these changes will not see an increase in their rents during 2015-16.

7.04 The capital expenditure in the Asset Investment Plan is set at £1.728m in 2015-16. This is a holding position until the 30 year HRA business plan is developed.

7.05 The detailed HRA budgetary information which underpins this section of the budget report can be found in the following Budget Proposals Report (including appendices) which was presented to the Policy and Resources Committee on 26 November 2014:

Policy & Resources Committee 26 November 2014	**F-068-F** 2015-16 Housing Revenue Account Budget and Charging Proposals http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=15275

The 2015-16 Asset Investment Plan (Capital Programme) Budget

8.01 The 2015-16 Asset Investment Plan Budget is set out in the table below:

Line No.	Description	2015-16 Budget (£000)
1	New Developments	17,143
2	Maintenance of Existing Assets	7,045
3	Spend to Save Projects	70
4	Housing Revenue Account Projects	1,728
5	Contingency	2,500
6	**TOTAL EXPENDITURE (equals lines 1-5)**	**28,486**
7	Scottish Government General Capital Grant	(7,363)
8	Other Capital Grants	(981)
9	Capital Receipts (General Fund and HRA)	(1,150)
10	Capital Funded from Current Revenue (GF,Harbour and HRA)	(1,278)
11	Draw on Reserves – Spend to Save	(70)
12	Draw on Reserves – Second Homes Council Tax	(100)
13	**TOTAL FUNDING (equals lines 7-12)**	**(10,942)**
14	**FUNDING SHORTFALL (equals line 6 plus line13)**	**17,544**
15	Borrowing for the AHS Replacement	(15,498)
16	Borrowing for the Eric Gray Replacement	(1,620)
17	Borrowing for Ferry Vessel Life Extensions	(426)
18	**TOTAL BORROWING (equals lines 15-17)**	**(17,544)**
19	**TOTAL FUNDING AND FINANCING (equals line 13 plus line 18)**	**(28,486)**
20	**BALANCED CAPITAL PROGRAMME BUDGET (equals line 6 plus line 19)**	**0**

8.02 There are 11 key implications for capital expenditure included within the Medium Term Financial Plan. These were –

1. No growth in the asset base.
2. All capital expenditure is to be focussed on the maintenance of existing assets (exception new Anderson High School and high-speed broadband).

3. Scottish Government Capital Grant will be applied to short life assets.
4. Capital Receipts will be targeted at core capital maintenance costs.
5. Capital Funded from Current Revenue will be used where appropriate to fund low value, shorter life capital expenditure.
6. All other capital expenditure will be financed by borrowing.
7. The services that benefit from the capital asset will be required to make sufficient revenue savings to free up budget to pay debt charges (interest charges and principal repayments of debt) for the borrowing. The only exception to this will be in relation to the New Anderson High School replacement project as this project was agreed prior to the introduction of the borrowing policy.
8. A full business case, including projected future demand and investment appraisal process should be completed before a project can be considered for inclusion on the Asset Investment Plan.
9. All capital projects clearly demonstrate the revenue consequences arising from a capital spending decision to assist Members in understanding the full financial impact.
10. No project will be considered for inclusion on the Asset Investment Plan, and existing projects will be removed, unless they have a robust financial estimate of cost.
11. Focus on selling existing assets that are surplus to requirements to reduce the asset base.

8.03 The proposed capital programme for 2015-16 (as set out in the Asset Investment Plan) adheres to all of these requirements set out in the Medium Term Financial Plan.

8.04 As a result of the Council being successful in securing £31m of external funding for the new Anderson High School and a higher level of capital grants, the 5 year programme can be delivered without requiring significant draws on reserves as previously required.

8.05 However, there is a requirement to borrow £17.544m for the AHS replacement, Eric Gray Resource Centre replacement and Ferry Vessel life extensions. The revenue consequences of which have been built into either the Medium Term Financial Plan or in the 2015-16 service budgets.

Asset Investment Plan 2015-2020

8.06 The Asset Investment Plan proposes to spend £94.587m over the next 5 years which represents a significant investment in the Council's infrastructure and this will require borrowing of £21.620m to meet the funding shortfall. The borrowing is required to finance the new Anderson High School, the new Eric Gray Resource Centre and Ferry Vessel Life extensions.

8.07 The focus of the Asset Investment Plan over the 5 years is on the maintenance of existing assets rather than the creation of new assets. The main exceptions to this rule are the building of a new Anderson High School and the new Eric Gray Resource Centre.

8.08 The detailed Capital Programme (Asset Investment Plan) budgetary information which underpins this section of the budget report can be found in the following Budget Proposals Report (including appendices) which was presented to the Policy & Resources Committee on 26 November 2014:

Policy & Resources Committee 26 November 2014	**CPS-017-F** Proposed 5 Year Asset Investment Plan 2015-20 http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=15275

Appendix 2

Shetland Islands Council – Revenue Estimates 2015/16

The Formal Resolutions Required

Recommendation

It is recommended that to provide for the expenses foreseen in the Revenue Estimates for 2015/16, the Council RESOLVE THAT:-

1 they IMPOSE and LEVY the following assessments for the period from 1 April 2015 to 31 March 2016.

(i) **RATES**

(a) **THE SHETLAND ISLANDS COUNCIL DO DECERN AND ORDAIN** the whole occupiers in Shetland Islands liable for the aforesaid assessments, to make payment thereof to the Executive Manager Finance, either by ten instalments, as near equal amounts as practicable, the first on or before 1 April 2015 and at monthly intervals thereafter, or in a single payment on or before 30 September 2015.

(ii) **COUNCIL TAX**

(a) **Council Tax:** Council Tax of £1,053.00 – Band D equivalent, on all chargeable dwellings in Shetland and to be paid by the persons liable therefor under the Local Government Finance Act 1992, as amended by the Local Government etc. (Scotland) Act 1994.

(b) **THE SHETLAND ISLANDS COUNCIL DO DECERN AND ORDAIN** the persons liable as described in the Local Government Finance Act 1992, in respect of chargeable dwellings referred to in paragraph (ii) (a) for the aforesaid assessments to make payment thereof to the Executive Manager Finance, either by 10 monthly instalments, as near equal in amount as practicable, the first on or before 1 April 2015 and at intervals thereafter, or in a single payment before 1 June 2015.

2 (a) The Council adopt the following regulations with regard to the lodging and hearing of appeals against rates, in terms of Section 283 of the Local Government (Scotland) Act 1947, viz:

(b) persons complaining that they have been improperly charged, must lodge their appeals with the Executive Manager Finance not later than 28 days after receipt of a rates demand note and these appeals will be heard by Council on a date to be notified to appellants. Appellants may appeal personally in support of their appeals or be represented by an agent.

(c) no appeal against the valuation entered in the valuation roll is competent.

3 The de minimis sum (used to establish whether expenditure of a capital nature should be charged to capital or revenue) for the year commencing 1 April 2015 should be set equal to £10,000.

4 To provide the necessary financing supplementary income from taxes, charges and grants, the Executive Manager Finance be authorised to ask the Bank of Scotland, Lerwick Branch to advance by way of overdraft, if and when necessary, a sum not exceeding £800,000.

Agenda Item
5

Shetland Islands Council

Shetland Islands Council **3 December 2014**

Chair's Report – Policy and Resources Committee – 26 November 2014
Report No. SIC-1203-F-055

Budget Proposals – Pension Fund

1.0 Summary

1.1 The purpose of this report is to consider the recommendation from the Chair of the Policy and Resources Committee in relation to a report requiring a Council decision.

1.2 The Committee was presented with a report detailing budget proposals for the Pension Fund.

2.0 Decision Required

That the Council **RESOLVES** to adopt the recommendation from the Policy and Resources Committee, namely to approve the Pension Fund budget proposals for 2015/16.

3.0 Report

3.1 This is the second year of budgeting for the Pension Fund. The 2014/15 budget set a net income of £7,291m for the year.

3.2 The table below shows the proposed 2015-16 budget for the Pension Fund, and includes indicative budgets for 2016/17 and 2017/18.

3.3 The budget has been based on existing staffing levels, administrative, support and systems costs, and fees and charges currently being paid, adjusted for known changes including:

- The reduction in actuarial fees as the next triannual valuation will not be required until 2017/18.
- The pension system upgrade costs in 2014/15 will be removed.

3.4 The investment managers' fees and income has been based on the current fund balances, and the expected return on investments in line with the new investment strategy moving from passive to active management.

3.5 The benefits payable and contributions received has been based upon the forecast outturn for 2014-15 adjusted for inflation.

3.6 The towage contribution is the amount agreed to be paid into the Pension Fund by the Council.

Description	2015/16 £0	2016/17 £0	2017/18 £0
Employee Costs	177	179	181
Support & System Costs	77	79	82
Administration Costs	5	5	5
Actuarial Fees	5	5	30
External Audit Fees	31	32	33
Investment Expenses	1,638	1,680	1,780
Benefits Payable	8,527	8,740	8,959
Total Expenditure	**10,460**	**10,720**	**11,069**
Other income	(28)	(28)	(28)
Contributions Received	(14,609)	(14,609)	(14,609)
Towage Contribution	(1,600)	-	-
Investment Income*	(1,518)	(1,615)	(1,915)
Total Income	**(17,755)**	**(16,252)**	**(16,552)**
Net Income	**(7,295)**	**(5,532)**	**(5,483)**

* Interest on cash deposits and property unit trust dividends.

3.7 Budgets for lump sums, death benefits, refunds and transfers in and out have been removed as these are too unpredictable to estimate. These will be reported on in the quarterly management accounts reports.

3.8 Copies of the report have been previously circulated, or can be accessed via the Council's website at the link shown, or by contacting Committee Services.

3.9 **The Chair will present information to the Council as to any debate or issues that the Committee considered.**

4.0 Implications

4.1 Detailed information concerning the proposals was contained within the report already circulated to Members, including the strategic and resources implications for the Council.

4.2 There are no additional implications to be considered by the Council, other than those set out in the report.

For further information please contact:

Mr G Robinson, Chair of Policy and Resources Committee
26 November 2014

List of Appendices
None.

Background documents:
Policy and Resources Committee – 26 November 2014
http://www.shetland.gov.uk/coins/agenda.asp?meetingid=4553

END

Appendix

6

Shetland Islands Council

Shetland Islands Council **3 December 2014**

Chair's Report – Policy and Resources Committee 26 November 2014–
Asset Investment Plan: Gateway Process – Service Need Case Reports
Report No. SIC-0312-P&R-CPS16

1.0 Summary

1.1 The purpose of this report is to consider recommendations from the Chair of the Policy and Resources Committee in relation to a report requiring a Council decision.

2.0 Decision Required

2.1 That the Council **RESOLVES** to approve the recommendations from the Policy and Resources Committee, namely to retrospectively approve for implementation the projects described in the report.

3.0 Report

3.1 The report to Committee presented two projects from within the Infrastructure Directorate that have been considered by the Capital Investment Group based on the submission of Service Need Case (SNC) reports. One relates to a replacement culvert close to Toft Ferry Terminal. The condition of this culvert has worsened significantly since the report was submitted due to adverse weather, forcing staff to take immediate action to resolve the resultant flooding. The other relates to road repairs near Ronas Voe.

3.2 Copies of the report have been previously circulated or can be accessed via the Council's website at the link shown below, or by contacting Committee Services.

3.3 The Chair will present any further information to the Committee as to the debate or issues that the Committee considered.

4.0 Implications

4.1 Detailed information concerning the proposals was contained within the report already circulated to Members, including the strategic and resources implications for the Council.

4.2 There are no additional implications to be considered by the Council, other than those set out in the report.

For further information please contact:

Mr G Robinson, Leader and Chair of Policy and Resources Committee
26 November 2014

List of Appendices
None

Background documents:
Policy and Resources Committee – 26 November 2014
http://www.shetland.gov.uk/coins/agenda.asp?meetingid=4553

END

Agenda Item
7

Shetland Islands Council

Shetland Islands Council **3 December 2014**

Long Term Financial Plan 2015-2050	
F-075-F	
Report Presented by Executive Manager – Finance	**Corporate Services**

1.0 Summary

1.1 The overall purpose of this Long Term Financial Plan (LTFP) is to provide Members with information on the Council's longer term financial outlook and the probable impacts that current trends and future decision-making will have on the financial health of the Council in the years to come.

1.2 Whilst the report is largely for information it does make a number of recommendations which the Council is asked to adopt in the decisions required.

2.0 Decision Required

The Council RESOLVES to:

2.1 NOTE the content of the Long Term Financial Plan ;

2.2 AGREE to the recommendations set out at 13.8 the LTFP and ask the Chief Executive to ensure that further reports are brought forward to Members so that these can be fulfilled.

3.0 Detail

3.1 The detail of the Long Term Financial Plan is set out at Appendix 1 to this report.

4.0 Implications

<u>Strategic</u>

4.1 <u>Delivery On Corporate Priorities</u>
This Plan supports the corporate priorities of "Dealing with challenges effectively" and "Living within our means".

4.2 Community /Stakeholder Issues – None arising directly from this report. However, the workstreams that will be created if the Council accepts the recommendations in the Long Term Financial Plan will have community and stakeholder issues that will need to be addressed as each further piece of work is brought forward.

4.3 Policy And/Or Delegated Authority
Determination of the Council's long term financial strategy is a matter reserved to the Council.

4.4 Risk Management
There are a number of financial risks identified in the Long Term Financial Plan which are set out in Section 12 of Appendix 1.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial
The Long Term Financial Plan contains financial modelling which seeks to set out the broad financial parameters in which future Councils will have to work.
There are no immediate direct financial consequences arising as a result of the production of the Plan.

4.8 Legal – There are no direct legal implications arising from the Long Term Financial Plan.

4.9 Human Resources – It is proposed that the Early Retirement and Redundancy Scheme is reviewed specifically on the future affordability of providing discretionary Compensatory Added Years (CAYs). If any subsequent recommendations came forward to remove or reduce this discretionary award, then discussions would be required with the Trade Unions.

4.10 Assets And Property – A fundamental issue in the Long Term Financial Plan is how the existing fixed asset base can be maintained into the future with limited resources. The Plan recommends that a Long Term Asset Investment Plan is developed for the period 2015-2050, which averages £10m of capital expenditure per year. It should be a Member prioritised plan, based on evidence such as condition and suitability of existing assets, service need, and linkages to corporate priorities.

5.0 Conclusions

5.1 Whilst the Council has successfully managed to bring its expenditure levels into line with its income, thus operating at a sustainable level, the organisation is not yet positioned to effectively manage the financial challenges in the longer term. This is mainly due to a lack of available information and/or application of information to inform decision-making and a lack of understanding in the relationship between capital and revenue expenditure.

5.2 An asset base has been built up over the past 35 years using oil revenues at a level from which the Council no longer benefits. There appears to have been no longer term thinking about how this asset base could be sustained into the future in light of falling oil revenues.

5.3 There is an estimated funding shortfall of over £200 million over the next 35 years on the level of capital expenditure required to maintain the existing asset base, whilst seeking to retain acceptable levels of revenue expenditure.

5.4 If future Councils continue to make similar financial decisions in the future as those in the past, particularly with regard to capital expenditure, it will become insolvent at some point over the next 30 years (assuming no central government intervention to take control of the Council).

5.5 In order for the Council to remain financially sustainable over the longer term it will have to:

- Reduce the size of its fixed asset base and prioritise future capital investment;
- Keep a tight control over future cost pressure allowances and constrain service growth;
- Ensure that resource allocation decisions reflect the changes in Shetland's demographic profile;
- Seek to increase existing income streams in the longer term, such as Council Tax, as well as creating new income streams (although at present there are no obvious sources available for this); and
- Manage the expectations of the Shetland public as to what is a sustainable level of service provision across the isles.

For further information please contact:
James Gray, Executive Manager - Finance
01595 744607
james.grayt@shetland.gov.uk
26.11.2014

List of Appendices
Appendix 1 – Long Term Financial Plan 2015-2050

Appendix 1

Shetland Islands Council
Long Term Financial Plan
2015-2050

Securing the Best for Shetland

Contents

1 Executive Summary

1.1 The overall purpose of this Long Term Financial Plan (LTFP) is to provide Members with information on the Council's longer term financial outlook and the probable impacts that current trends and future decision-making will have on the financial health of the Council in the years to come.

Main Findings

1.2 Whilst the Council has successfully managed to bring its expenditure levels into line with its income, thus operating at a sustainable level, the organisation is not yet positioned to effectively manage the financial challenges in the longer term. This is mainly due to a lack of available information and/or application of information to inform decision-making and a lack of understanding in the relationship between capital and revenue expenditure.

1.3 An asset base has been built up over the past 35 years using oil revenues at a level from which the Council no longer benefits. There appears to have been no longer term thinking about how this asset base could be sustained into the future in light of falling oil revenues.

1.4 There is an estimated funding shortfall of over £200 million over the next 35 years on the level of capital expenditure required to maintain the existing asset base, whilst seeking to retain acceptable levels of revenue expenditure.

Overall Conclusions and Recommendations (See Section 13)

1.5 If future Councils continue to make similar financial decisions in the future as those in the past, particularly with regard to capital expenditure, it will become insolvent at some point over the next 30 years (assuming no central government intervention to take control of the Council).

1.6 In order for the Council to remain financially sustainable over the longer term it will have to:

- Reduce the size of its fixed asset base and prioritise future capital investment;
- Keep a tight control over future cost pressure allowances and constrain service growth;
- Ensure that resource allocation decisions reflect the changes in Shetland's demographic profile;
- Seek to increase existing income streams in the longer term, such as Council Tax, as well as creating new income streams (although at present there are no obvious sources available for this).

1.7 For the Council to make sound financial decisions it is critical that it recognises the relationship between capital expenditure and the revenue spending. If the Council borrows money to maintain or replace an asset, it is very much like a mortgage in that it results in borrowing costs, and meeting those costs means not spending that money on providing day to day services. So there is a balance to be struck between the quality of the assets provided by the Council and the quality of the service that is provided using those assets.

1.8 A Long Term Asset Investment Plan should be developed for the period 2015-2050, which averages £10m of capital expenditure per year over the period. It should be a Member prioritised plan, based on evidence such as condition and suitability of existing assets, service need, and linkages to corporate priorities.

1.9 In order to feed into this exercise the relevant services should ensure that robust asset management plans are in place which include information on condition, suitability, utilisation and future investment required on those assets.

1.10 Members should also periodically review strategic priorities and ensure that they are satisfied that the resources at the Council's disposal are adequately aligned to those priorities.

1.11 Further work should be undertaken on the financial modelling of the Sella Ness Port. Once completed, Members should take a strategic decision regarding whether to retain the Port and run it on commercial lines to make a sufficient investment return, or whether to seek to sell it and invest the sales proceeds with the Council's fund managers.

1.12 The Council should agree to treat the Council's invested reserves as an Endowment Fund. This policy would mean that the Council would commit to preserving the capital value of the reserves over the lifetime of a Council, by following Section 95 Officer's assessment as to what a sustainable draw on reserves each year equates to, and living within this limit. This approach would mean that a Council would become a custodian of the oil reserves with a duty to protect their value, rather than viewing them as a short term funding source to meet short term objectives.

2 Purpose and Principles

2.1 The purpose of this Long Term Financial Plan (LTFP) is to provide Members with information on the Council's longer term financial outlook and the probable impacts that current trends and future decision-making will have on the financial health of the Council in the years to come.

2.2 The key considerations for Members when taking financial decisions that will impact upon the longer term are the same as those in the Prudential Framework – **affordability**, **sustainability** and **prudence**. These are key indicators that are used frequently throughout this plan.

2.3 The LTFP is not intended to be a 35 budget strategy tool in the same way that the Medium Term Financial Plan is for the next 5 years; there are so many political, financial, social and economic variables that it is not possible to forecast the level of funding that will be available to the Council in 2050, and expenditure levels will be determined by political decisions that are not yet made.

2.4 However, the value of a LTFP comes from being able to understand the broad direction of financial travel that the organisation is currently on, and the impact that current decision making will have on the long term financial health of the Council.

2.5 The Plan does not cover the Housing Revenue Account as work is still ongoing to produce a 30 year business plan that will set out future housing investment needs.

2.6 In order for the LTFP to remain useful, it should be reviewed and updated every 2 years to reflect the political, financial, social and economic changes that have taken place during the intervening period.

Approach to the LTFP

2.7 There are 4 main strands to the work that has been undertaken on the LTFP, which have been brought together to provide an idea of the financial health of the organisation by 2050 if the current direction of travel continues, and to present possible alternative scenarios. These 4 strands are –

- Future income forecasts – the best estimate of future government grant levels, Council Tax income and surpluses from the Ports and Harbours (including TOTAL);
- Future cost pressures – this includes general inflation, financing future capital investment, and the impact that forecast demographic changes are likely to have on future council budgets;
- Managing the Council's balance sheet – the key elements of this are the Council's fixed assets (property, plant and equipment), the Council's investments (the reserves)

ensuring the Council remains liquid through working capital management (has enough money to pay bills as they fall due) and managing the current pensions liability;

- Identifying financial risks and possible solutions – financial risk exists because of inherent uncertainties about the future and as a result of particular decisions that have been taken. This part of the LTFP sets out what those are in a Shetland Islands Council context and the work that needs to be undertaken to manage these in future years.

2.8 These four strands of work have fed into the financial modelling that has been undertaken to provide an illustration of the long term financial health and sustainability of Shetland Islands Council under a number of different scenarios.

Principles of the plan

2.9 The Plan is not intended to be used as a long term financial planning tool. Instead, it seeks to set out broad financial parameters which should be borne in mind when making financial decisions over the short and medium term.

2.10 Given the long term nature of the plan and the number of variables, the plan focuses on large, broader areas rather than the specifics of directorate spending levels and specific cost pressures. This results in the Plan being thematic in nature.

2.11 On the basis that more and better information will lead to improved future iterations of the Plan, there are a number of recommendations made that seek to improve the level and quality of information that is held by the Council.

2.12 The Plan does not seek to set out a particular course of action for the future, and is therefore not prescriptive, instead its purpose is to underpin future plans and strategies such as a Long Term Asset Investment Plan.

Benefits of the Plan

2.13 The Plan should lead to a more informed Council and public around the financial impact that different choices have in the long term, which should result in better decision making.

2.14 The Plan seeks to clearly illustrate the link between capital expenditure and revenue expenditure and how one comes at the expense of the other.

2.15 The Plan provides the organisation with an early indication of the key financial risks facing the Council over the longer term.

2.16 The Plan recommends areas where further work should be undertaken, which if completed, will also enhance the information available to decision-makers prior to choices being made.

2.17 It sets out the parameters for a Long Term Asset Investment Plan to be developed, which seeks to address Shetland's infrastructure priorities into the middle of the century.

3 A short financial history of Shetland Islands Council since 1975

3.1 Since the inception of Shetland Islands Council in 1975, it has been on a financial journey that must surely be unique amongst UK Local Authorities. The Council was able to position itself to benefit from the oil industry activity in the islands and that has fundamentally shaped the financial context of the organisation ever since.

3.2 It is important to look back over the period since 1975 to understand what has happened to the Council in a financial sense, and how this has shaped the current financial standing of the organisation, and how it has created perceptions in the community that are now far removed from the financial reality of today.

3.3 It is not possible to provide a 100% accurate picture of all financial aspects of the Council over the period since 1975 because of the age or some records and the reporting requirements of the day. However, a review of all sets of annual financial statements since 1975-76 has allowed a picture to be built up which is over 90% accurate, so will materially represent what has happened over the time period.

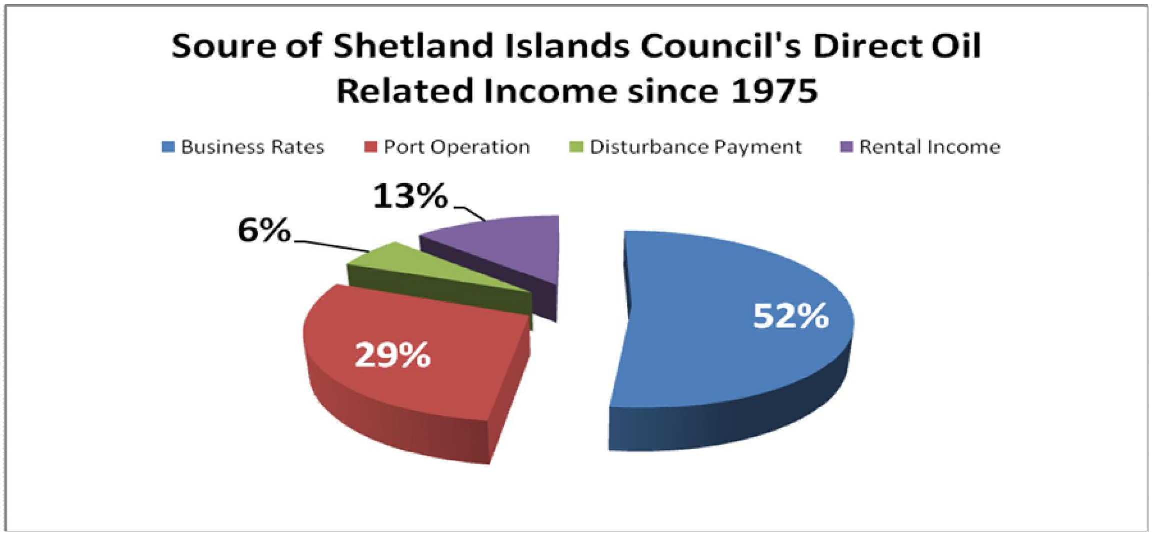
3.4 The 3 main areas where the experience of Shetland Islands Council has been significantly different to other local authorities are **income**, **capital expenditure** and **reserves**. This is the focus of the review of the financial history of the Council.

Income

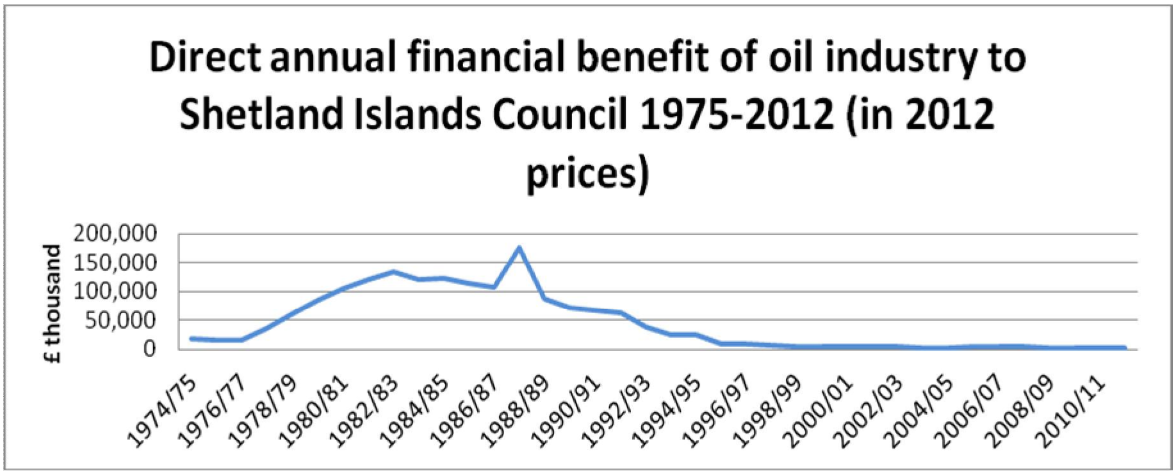
Key Fact

During the 1980s Shetland Islands Council earned an average of more than £100m each year directly from the oil industry's presence in Shetland. Today the Council's only direct source of income from the oil industry is the Harbour Account, where the biggest challenge is currently to avoid making a loss on its operations.

3.5 Between 1974-75 and 2011-12 the Council received direct net income of approximately £1.6 billion (in 2012 prices) as a result of the oil industry presence in Shetland. The pie chart below shows how this is broken down into the different income sources. Shetland Islands Council was able to retain National Non-Domestic Rates income locally until the early 1990s when it became pooled nationally. This has been the biggest source of direct oil related income to the Council over the period.

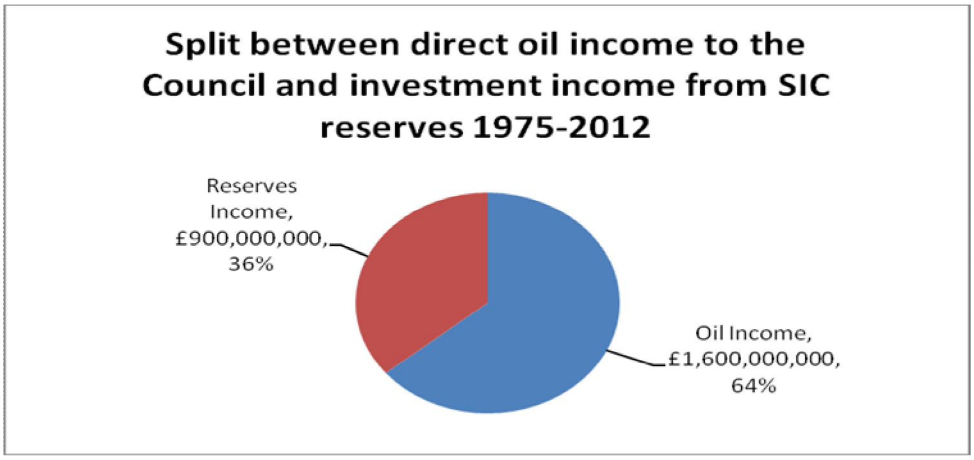


3.6 The line chart below shows the timing of the direct financial benefit to the Council over the period:



3.7 The period of greatest financial benefit to the Council was between 1980 and 1990 when it received approximately £1.1 billion (in 2012 prices) of net income over that decade – that equates to an average of over £100 million per year. As a result of National Non Domestic Rates income being pooled nationally in the early 1990s and the reduction in throughput at the Sullom Voe Terminal, the Council has received less that £300 million of direct financial benefit from the oil industry over the past 20 years (in 2012 prices).

3.8 In addition to the direct financial benefit that the Council has received from the oil industry since 1975, there has also been a significant income stream as a result of investing some of the oil income with fund managers. Since the Council started investing excess cash in the late 1970s it has generated approximately £900 million (in 2012 prices) from investment returns. The pie chart shows the significance of this in the overall direct and indirect income streams that have been generated from the oil industry since 1975:



3.9 The pie chart also shows that in total, the Council has received **£2.5 billion** (in 2012 prices) of income (directly and indirectly) from the oil industry presence in Shetland since 1975.

Capital Expenditure

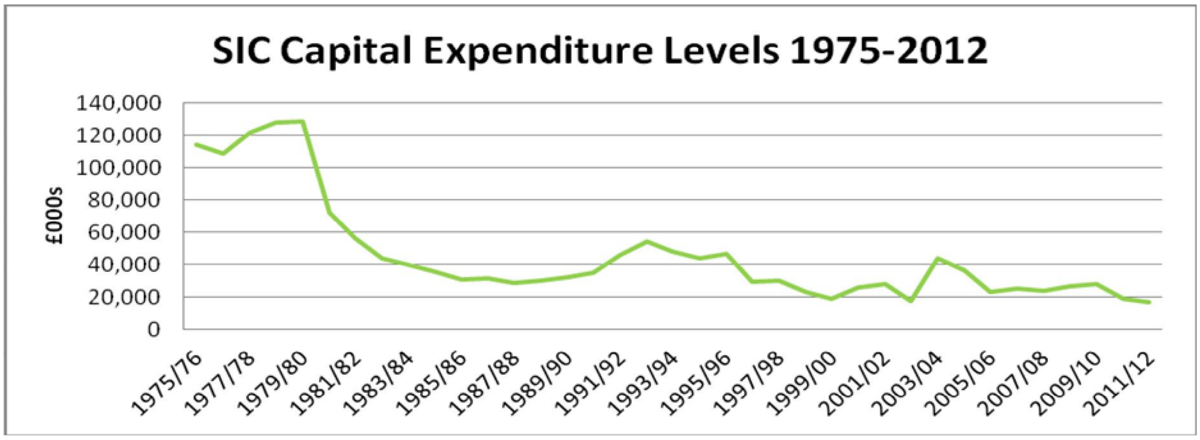
Key Fact

Between 1980 and 2010 the Council spent an average of £34.8m each year on Capital Expenditure. That is approximately £25m higher than the current level of capital expenditure in 2014-15.

3.10 When Shetland Islands Council was created on 15 May 1975, its total fixed asset base was valued at £19.7 million, which equates to £140 million in 2012 prices.

3.11 Following the decision to build an oil terminal in Shetland, the Council embarked upon an unprecedented capital programme to grow Shetland's physical infrastructure. There was significant investment at Sella Ness, in house building, highway construction and improvements, new school building and refurbishment of existing schools, and an inter-island ferries upgrade programme.

3.12 The table below sets out the annual level of capital expenditure incurred by the Council between 1975 and 2012 (in 2012 prices):



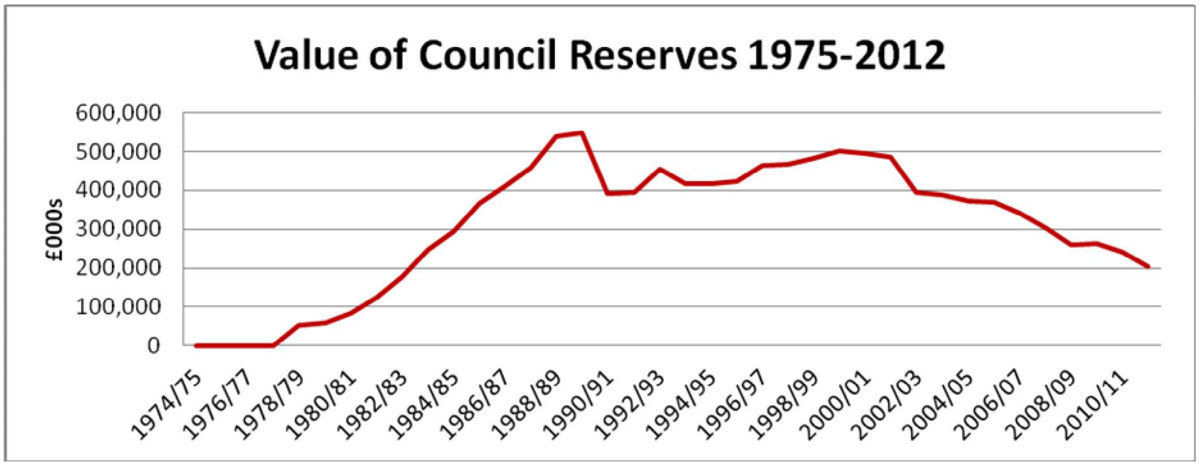
3.13 The table shows that there was an average annual capital spend of over £100 million per year in the second half of the 1970s as the Council developed its port at Sella Ness and built infrastructure to support the oil industry. The level of capital expenditure reduced to an average of £40 million per year during the 1980s which was still very high by today's standards. In the 1990s the average annual spending on capital continued to fall to £37.5 million and then to £28 million in the 2000s.

Reserves

Key Fact

The Council began to grow reserves from the late 1970s as income from the oil industry exceeded spending levels meaning there was excess cash. As income from the oil industry declined towards the end of the Millennium, spending levels did not decrease in proportion, meaning the reserves declined by 60% between2000 and 2012.

3.14 The table below sets out the movement in the value of the Council's reserves from 1975 to 2012 (in today's prices):



Note: Steep decline in 1990-91 represents Shetland Charitable Trust reserves being separated from the Council's reserves for reporting purposes.

3.15 There are 3 broad phases to the history of the Council's reserves, as can be seen in the table. Beginning with no reserves in the 1970s, the Council saw a rapid increase in the value of its reserves during the 1980s, a levelling off of the value during the 1990s and a steady decline in the value since 2000.

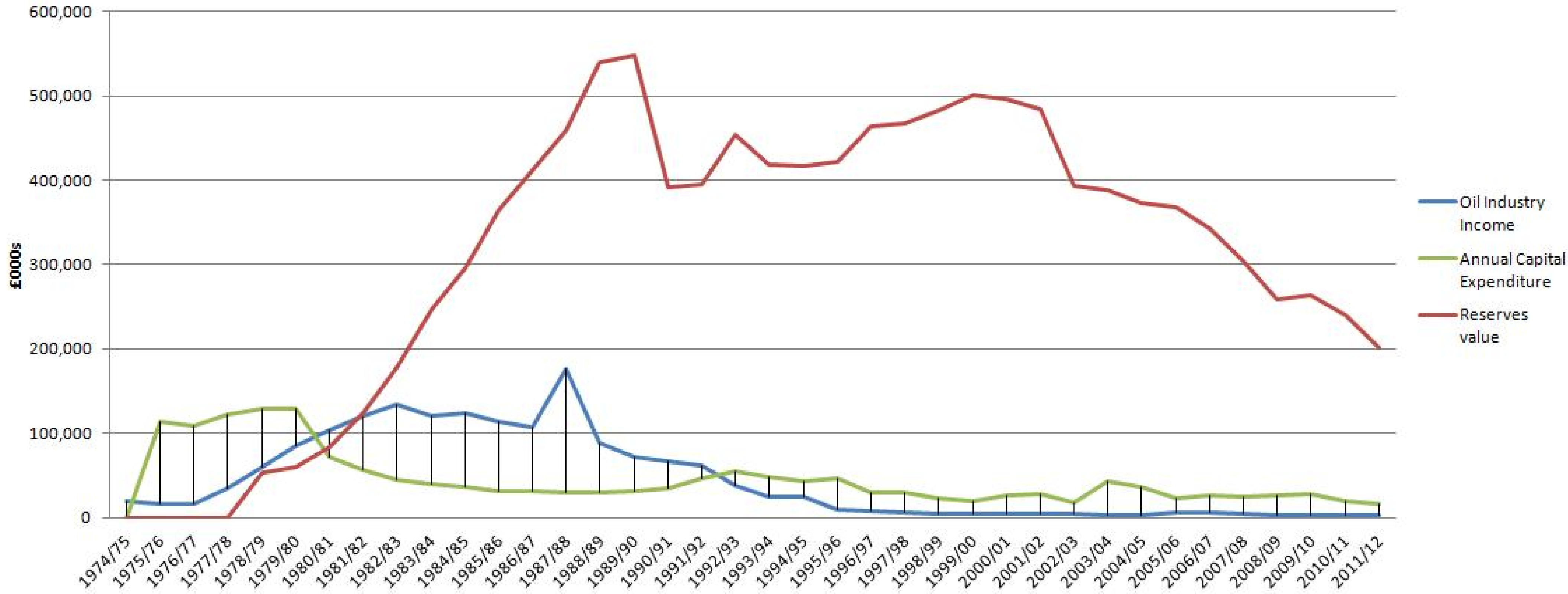
3.16 The table sets out the characteristics of the 3 phases of the Council's reserves:

	Phase	Characteristics
1980s	Rapid Growth £0 to £400 million	High level of income from oil industry (over £100m per year). High capital expenditure (£40m per year). Overall significantly more income generated than expenditure incurred.
1990s	Slowing growth and Peak £400 million to £500 million	Decreasing income from the oil industry but still significant (£25m per year). High reserves level generating significant investment returns (£20-25m) per year. High capital expenditure (£37.5m per year). More income generated than expenditure incurred, but a narrowing gap as the decade progresses.
2000s	Steady Decline £500 million to £200 million	Significant tailing off in come from oil industry (£4 million per year). Falling investment income as the capital value of the reserves erodes averaging £25m per year in 2000 but declining to £10m per year by 2012. Capital expenditure reduces but remains high (£28 million per year) From 2007 onwards, revenue expenditure increases significantly above available resources, requiring deficit funding from the reserves. More expenditure than income over the period results in the reserves decreasing by 60% over a 12 year period.

3.17 By 2012 the value of the Council's reserves stood at £200m which was the lowest level since the early 1980s when the Council was in the early years of wealth accumulation from the oil industry.

3.18 The table below shows the relationship between the level of oil income and capital expenditure and the impact that it has had on the value of the Council's reserves between 1975 and 2012:

The annual income from the oil industry and annual capital expenditure and the impact of this on the Council's reserves 1975-2012



Conclusion 1 – The high level of capital expenditure during the 1980s was only affordable because of the income generated from the oil industry.

Conclusion 2 – Attempts to maintain capital expenditure levels at high levels during the 2000s when oil income fell has contributed to the decline in the reserves value.

Conclusion 3 – Oil income is set to remain low into the future but 1980s and 1990s capital expenditure levels will be required in the future to sustain the Council's existing asset base as old assets are decommissioned and require replacement.

4 Current Context

4.1 Shetland Islands Council has had a strong focus on bringing its expenditure into line with its income over the past 3 to 4 years. This has resulted in the Council being able to set a sustainable budget in 2015-16 for the first time since the 1990s. The process has also halted the decline in the reserves which had occurred between 2000 and 2012. However, whilst the amount of money being spent is now sustainable, this is something that will need to continue into the future if the Council is to retain its reserves.

4.2 Along with all other Scottish Local Authorities, the next 5 years are set to be extremely challenging for the Council as it seeks to continue to live within its means whilst seeing significant cost pressures coming through. Beyond 2020 this Plan assumes that real terms spending in local government will increase for the first time in a decade.

4.3 However, whether budgets are rising or falling, financial planning is underpinned by choices. The main two areas of choice in this plan are the balance between capital investment on one hand, and maximising revenue spending on day to day services, and the resource allocation choices between services.

4.4 As covered in the previous section, Shetland has invested heavily in its infrastructure over the past 35 years, and there will be choices to be made in the future as to what extent the Council wishes to maintain and replace its existing asset base at the expense of providing day to day services, or seeks to reduce the number of assets it has, in order to be able to spend more on providing day to day services to the public.

4.5 Shetland's changing demographic make-up will also create pressure on budgets in the coming decades as life expectancy levels continue to increase. The Councils of the future will have to make choices about how they allocate their resources in light of these changing demographics. With these key issues in mind it is appropriate for the Council to take a longer term look at its finances to ensure that decisions taken over the next few years are affordable, sustainable and prudent.

4.6 In January 2014 Audit Scotland published a follow up to its 2011 Scotland's Public Finances report. It reported that there was limited evidence of longer-term financial planning but that they were important because they "...help clarify the financial sustainability of an organisation over an extended period and can help identify problems with affordability at an early stage. Although funding allocations from Scottish Government typically cover one to three-year spending review periods, this should not prevent public bodies assessing their spending needs and options over a longer period."

4.7 As a result this Plan has been developed which sets out some financial parameters for the next three decades to help inform decision making over issues such as future levels of capital investment and the allocation of resources to meet relative service demand.

5 Managing the Balance Sheet

5.1 The Council's balance sheet provides a snapshot in time of the financial position and standing of the organisation at a point in time. It is a useful tool for managing the financial strength of the organisation and ensuring that it remains sustainable into the future.

5.2 The table below is a copy of the Council's audited balance sheet as at 31 March 2014:

31 March 2013 £000		Notes	31 March 2014 £000
371,936	Property, Plant and Equipment	12	401,012
4,756	Heritage Assets	13	4,743
622	Intangible Assets	14	575
205,732	Long Term Investments	15	203,483
2,335	Long Term Loans	15	2,126
3	Other Long Term Debtors	18	5,054
585,384	**Long Term Assets**		**616,993**
736	Assets held for Sale	16	875
5,141	Inventories	17	5,372
12,280	Short Term Debtors	18	20,169
4,118	Cash and Cash equivalents	19	7,936
22,275	**Current Assets**		**34,352**
(16,774)	Short Term Creditors	20	(15,670)
(95)	Provisions	21	(192)
(16,869)	**Current Liabilities**		**(15,862)**
(4,663)	Finance Lease Liability	31	(6,089)
(129,250)	Pension Liability	34	(148,562)
0	Provisions	21	(810)
(158)	Other Long Term Liabilities		(32)
(134,071)	**Long Term Liabilities**		**(155,493)**
456,719	**Net Assets**		**479,990**
(222,764)	Usable Reserves	22	(240,872)
(233,955)	Unusable Reserves	23	(239,118)
(456,719)	**Total Reserves**		**(479,990)**

5.3 The three main categories that dominate the Council's balance sheet are fixed assets/capital expenditure (Property, Plant and Equipment), Long Term Investments (Council's reserves) and the Pension Liability. These three balance sheet items are the ones that will need to be managed effectively to ensure the long term financial health of the Council.

5.4 As a result, this Plan focuses mainly on how the Council can manage its existing fixed asset base, whilst ensuring that there is adequate funding for Council services without damaging the real terms value of the Council's reserves.

6 Property, Plant and Equipment

Key Fact

The Council has £1.4 billion of fixed assets, including the Council's road carriageway, which it has largely accumulated over the past 35 years. No planning was undertaken to set out how this asset base could be afforded into the future as revenues from the oil industry, and investment returns from the reserves, decrease.

It will become increasingly expensive for the organisation to sustain this asset base into the future, so in order for it to remain affordable, the Council will need to make choices to prioritise key infrastructure assets as part of a managed reduction in its asset base.

6.1 The Council has Property, Plant and Equipment assets totalling £401 million on its balance sheet as at 31 March 2014. At present the Council is not required to disclose the full value of its roads network on its balance sheet, but this will be changing in the future. At present the Council's road carriageway network is valued at £1,160 million on 31 March 2014 according to the audited Whole of Government Accounts return that the Council is required to prepare each year.

6.2 Therefore in total, the Council has an asset base of approximately £1,561 million which is aging and will require significant maintenance and replacement expenditure in order to sustain it into the future. Section 13 of this report sets out an initial estimate of the amount of capital expenditure required each year on average to maintain this asset base up to 2050 and the revenue cost pressure generated from that. The headline finding is that the amount of capital expenditure required each year is not affordable.

6.3 At present the Council has a strong balance sheet, and a significant contributing factor is that the existing asset base is almost fully funded. This means that there is no debt on the balance sheet, which would show as a liability and therefore reduce the net assets of the organisation. The reason that there is no debt is because the assets were funded as they were built/purchased through the use of reserves.

6.4 However, the downside to having used reserves is that they are now worth £203 million instead of the £500 million that they were worth in 2000. Therefore, borrowing or using reserves to fund capital expenditure is going to result in a weakening of the Council's balance sheet into the future, and it will also create pressure on the revenue budget.

6.5 Given this situation, in order to secure the future financial strength of the Council, a Long Term Asset Investment Plan (LTAIP) will be required which should be developed within the parameters of the Prudential Framework – prudent, affordable and sustainable.

6.6 The LTAIP will not meet all future capital expenditure demands and will therefore need to be prioritised. This should be based on evidence such as condition and suitability of existing assets, service need, and Members' corporate priorities.

7 Long Term Investments

Key Fact

The Council's investments can provide the organisation with a sustainable, inflation protected, average return of 5% each year. At their current value of £200 million this equates to £10 million each year that the Council can use to supplement its annual budget.

It is therefore important that the Council continues to manage the use of reserves effectively to ensure that they continue to provide a sustainable source of income for future Councils so that they can continue to provide an enhanced level of public services to the people of Shetland.

7.1 The Council's Long Term Investments were valued at £203 million in 31 March 2014. This is the amount of reserves that the Council has invested with fund managers.

7.2 The short term view taken on the Council's Long Term Investments in the past has resulted in their value decreasing from £500 million in 2000 to today's value of £200 million. The impact of this is that the Council has £15 million per year less to affordably spend on providing Council services than it would have if the reserves had been maintained at £500 million. To put this into context, an additional £15 million to spend each year is almost equivalent to the Council's entire secondary school education budget.

7.3 The Council has an investment strategy in place which seeks to deliver a 4% to 5% return each year (after inflation) to supplement spending on services. This equates to about £10 million per year. If the remaining £200 million of reserves are spent, the £10 million of annual supplementary income would be lost too, in addition to the £15 million already lost.

7.4 Therefore, in the long term, the Council is better off preserving the value of the reserves so that it has a sustainable income stream to supplement services indefinitely, because as history shows, the capital value of the reserves can only be spent once.

7.5 It is therefore recommended that the Council should agree to treat the Long Term Investments as an Endowment Fund. This policy would mean that the Council would commit to preserving the real terms capital value of the reserves over the lifetime of a Council, by following the Section 95 Officer's assessment as to what a sustainable draw on reserves each year equates to, and living within that limit. This approach would mean that the Council would become a custodian of the oil reserves with a duty to protect their value, rather than viewing them as a short term funding source to meet short term objective.

8 Pension Liability

Key Fact

Shetland Islands Council provides its staff with defined benefit pension schemes. Whilst these schemes provide excellent retirement benefits to staff, they are expensive schemes and present a financial risk to the organisation.

Members should be aware that if pension liabilities cannot be covered by the pension investments, it could result in Employer contribution rates increasing which presents a revenue cost pressure to the Council.

8.1 The balance sheet shows that the Council had a pension liability of £149 million at 31 March 2014. This is actually a net liability – there is a total pension liability of £441 million but this is offset against pension investments of £292 million. This net pension liability represents the shortfall in money available at the 31 March 2014 to meet the future pension payments that will be made as a result of the service accrued by scheme members at 31 March 2014. This pension liability does not include the Council's teaching staff as they are in a national teachers' pension scheme are therefore not included in the Local Government Pension Scheme.

8.2 The Council adopted a new Pensions Investment Strategy in 2014 and appointed three new fund managers with a view to ensuring that the pension scheme is fully funded by 2027. However, the Council has little scope to influence the size of the pension liability as it is driven by actuarial assumptions such as how long people live after they retire (longevity and state retirement age), future inflation rates, future pay inflation and future pension inflation.

8.3 An ongoing financial risk to the Council is that if the pension investment assets do not grow fast enough to cover the pension liabilities, there will be pressure from the Council's actuaries to increase Employer Pension Contribution Rates in order to meet the shortfall. At present the Council's Employer Contribution rate to the Local Government Pension Scheme (LGPS) is 18.8% which equates to £11.7 million per year. The rate for the Teachers' Pension Scheme is 14.9% which equates to £2.3 million per year, meaning that in total, £14 million of the Council's £109 million net budget is to be spent on making pension contributions, and despite this, there is still a £149 million pension liability as at 31 March 2014.

8.4 For every 1% that the Council might have to increase its LGPS Employer Contribution Rate in the future, based on current estimates it would result in a cost pressure of £622,000 per year. If contribution rates in the future had to increase from the current level of 18.8% to a level in the mid-20%s, which is not inconceivable, it would mean an additional annual cost pressure of £3m-£4m which is significant.

8.5 One way in which Members could reduce future pension costs would be to review its Early Retirement and Redundancy Scheme with a view to removing Compensatory Added Years (CAYs) which is a discretionary benefit.

8.6 The Council currently has the option to award a staff member with up to 5 CAYs, which has been reduced from the previous policy of awarding up to 10 CAYs. The benefit to a staff member of receiving CAYs is that they can retire up to 5 years before the normal retirement age, with a pension entitlement equal to what they would have had if they had worked for the additional 5 years. There is a cost to allowing a staff member to access their pension in this way at an earlier stage, and this is paid for by the Council each year for the remainder of that employee's life.

8.7 As a result of this policy the Council makes an annual payment to the Pension Fund of approximately £2 million per year to cover the cost of the CAYs that have been awarded in the past to former employees who are still in receipt of a pension. The cost to the education budget is around £800,000 per year alone.

8.8 It is therefore recommended that the Council reviews the long term affordability of continuing to provide CAYs in its Early Retirement/Voluntary Redundancy Scheme.

9 Sources of Funding

Key Fact

The Council has 3 main sources of funding; the Scottish Government General Revenue Grant (incorporating a share of pooled National Non-Domestic Rates), Council Tax and income generated from oil industry activity. This funding is then supplemented by a sustainable draw on reserves of 5% (worth around £10 million per year) to come to total of what the Council can afford to spend each year.

The Scottish Government revenue grant is by far the most significant element of the Council's funding, so the Council will remain susceptible to external economic factors that drive the size of the core grant.

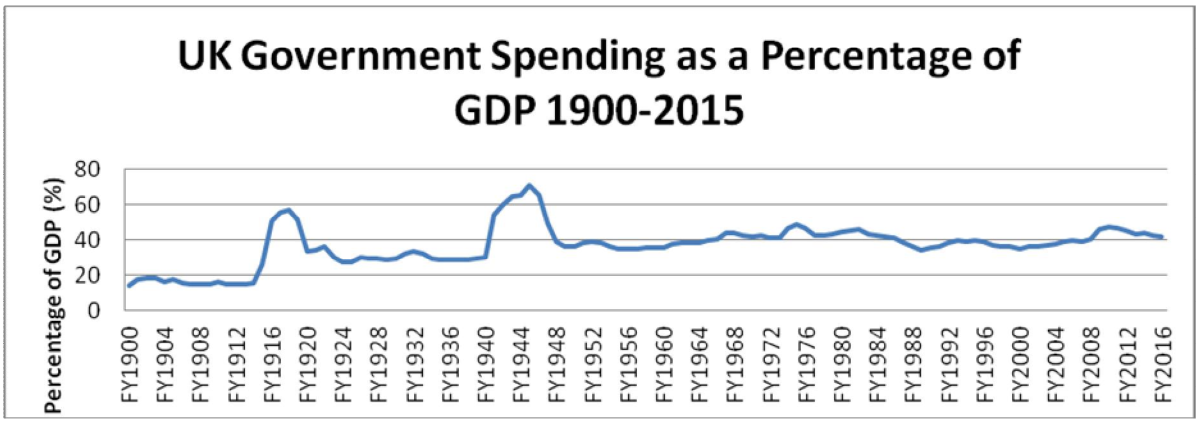
9.1 This section of the Plan sets out future expectations for levels of funding that will become available for services from these 3 key income streams.

Scottish Government General Revenue Grant

9.2 The Medium Term Financial Plan (MTFP) sets out assumptions for the Scottish Government General Revenue Grant up to 2020 based on the information and indications that are being made by HM Treasury. This Plan is based on those same assumptions that the core revenue grant will reduce in real terms until 2020.

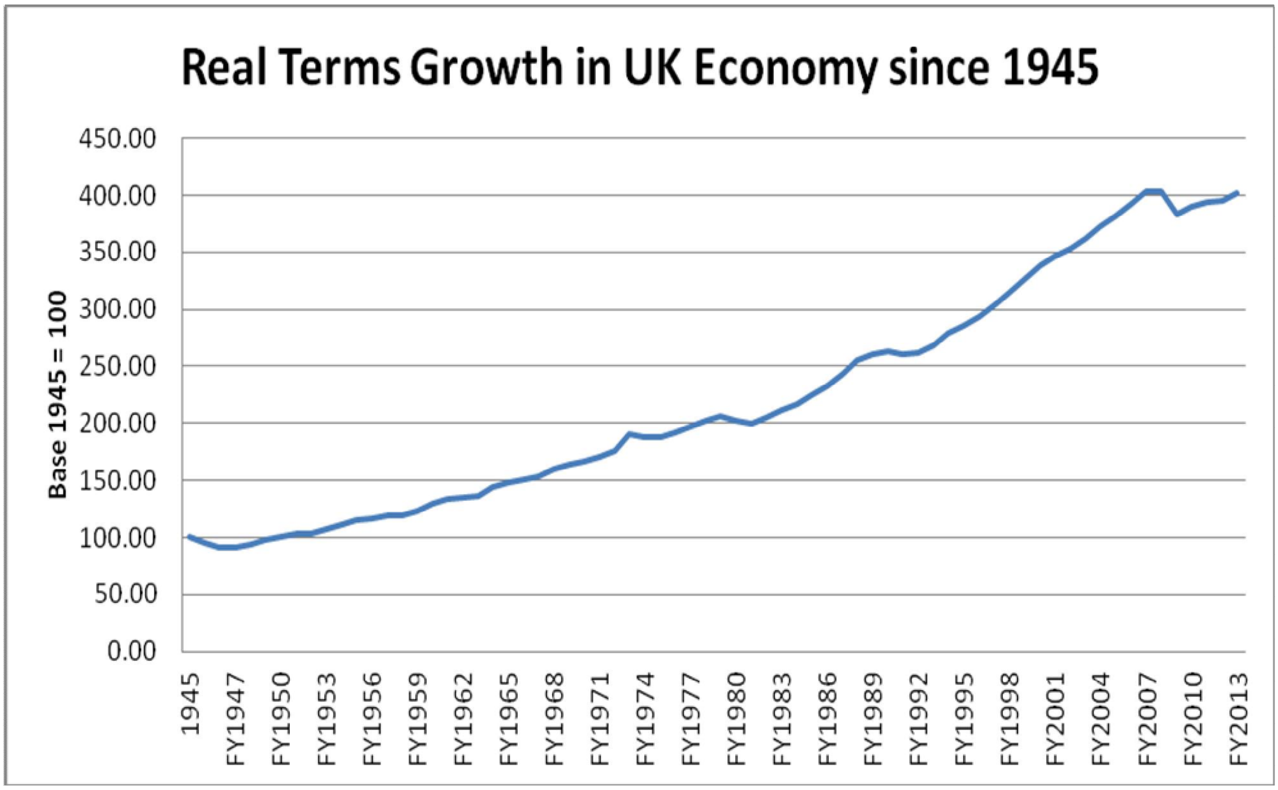
9.3 However, a key assumption in the Plan is that after 2020 the economy will "normalise" and return to the trends seen prior to the "Great Crash" of 2008. There are 2 key assumptions made around "normalise", the first is that UK Government Spending as a percentage of the economy will continue in the future, and the second is that the UK will return to historic levels of average annual economic growth,

9.4 The graph below shows the level of UK Government spending as a percentage of GDP (i.e. the economy) since 1900:



9.5 The graph shows that the UK Government has consistently spent at a level equal to around 40% of GDP since the Second World War. It is assumed that this trend will continue through the lifetime of this Plan. This means that there should be a direct correlation between UK economic growth and future increases in the core revenue grant.

9.6 The table below sets out UK real terms (i.e.net of inflation) annual economic growth since 1945:



9.7 The table shows that over the period the UK economy has historically grown by an average of 2% per year after having taken account of inflation. This average covers a period of nearly 70 years which has seen significant recessions, low growth and higher growth, so an average of 2% growth per year seems reasonable. However, there is a school of thought that the UK economy won't be able to sustain 2% growth per year in light of the growing competition from emerging markets.

9.8 However, for the purposes of this Plan it is assumed that the UK economy will grow by 2% per year in the long term, but this will need to be reviewed periodically to ensure that it remains a reasonable assumption.

9.9 When these factors are taken into account the Plan assumes that the Scottish Government General Revenue Grant will increase by 2% above inflation each year (on average) from 2020 onwards, and that has been factored into the financial modelling that has been undertaken.

Local Taxation – Council Tax

9.10 Local Taxation comprises of National Non-Domestic Rates (NNDR) and Council Tax. However, whilst NNDR is billed and collected locally, the tax receipts generated are pooled nationally and redistributed to local authorities by the Scottish Government. It is therefore assumed in the financial modelling exercise in the Plan that this will continue into the future.

9.11 The Plan also assumes that Council Tax remains into the future and is not replaced by an alternative local tax. The financial modelling that has been undertaken assumes that there will continue to an underlying 1% increase in the taxation base each year, which represents the net increase in domestic properties in Shetland. In addition, it is assumed that Council Tax will remain frozen until 2018-19, but will then be increased annually by 3% from 2019-20 onwards.

9.12 Given that Shetland has a small population in relation to the amount of money that is spent on public services in the local authority area, it is unlikely that Council Tax will ever be able to a significant percentage of the Council's funding. This is because it would require such significant annual increases that it would result in Shetland being the most heavily Council Taxed local authority area, which would be unpopular with residents. At present it generates an average of 7% of the Council's total funding compared to a Scottish average of over 20%.

9.13 However, over a sustained period of time the cumulative impact of annual above inflation increases in Council Tax would provide an enhanced income stream for the Council. For example, if the Council were to increase Council Tax by 5% per annum for 30 years from 2020, it would mean that in real terms, the Council would have nearly £17 million of Council Tax income each year, which is double the current figure.

9.14 The table below sets out the differing average annual amount of income that could be collected each year based on different annual increases:

Annual Council tax increase from 2019-20 to 2049-50	Average annual amount of Council Tax collected in real terms	Real Terms value of Council Tax levied in 2049-50
0%	**£5,588,000**	**£3,726,000**
1%	**£6,488,000**	**£5,073,000**
2%	**£7,487,000**	**£6,884,000**
3%	**£8,748,000**	**£9,316,000**
4%	**£10,282,000**	**£12,569,000**

Annual Council tax increase from 2019-20 to 2049-50	Average annual amount of Council Tax collected in real terms	Real Terms value of Council Tax levied in 2049-50
5%	**£12,155,000**	**£16,910,000**
6%	**£14,447,000**	**£22,686,000**
7%	**£17,260,000**	**£30,350,000**
8%	**£20,718,000**	**£40,495,000**
9%	**£24,978,000**	**£53,888,000**
10%	**£30,232,000**	**£71,522,000**

9.15 What the table shows is that for Council income to retain its real term value over the period it will require annual increases of about 3% per year from 2019-20 to protect it against inflation.

9.16 If future Council Tax rises are below 3% the funding value of the Council Tax base will be eroded by inflation, and Council Tax will continue to lose its significance as a source of funding for public services in Shetland.

9.17 If Council Tax increases from 2019-20 were above inflation it would increase the real terms funding value of the income stream. However the larger the real terms increases in annual bills, the more likely that the public are to complain about the size of their bills.

9.18 Therefore for the purposes of the financial modelling exercise, it has been assumed that Council Tax will be increased by 3% per year to hold its real terms value against the impact of inflation.

9.19 It is important that the Council recognises that once the period of Council Tax freezes has been ended, there will be an opportunity to have a meaningful discussion with the community about how much they are prepared to pay for services. If the Shetland public wish to continue to have the highest level of public services in Scotland, there are implications regarding the size of the contribution that the public makes to fund those local services.

Oil & Gas

9.20 The indication from the industry is that income from oil and gas related activity will continue to provide the Council with an income stream until the middle of the century. However, it will not be on the scale that was seen from the mid-1970s to mid-1990s. The two sources of income for the Council will be from the TOTAL land lease agreement and from the operation of the Sella Ness Port which services the Sullom Voe Terminal (SVT).

9.21 In order to provide an indication of the income streams that the Council is likely to receive in the future, two separate financial modelling exercises have been completed to feed into the Long Term Financial Plan modelling.

9.22 The future income from TOTAL for the lease of the land on which the new plant has been built is linked to the price and throughput of oil and gas through the gas plant. An independent oil and gas consultant has estimated future throughput levels and prices which have been used in the Council's financial model. This model has been independently reviewed by SOLACE enterprises to ensure that it is robust. The model estimates that the Council will receive approximately £2m-£3m per year from TOTAL and this has been included in the financial modelling in this Plan.

9.23 The Finance service also undertook a financial modelling exercise on the Sella Ness Port based on throughput levels provided by BP. This work has been independently reviewed by SOLACE enterprises and has been reported separately to Council. Further work is required to strengthen the figures in the model, but early indications suggest that the Council could generate higher returns by selling the Port and investing the proceeds rather than continuing to operate the Port in its existing format.

9.24 However, for the purposes of this Plan's financial modelling exercise, it is assumed that the Port will continue to be operated by the Council and that the existing operating model will continue.

9.25 Further work will be undertaken on the Port financial modelling to improve future income projections by contracting an independent oil and gas expert to undertake a forecasting exercise. The results of this work will be fed into the financial model to update expectations of future surplus levels.

9.26 It should be noted that given the size of future cash flows at the Port in relation to the size of the Council, continuing to operate the Port represents a significant financial risk to the Council, as any shortfall in future surpluses will have a material impact on the Council's revenue budget.

10 Cost Pressures

10.1 Every organisation faces cost pressures each year. It is important that these are closely managed to ensure that spending levels do not start to creep upwards, and away from affordable levels. Therefore good cost control will be important if the Council is to continue to be operated on a sustainable basis into the future.

10.2 The main areas of cost pressure that the Council is likely to face in the long term is in relation to general inflation (particularly staff salaries), demographic change, and financing capital expenditure to support the Council's asset base.

General Inflation

Key Fact

The Bank of England has a target to manage inflation to 2% per annum. Managing inflation has been a central tenet of government economic policy since the 1980s and over the past 20 years inflation has averaged 3%. It is likely that the low inflation policy will continue into the future providing an element of comfort for future planning purposes.

10.3 The UK has a strong track record of managing inflation so the model assumes that inflation will be controlled at around 2% over the long term. However, pay rises are likely to be 1% above inflation so the financial modelling undertaken in the plan assumes that the Council will face an average of 3% inflation on its costs on an annual basis.

10.4 The 3% annual allowance should cover pay rises, contract inflation, utilities and fuel cost rises.

10.5 There will always be specific cost pressures that occur over time, but it is assumed that these will be manageable through good financial planning and therefore no specific allowance has been made for them in the financial modelling.

Shetland's Shifting Demographics

Key Fact

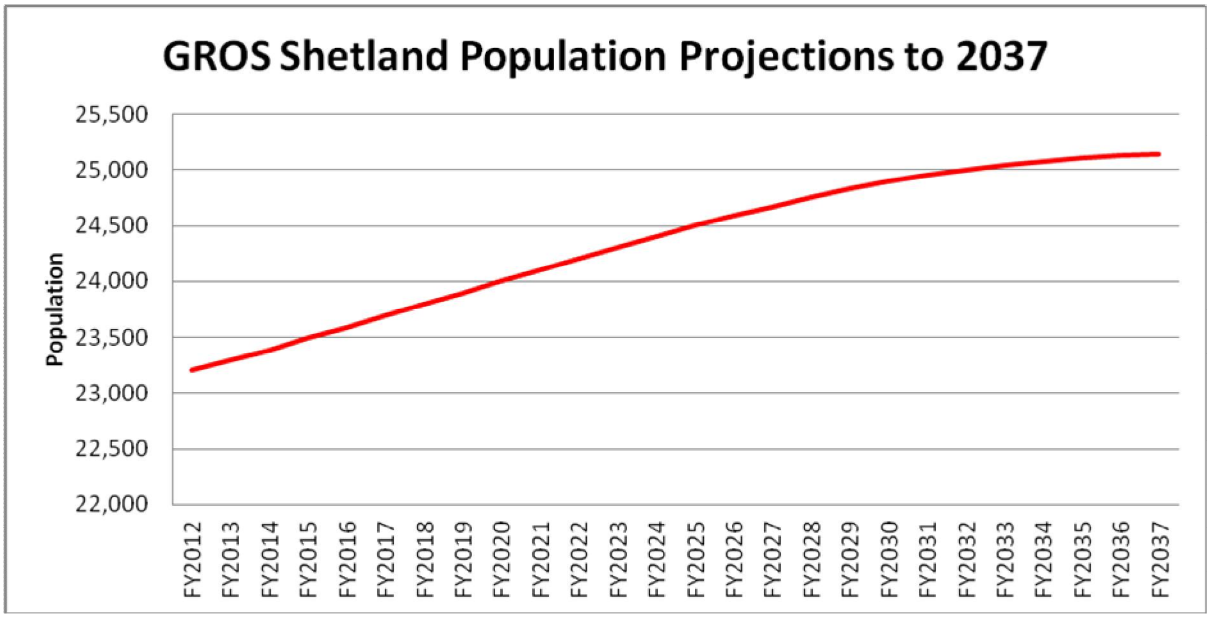
Shetland's population projections over the next 25 years indicate that there will be a material shift in the age profile of the community, with falling numbers of 0-16 year olds and 17-64 year olds, but a significant increase in over 65 year olds.

If the Council does not allocate its available annual resources towards the areas of highest service demand, it will either result in the Council failing to provide an appropriate level of service, or using reserves unsustainably to fund this cost pressure.

10.6 In line with the rest of Scotland and the UK, Shetland is expected to experience a significant change in its age demographic profile over the next 25 years. As the percentages of people in different age groups alters over this period of time, so too does the relative demand for services that are most closely associated in those age groups.

10.7 This section of the report uses data that is published by The General Register Office for Scotland (GROS) on population forecasts for Shetland over the period 2012-2037. The information is then used to draw broad conclusions on the impact that Shetland's changing demographic might have on demand for Council services in the future.

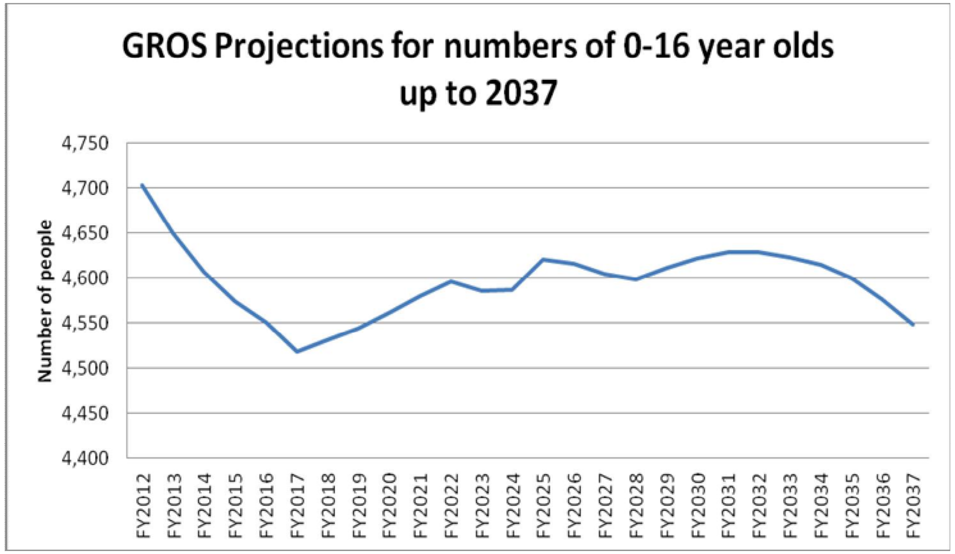
10.8 The first table below sets out GROS's overall population forecasts for Shetland for the 25 year period to 2037.



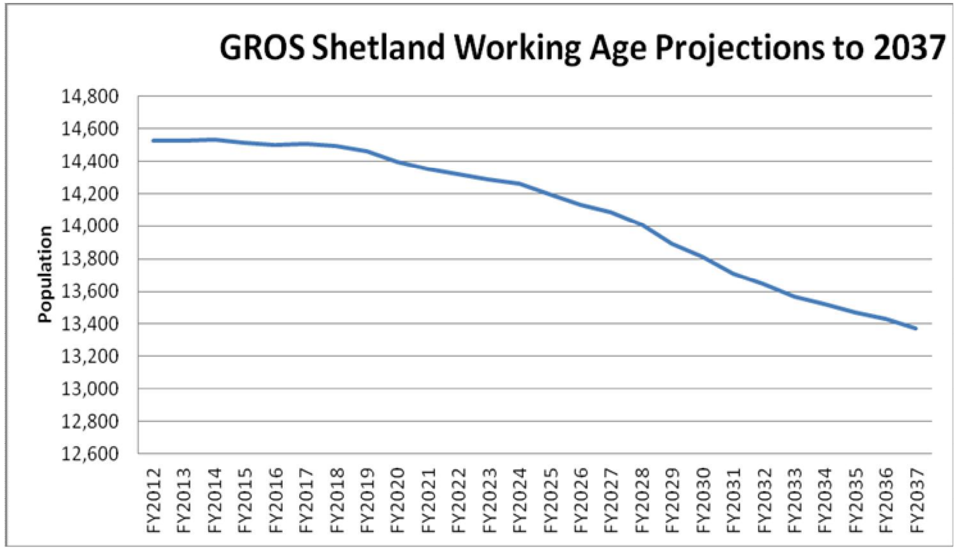
10.9 The table shows that there is expected to be an increase in the overall population in Shetland over the 25 year period, with it reaching over 25,000 by 2037. This increase is a little below the expected percentage increase in the overall Scottish population, but it is sufficiently close that, for resource allocation purposes, Shetland should still attract a similar proportion of Scottish Government funding. Therefore no assumption has been factored in for Shetland's relative share of the overall Scotland population decreasing slightly.

10.10 Whilst upon first glance the increase in Shetland's population looks encouraging for the community's sustainability, once you look at the age break-down between children (0-16 year olds), working age adults (17-64) and the retirement age population (over 65 year olds), it tells a different story. The next three tables set out GROS's population forecasts for each of these three age groups over the 25 year period to 2037:

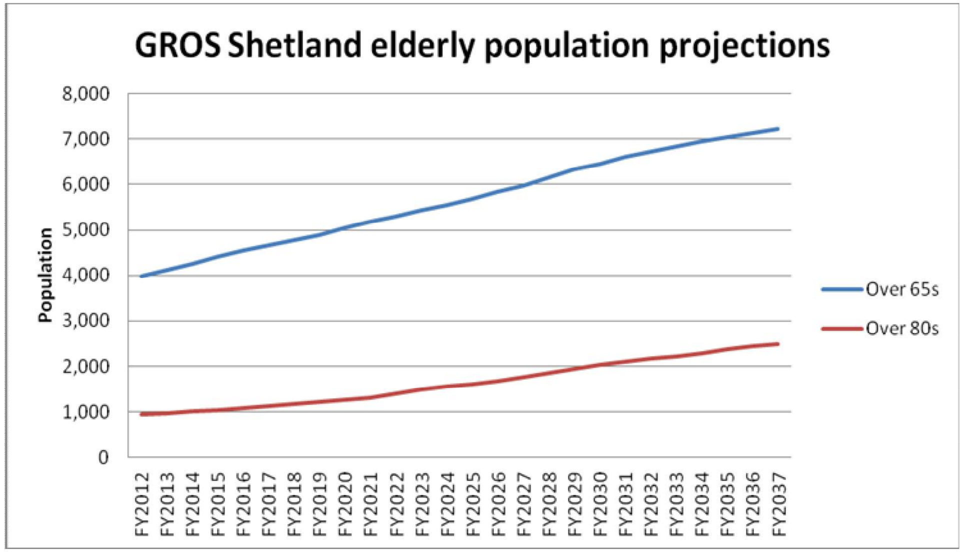
1. Shetland's 0-16 year old population is set to reduce over the period.



2. Shetland's working age population is set to reduce over the period.



3. Shetland's retired population is set to significantly increase over the period.

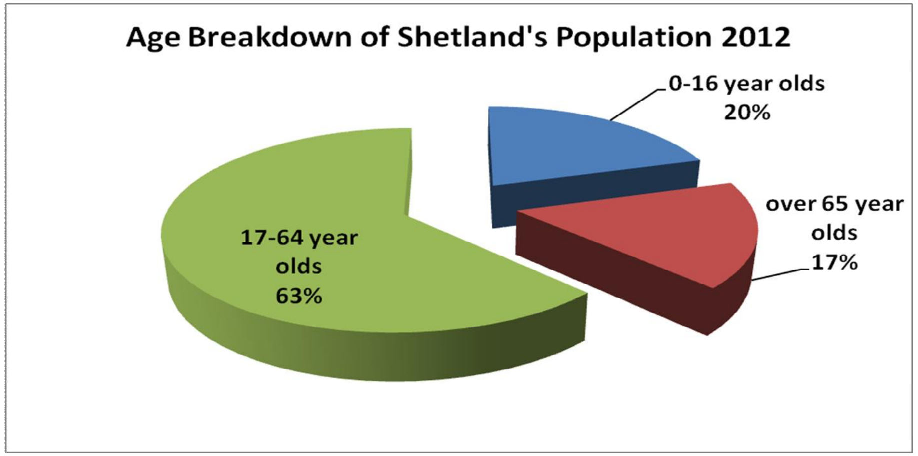


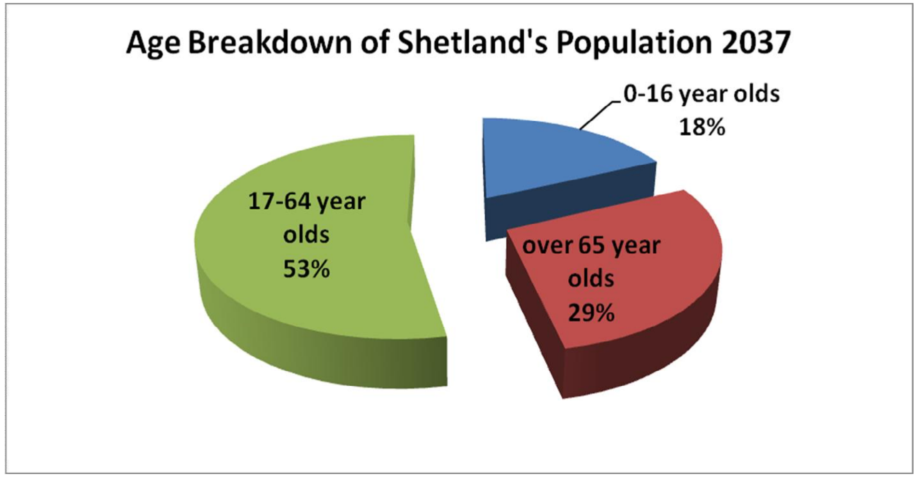
10.11 The three tables show that whilst the overall population of Shetland is set to increase to over 25,000 by 2037, there is set to be a reduction in the number of children and working age people in the community. It is the 75% increase in the number of over 65 year olds that accounts for the forecast increase in Shetland's population.

10.12 The third table also highlights the fact that the number people who are over 80 in Shetland is set to more than double by 2037.

10.13 When taken together, a broad conclusion that can be drawn is that there will be a decrease in demand for children's services and an increase in demand for services to the elderly.

10.14 The pie charts below show the relative size of the 3 age groups as a percentage of Shetland's population in 2012, and what they are forecast to be in 2037.





10.15 What the pie charts show are that over the next 25 years the over 65 year olds age group will become a larger proportion of the Shetland population whilst the 0-16 year olds will become a smaller proportion.

10.16 The result of this change is that there will be a relative increase in demand for services that are predominantly provided to older people, whilst there will be a relative reduction in demand for services to younger people.

10.17 The table below has been copied from the 2012-2017 Medium Term Financial Plan and sets out how the current Council is seeking to re-balance resources between the directorates during the lifetime of the current council:

Directorate	2012-13 % of General Fund	2017-18 % of General Fund	Movement in % share of funding between 2012-13 and 2017-18
Chief Executive	1.30%	1.26%	-0.04%
Children's Services	37.18%	38.58%	1.40%
Community Care	18.79%	19.95%	1.16%
Corporate Services	9.68%	9.63%	-0.05%
Development	14.41%	11.74%	-2.66%
Infrastructure	18.64%	18.84%	0.19%
TOTAL	100%	100%	0%

10.18 The table highlights that the current Council has prioritised Children's Services as its number one priority and has shifted a larger percentage of available resources to it. Whilst it is perfectly appropriate for a Council to choose to do this, in the future greater use of demographic information should be used to inform the resource allocation decisions of the Council.

10.19 If the Council does not re-align existing resources away from areas of falling demand to areas of increasing demand for services, it will mean that overall spending levels will have to increase. This is because the Council has to provide care services to the elderly, so if resources aren't reduced in other areas to allow greater spending in the area of care, it will simply mean an overall increase in spending to meet demand for care services.

10.20 If the Council increases overall spending to meet increasing demand for care services, rather than re-allocate existing resources to care, it will increase the likelihood of the Council returning to an unsustainable position.

10.21 In addition, any future growth in government grant from the Scottish Government could find itself used entirely to meet the extra demand in care services. This would limit the scope for future Councils to improve other services to the public.

10.22 The financial modelling that has been undertaken in the Plan assumes a 3% increase in the community care budget each year will be required to meet increases in service demand as a result of Shetland's changing demographics.

Financing Future Capital Expenditure

Key Fact

If the Council seeks to maintain the size of its existing asset base in the future, it will mean reducing levels of revenue expenditure on day to day services. This is because the available capital resources to spend on the Asset Investment Plan will be at insufficient levels to meet capital expenditure demand. The shortfall would have to come from revenue funding, either through servicing debt or directly funding capital from current revenue.

10.23 As highlighted in Section 6, Shetland Islands Council has a large asset base which will require significant investment into the future if it is to be maintained.

10.24 An initial review into how much would need to be spent to maintain the existing asset base has been undertaken as follows:

- The Executive Manager – Ferries Service has developed a 35 year ferry and ferry terminal replacement programme to ensure continuity and reliability of service;

- The Executive Manager – Estate Operations has undertaken a review of the capital maintenance costs (Lifecycle Costs) required on average each year to maintain the existing compliment of buildings across the Council;

- The Executive Manager – Roads has completed a piece of work to determine the average annual capital investment required to maintain the roads at their current state of repair over the next 35 years;

- At present there are no clear plans for the replacement of existing buildings (with the exception of the Anderson High School and the Eric Gray Resource Centre). An assumption has been made that the Council's £150 million of buildings have an average life of 50 years, and that an annualised average spend on new build replacements is £3 million per year;

- There is no integrated ferry maintenance and replacement programme in place. Therefore in order to forecast a likely level of ferry vessel capital maintenance expenditure, the average annual spend in the existing 5-year Asset Investment Plan has been used;

- There is no vehicles asset management plan in place so in order to determine an average annual cost for capital expenditure on vehicles, the average from the existing 5-year Asset Investment Plan has been used;

- There is no ICT asset management plan in place, so again in order to determine an average annual spend on ICT the average from the existing 5-year Asset Investment Plan has been used;

- In addition, two additional areas of significant plant have been included, the Scord Quarry and the Energy Recovery Plant, and again the average spending over the next 5 years has been used as an average for future spending levels;

- It is assumed that miscellaneous capital expenditure on items such as the landfill site and burial grounds could be absorbed in the £3m annual allowance for new build replacement assets;

- No provision has been made for maintaining or replacing piers.

10.25 With regard to capital income, it is assumed that the base capital grant from Scottish Government will be £6 million per year and that will increase in line with inflation to match the increased costs of capital expenditure. With regard to capital receipts, the starting assumption is that the Council wants to maintain its asset base and therefore will only receive an average of £250,000 per annum from the sale of assets.

10.26 The table below brings this information together to see what the average additional Capital Financing Requirement (i.e. the need to borrow to finance capital expenditure) would be each year:

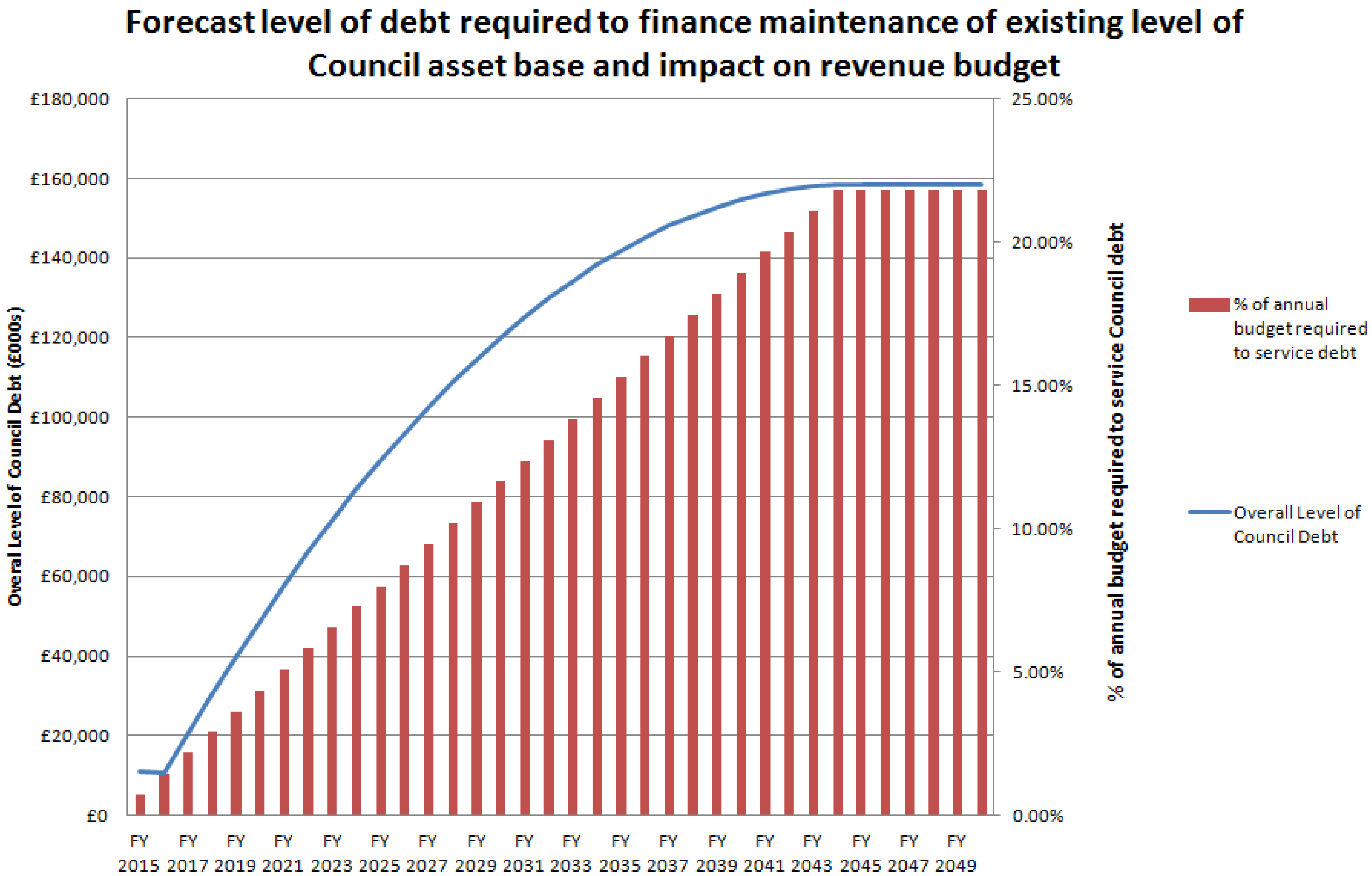
Annual (average) Expenditure	£000s
Ferries and Terminals Replacement	£3,857
Building Replacement Programme	£3,000
Roads	£4,502
Building Maintenance (Lifecycle Costs)	£2,068
Ferries Maintenance	£1,236
Vehicles	£1,200
ICT Hardware and Public Sector Network	£676
Scord Quarry	£175
Energy Recovery Plant	£450
Estimated annual expenditure to maintain existing asset base	**£17,164**
Available Resources	
Capital Grant	£6,000
Capital Receipts (from sale of assets)	£250
Total core capital income	**£6,250**
Annual Shortfall to be borrowed	**£10,914**

10.27 The table estimates that the Council would need to spend an average of £17.164 million per year on capital until 2050 in order to "maintain" the existing asset base. It is important to highlight that by "maintain" it means any replacement assets would be of the same scale of the asset it was replacing and that there wouldn't be a net increase in assets. For example, the proposed replacement of the Eric Gray Resources Centre seeks to enlarge capacity and is therefore a growth project.

10.28 Any decision by the Council to replace an asset with something on a larger scale would be in addition to the estimated £17.164 million needed each year to "maintain" the existing asset base.

10.29 The table above shows that once recurring annual capital resources of £6.25 million are offset against the cost, there is a requirement to borrow an average of £10.914 million each and every year. This has a cumulative effect in that by the end of Year 2 the Council would have required debt of £21.828 million (£10.914m x 2), by Year 3 this would rise to £32.742m and so on.

10.30 The graph below shows the impact that this annual borrowing requirement would have on the overall Council debt level (the blue line) over the next 35 years. The left hand axis on the graph shows the overall level of net debt (i.e. the amount borrowed less the amount repaid) in each of the years.



10.31 It can been seen that debt levels would rise year on year, until year 30 when the debt would level off at £159 million as a result of debt repayments reaching the same level as new borrowing in a year.

10.32 The graph also shows the impact that the overall debt level would have on the revenue budget (the red bars). The right hand axis shows that debt servicing costs (interest payments and the principal repayment of debt) would rise from taking up less than 1% of the Council's net revenue general fund budget to nearly 22% by year 30 when it would level off.

10.33 This would mean that the Council would have to make £23.4m of recurring spending reductions in order to have sufficient budget available to pay for debt servicing costs. So instead of spending £107m on services each year, the Council would have to reduce that budget to £83.6m per year.

10.34 If this were to be funded by the local Council Tax payer, it would require the rate of Council Tax on a Band D property to be increased from £1,056 per year to £2,961 (a 281% increase).

10.35 The conclusion that can be drawn from the table is that it would require a significant sacrifice on day to day spending on services to maintain the existing asset base, let alone seek to continue expanding the asset base with projects like the new Eric Gray Resource Centre.

10.36 Therefore a key challenge for Councils in the long term is going to be deciding an appropriate level of trade off between capital expenditure and providing revenue services. The financial modelling exercises undertaken in the next section of the report set out some scenarios, with the key focus on funding the capital programme.

11 Financial Modelling

Key Fact

Over a period of 35 years there are endless numbers of long term financial models that could be developed because of the variables involved and assumptions made. In order to provide decision-makers with an understanding of the parameters involved it is necessary to model the extreme examples to understand the limitations of what is possible.

11.1 Based on the information gathered from the Long Term Financial Planning process 4 financial models have been produced to give an indication of the broad financial impact arising from the different scenarios. The 4 scenarios that have been modelled are as follows:

The "Noughtie Council" Scenario

11.2 In this scenario future Councils elected after 2017 demonstrate the financial behaviour of the Councils that were responsible for financial decision-making during the first decade of this Century – The "Noughties". In this scenario spending is driven by public demand for service growth and new assets (capital expenditure). Real terms increases in government grant fund service growth, whilst cost pressures (inflation) and the revenue consequences of capital expenditure are uncontrolled. Resources are not re-allocated to areas of demand, instead the Council meets the demand by increasing overall spending levels. No consideration is given to restraining expenditure to keep it in line with income, and therefore a structural deficit emerges as happened between 2000 and 2012.

The "Unplanned but Good Intentioned Council" Scenario

11.3 If the current and future Councils do not take a longer term view when it comes to the impact that current decisions will have on the future sustainability of the organisation, this scenario, or something similar, is a likely outcome. As a result of the previous Councils' investment in infrastructure, there will be significant future financial pressures to replace these aging assets so that service levels to the public are maintained. In addition, if resources are not re-aligned to where future increased service demand pressures lie, it will put further pressure on budgets which could lead to overspending. In this scenario, the Council shows restraint in service growth, but hasn't undertaken long term planning to understand the issues around affordability, sustainability and prudence when it comes to future capital investment. This leads to the Council continuing to replace all capital infrastructure as and when it is required and then only realising after borrowing has been undertaken, that in fact it was unaffordable. The borrowing is committed by this stage and is therefore paid for from reserves and eventually they run out leading to significant cuts in revenue expenditure.

The "Sustainable Capital Focussed Council" Scenario

11.4 In this scenario future Councils continue with a strong focus on financial planning to ensure that the organisation remains sustainable into the longer term and maintains the capital value of the reserves at over £200 million. Within this sustainable approach, future Councils' focus on ensuring that the existing asset base can be maintained, by borrowing whatever is required to finance a general fund capital programme of £17 million per year, which is the level required to maintain the existing asset base. The increasing borrowing levels mean that future Councils have to forgo spending as much money on providing day to day services in order to be able to meet the costs that arise from the borrowing – interest costs and principal repayment of the loan. In total the Council has £200 million less to spend (in 2014 prices) on day to day services over the next 35 years than it would have without debt, because of its preference to maintain the existing asset base. The biggest financial risk to this approach is over future interest rates, because if they rise, the Council would have to make additional revenue savings to pay for the higher borrowing costs.

The "Sustainable Revenue Focussed Council" Scenario

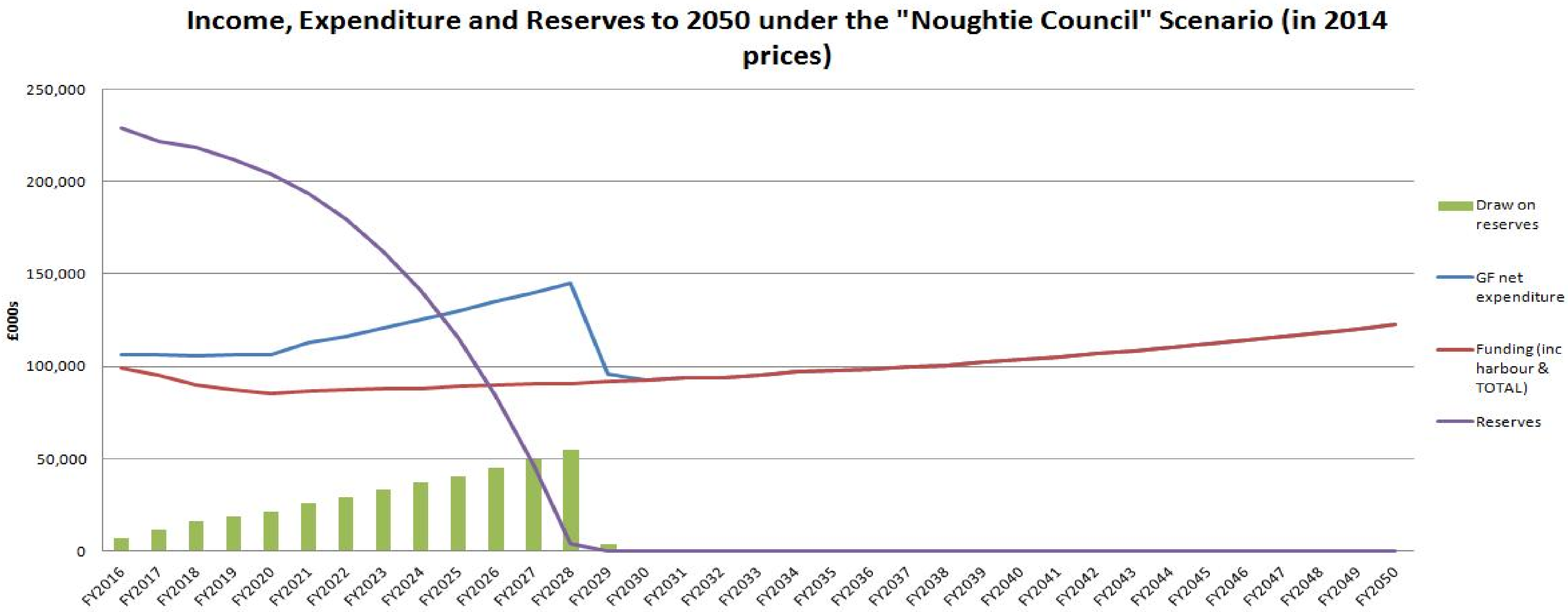
11.5 Again, in this scenario future Councils continue with a strong focus on financial planning to ensure that the organisation remains sustainable into the longer term and maintains the capital value of the reserves at over £200 million. Within this sustainable approach, future Councils' focus on maximising the revenue that is available to spend on delivering day to day services. This results in a higher level of spending on service provision than under any of the other models, and £200 million more than the Capital Focussed model. However, the opportunity cost is that there is a severe restriction in future capital investment, with average annual spending limited to £6.25 million per year to ensure that no future borrowing is required. Against the level of expenditure required to maintain the existing asset base, this represents an underinvestment of over £10 million per year and would have significant consequences on the future size of the Council's existing asset base, which could result in it more than halving in size over the next 35 years.

11.6 The table on the next page sets out the key assumptions used in each model, and the subsequent 4 pages set out the results of the financial modelling for each of the four scenarios.

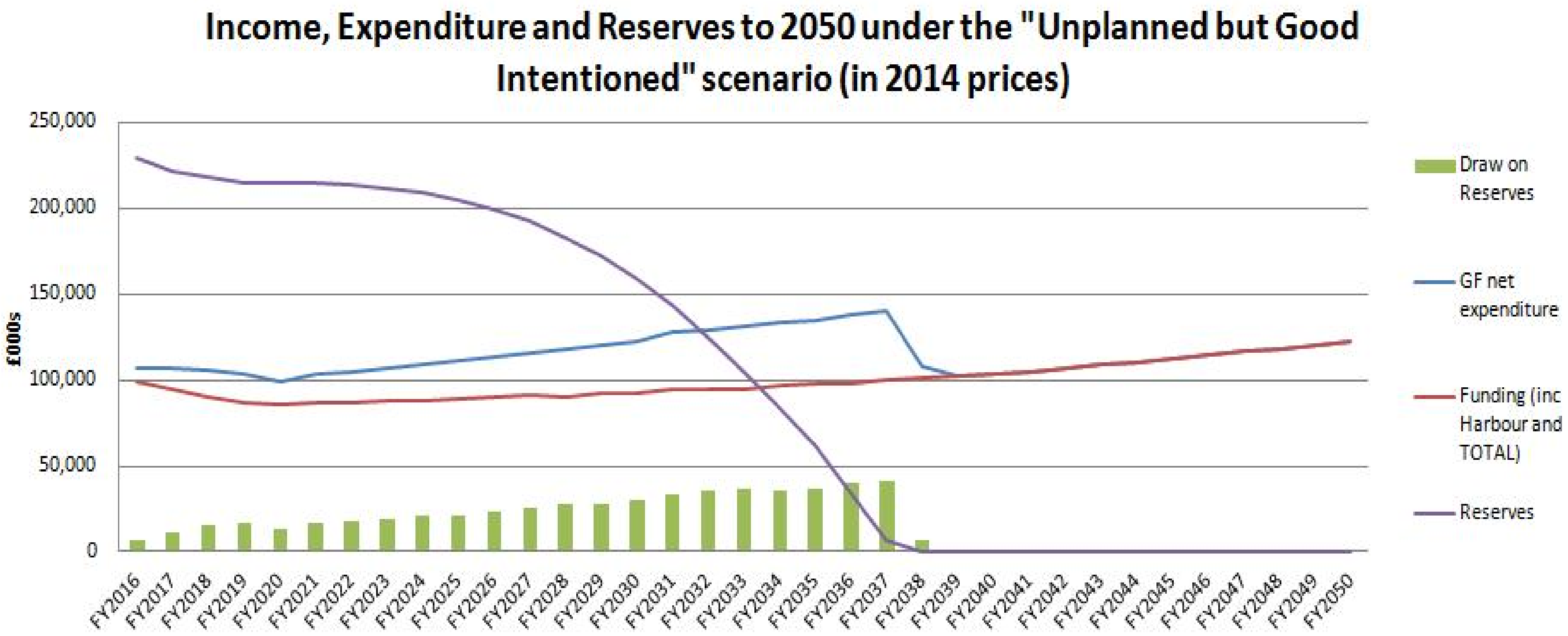
Key assumptions of each model

Assumptions	The "Noughtie Council"	The "Unplanned but Good Intentioned" Council	The "Planned sustainable Council with Capital Focus"	The "Planned sustainable Council with Revenue Focus"
Inflation (Cost Pressures)	2.5% built in to budget annually	2.5% built in to budget annually	2.5% built in to budget annually	2.5% built in to budget annually
Demographic Pressures	3% increase in community care budget annually from 2020 funded by increasing budget.	3% increase in community care budget annually from 2020 funded by increasing budget.	3% increase in community care budget annually from 2020 funded by realigning resources from other areas.	3% increase in community care budget annually from 2020 funded by realigning resources from other areas.
Service Growth	3% increase in Council budget per year from 2020.	Restraint shown by only allowing 1% growth per year	No service growth throughout the period.	Affordable service growth throughout the period.
Capital Expenditure	Unconstrained – consciously meeting all future demands resulting in significant borrowing cost pressure.	Unplanned – meeting all future demands without fully understanding the long term implications resulting in a significant borrowing cost pressure.	All capital expenditure requirements met over the next 35 years.	Severely restricted as no new borrowing permitted under this scenario. Asset Investment Plan limited to £6.25m per year.
Core Government Grant	Return to 2% annual real terms increase from 2020.	Return to 2% annual real terms increase from 2020.	Return to 2% annual real terms increase from 2020.	Return to 2% annual real terms increase from 2020.
Council Tax	3% annual increase from 2020.	3% annual increase from 2020.	3% annual increase from 2020.	3% annual increase from 2020.
Interest Rates	Remain low – 4%	Remain low – 4%	Remain low – 4%	Remain low – 4%
Oil & Gas related income	Income assumptions in line with financial modelling of Harbour and TOTAL gas plant income.	Income assumptions in line with financial modelling of Harbour and TOTAL gas plant income.	Income assumptions in line with financial modelling of Harbour and TOTAL gas plant income.	Income assumptions in line with financial modelling of Harbour and TOTAL gas plant income.

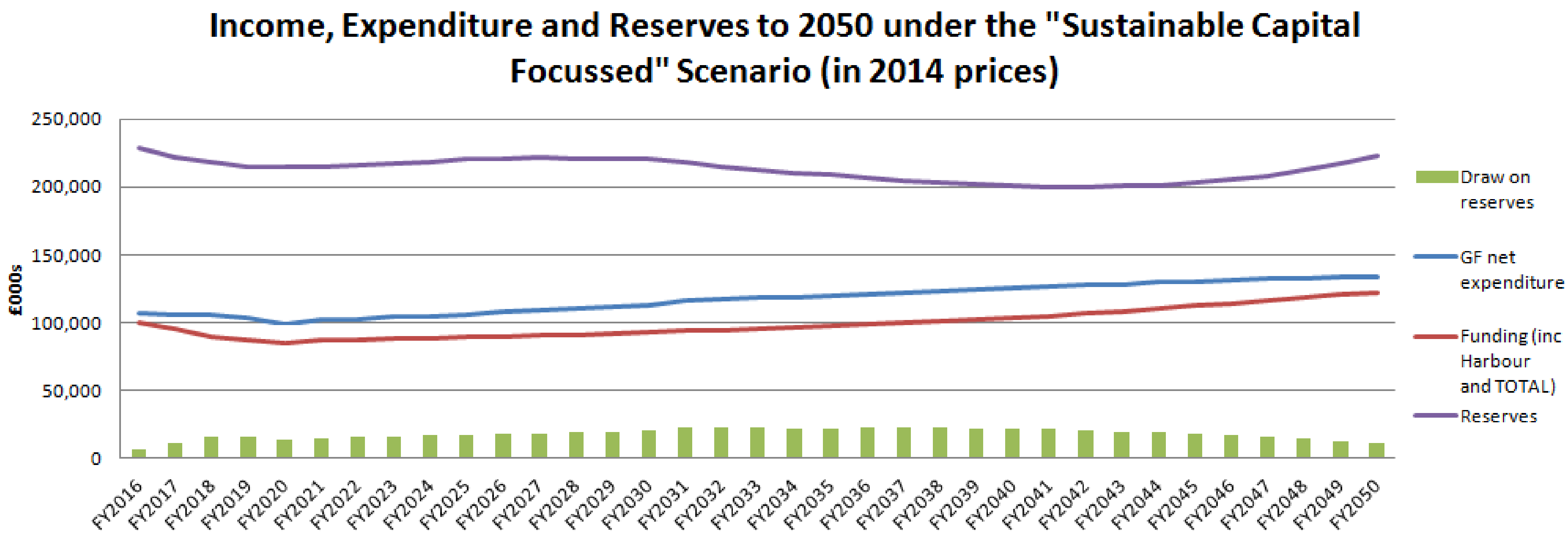
Assumptions	The "Noughtie Council"	The "Unplanned but Good Intentioned" Council	The "Planned sustainable Council with Capital Focus"	The "Planned sustainable Council with Revenue Focus"
Draw on Reserves	Unconstrained – whatever is required to meet expenditure level. Reserves fully depleted by 2029.	Unplanned – draw on reserves steadily increases year on year to meet expenditure levels. Reserves fully depleted by 2038.	Controlled – kept at sustainable levels and over £200 million of reserves remaining in 2050.	Controlled – kept at sustainable levels and over £200 million of reserves remaining in 2050.
Reserves	Average 7.3% annual return	Average 7.3% annual return	Average 7.3% annual return	Average 7.3% annual return
Revenue Expenditure over period	£3,670million	£3,685 million	£3,727 million	£3,931 million
Capital Expenditure over period	£395 million	£461 million	£544 million	£219 million
TOTAL Spending over period	£4,065 million	£4,146 million	£4,271 million	£4,150 million
Sustainability	Unsustainable	Unsustainable	Sustainable	Sustainable
Key Risks	Unsustainable so reserves will run out.	Unsustainable so reserves will run out.	Most susceptible to interest rate rises.	Insufficient capital expenditure to maintain the existing asset base.



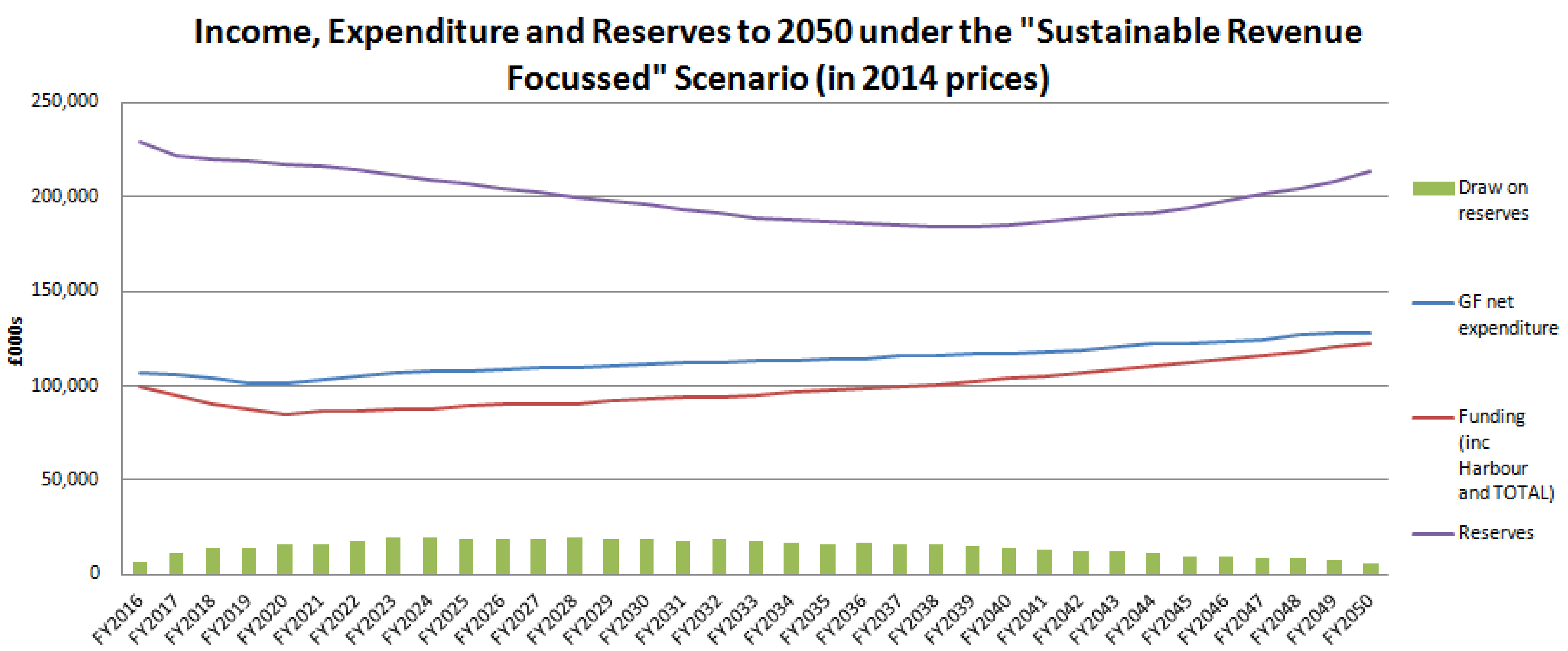
Positive Characteristics	Negative Characteristics
No structural savings (£4.8m) made in 2018-19 and 2019-20	Reserves run out in 2029-30 resulting in over £50m of recurring cuts (in 2014 prices) to align income and expenditure levels.
Unconstrained capital programme until 2028-29 – like for like asset replacement as required.	Severe constraint on capital spending after 2028-29 resulting in only current capital expenditure levels being affordable i.e. no new builds
An annual 3% real terms growth in budgets from 2020 as Government Grant starts to rise in real terms.	The Council's spending levels would have to fall in to line with national levels after the reserves were depleted.
No re-allocation of resources from decreasing areas of demand to increasing areas of demand – instead an increase in overall spending to meet demand.	Debt level by 2028-29 means the £50m of cuts would have to come out of services – a 41% reduction in service spending levels. This would make it challenging to meet growing service demand.
Net revenue expenditure recovers to 2011-12 levels in real terms by 2026-17.	After 2028-29, no reserves means a new lower level of spending, meaning by 2050 real terms spending is still lower than 2015-16.



Positive Characteristics	Negative Characteristics
Unconstrained capital programme until 2037-38 – like for like asset replacements as required.	Capital expenditure would have to significantly reduce after 2038-39 meaning replacement assets would become unaffordable.
An annual 1% real terms growth in budgets from 2020 to 2038 as Government Grant starts to rise in real terms.	The Council would have to find £18m of recurring revenue savings (in 2014 prices) after the reserves ran out in 2038.
No re-allocation of resources from decreasing areas of demand to increasing areas of demand – instead an increase in overall spending to meet demand.	The level of savings necessary after the reserves ran out would make it challenging to meet growing service demand.
Reserves last 10 years longer than “Noughtie Council” Scenario, so higher levels of spending supported for longer, meaning a total of £81m in additional spending on services over the period to 2050.	Reserves would run out by 2038 so the investment income generated from them to support higher spending would be lost.



Positive Characteristics	Negative Characteristics
An adequate sized capital programme to ensure that the existing asset base can be maintained into the future.	The borrowing costs (based on current interest rates) would mean that there would be over £200 million less money to spend on services over the next 35 years than there would be if the Council decided to have a smaller capital programme that didn't require borrowing.
Sufficient growth in the budget to fully fund cost pressure arising from demographic change.	As a result of the focus on capital expenditure, services to the public won't improve as overall living standards improve, because all future growth in government grant would be required to service the debts accumulated to finance the Asset Investment Plan (AIP).
A sustainable model - reserves retained with a capital value of over £200 million (in today's prices) by 2050.	
A higher level of total expenditure over the 35 year period than the other models because the reserves are retained. Compared to the "Noughtie Council" scenario, there would be £206 million of additional expenditure over the 35 years.	The high reliance on borrowing to finance the AIP increases the Council's exposure to interest rate risk. The model assumes rates will continue to be available at current low rates. Any increases in rates would reduce the amount of borrowing that is affordable.



Positive Characteristics	Negative Characteristics
This scenario has the highest level of spending on day to day services over the 35 years, at over £200 million higher than the capital focussed model.	The capital programme would be limited to an annual average of £6.25 million which would result in a significant reduction in the Council's asset base. This would in turn have implications for the quality of services. For example, a lack of investment in ferries could result in the service becoming unreliable if there are frequent break downs of old and/or poorly maintained vessels.
The model allows for growth in service budgets, in addition to inflation, therefore providing scope to increase the quality of the services that are provided to the public.	
Sufficient growth in the budget to fully fund cost pressure arising from demographic change.	
A sustainable model - reserves retained with a capital value of over £200 million (in today's prices) by 2050.	

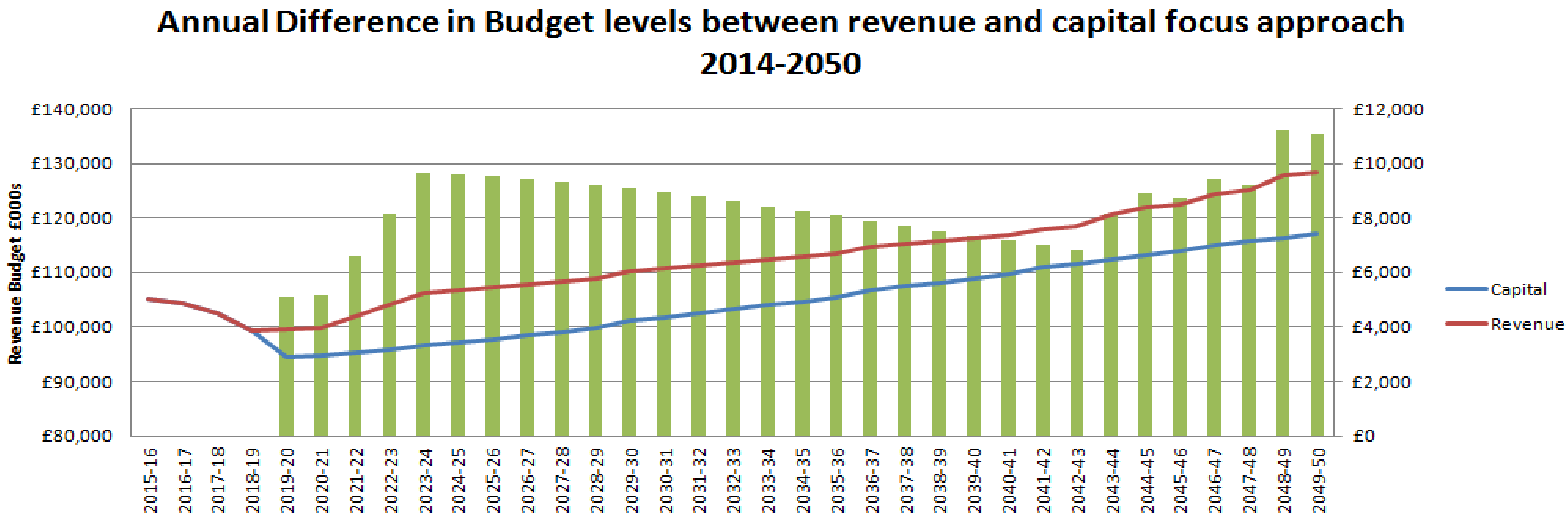
Assets versus Services

11.7 On the face of it the sustainable capital and sustainable revenue scenarios look similar in that income and spending are at similar levels and both scenarios retain reserves at around £200m in real terms over the period.

11.8 However, there is a significant difference with regard to the revenue expenditure that would be available to spend on services between the two models. This is because in the capital focussed model, there would be a higher level of borrowing to support capital expenditure for maintaining the existing asset base. The borrowing costs – repayment of debt and interest charges – would have to be found from the revenue resources available to the Council, which would otherwise be spent on running services. However the revenue focussed model seeks to minimise borrowing so that there is more to spend on day to day services, which means the there is a smaller capital programme that will be insufficient to meet necessary asset replacement.

11.9 The table below sets out the annual difference in the amount that would be available to spend on services under the two approaches. The red line represents the revenue focussed approach whilst the blue line represents the capital focussed approach. The left hand axis shows the amount that is available each year to be spent on services, which highlights that by 2050 there would be almost £130m per year to spend under the revenue approach and just under £120m per year on the capital approach.

11.10 The green bar highlights the amount of extra money that would be available each year to spend on services under the revenue approach, with the amounts set out on the right hand axis.



11.11 The table shows that on average the revenue focussed approach, which seeks to minimise borrowing costs in order to maximise spending on services would result in an average of £8.7m per year extra being available for day to day council services, compared to the capital focussed approach.

11.12 Expressed another way, as a result of the higher borrowing costs under the capital focussed approach, meaning less available to spend on day to day services, it would result in over £200 million less being spent on day to day services over the 30 year period, 2020-2050 as compared to the revenue focussed approach.

11.13 However, the purely revenue focussed approach neglects the capital investment required to sustain an asset base, as it does not allow for any new borrowing whatsoever until 2050, which would limit the annual capital expenditure to £6.25m per year over the period. As highlighted earlier, the Council needs to spend in the region of £17 million per year on average to maintain the existing asset base and therefore under this approach it would be under-investing by over £10 million per year, which equates to over £300 million over the lifetime of the Plan.

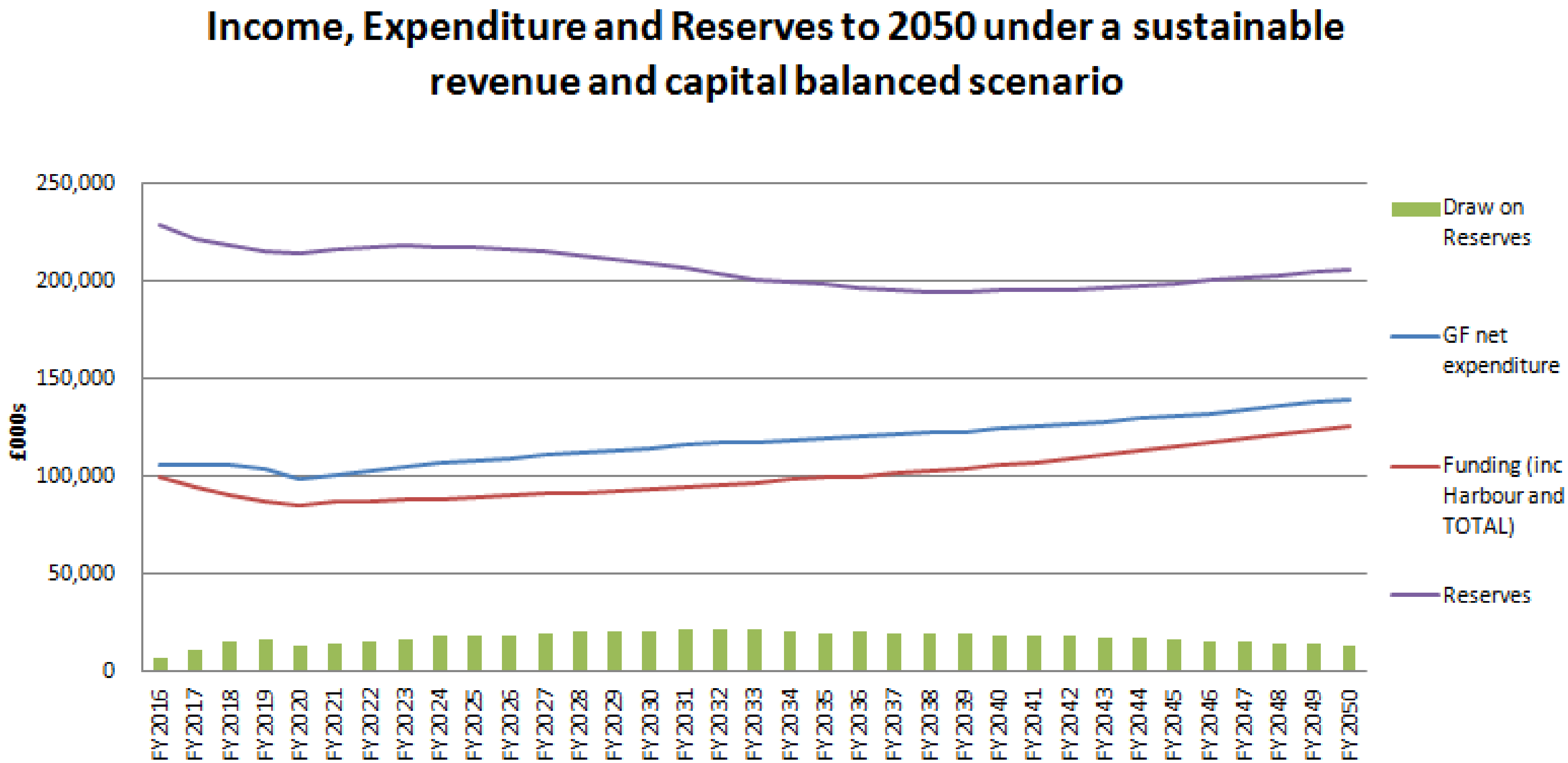
A Balanced and Sustainable Approach

11.14 The next model presents a balanced approach between capital expenditure and revenue expenditure and one that ensures that the Council can operate sustainably in the longer term. The model shows a level of spending that starts to increase in real terms from 2020 and by 2050 reaches a level that exceeds spending levels in 2010-11 whilst retaining reserves with a real terms value in excess of £200 million.

11.15 Under this model, there would be a total of £3,848 million of revenue expenditure over the period and £432 million of capital expenditure. That means on average, the Council could sustain a capital programme of £12.3 million per year. However, that is on the assumption that interest rates continue at their current rates into the future, which is unlikely. Even at an average annual capital programme at this level, it is approximately £5 million less per year than officers believe is necessary to maintain the existing asset base.

11.16 From a revenue point of view, the model requires a level of debt that would result in £83 million of borrowing costs, which would otherwise have been spent on providing day to day services for the public. It is therefore important that Members understand the trade off between capital and revenue expenditure in order to get the balance right between the two.

11.17 The assumptions used in this model for government grant, council tax, investment returns, interest rates and inflation are the same as those used in the previous models.


Income, Expenditure and Reserves to 2050 under a sustainable revenue and capital balanced scenario
250,000
200,000
150,000
100,000
50,000
0
£000s
FY2016
FY2017
FY2018
FY2019
FY2020
FY2021
FY2022
FY2023
FY2024
FY2025
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FY2040
FY2041
FY2042
FY2043
FY2044
FY2045
FY2046
FY2047
FY2048
FY2049
FY2050
Draw on Reserves
GF net expenditure
Funding (inc Harbour and TOTAL)
Reserves

Long Term Asset Investment Plan

11.18 The key risk in this financial model is the future level of interest rates. The model assumes that interest rates will continue at their historically low levels, which in turn will keep the cost of borrowing low for the Council.

11.19 At present the Council's loans fund interest rate is below 5% which would support an average annual capital programme of £12.3 million per year. However, the table below sets out the average annual size of an affordable capital programme under different interest rate levels:

Interest Rate	Average annual capital programme expenditure
5%	**£12.0 million**
6%	**£11.4 million**
7%	**£10.8 million**
8%	**£10.2 million**
9%	**£9.6 million**
10%	**£9.0 million**

11.20 Historic interest rates for borrowing in the UK have been between 7-8% (UK base rate averaged 7.2% in the 20 years prior to the 2008 crash) and it is likely that in the long term rates could rise to these levels again.

11.21 The table below sets out the level of Council spending in the current 5 year Asset Investment Plan

General Fund	£
Total Capital Expenditure proposed in 2015-2020 Asset Investment Plan	**£88,059,236**
Less SG contribution for AHS	**(£31,000,000)**
SIC funded Capital Expenditure	**£57,059,236**
Average annual spending	**£11,411,847**

11.22 The table above shows that at present that once external funding is excluded, the Council is spending an average of £11.4 million per year on its Asset Investment Plan.

11.23 Based on the financial modelling undertaken, and future expectations on interest rates, it is recommended that the Council base its Long Term Asset Investment Plan on an annual average spending level of £10-11m which is in line with current spending levels, and will ensure a prudent, affordable and sustainable approach.

11.24 This is £6m-£7m less per annum, or £210 million to £245 million less than officers estimate is required to maintain the existing asset base.

11.25 It is therefore important that the Long Term Asset Investment Plan is prioritised so that Members can take individual decisions on marginal projects to decide whether they should be funded at the expense of having more resources to spend on day to day activities. See recommendations section for more information.

12 Financial Risks

Key Fact

There are financial risks associated with any financial modelling exercise. It is important that these risks are fully understood so that they can be quantified and managed appropriately to minimise the likelihood of them happening, or if they do, minimise the impact that they have on the organisation.

12.1 As a result of compiling this Long Term Financial Plan a number of key financial risks have been identified which are set out in this section. They are:

Organisational culture

12.2 Capital expenditure has been treated as a free good for services for 35 years. This has created a culture where there are no financial costs to a service for using an asset, so therefore no need to reduce spending elsewhere in the service to pay for the asset. This has led to an over-provision of assets, which whilst not impacting upon the individual services' budgets, it has had a large impact on the Council as its reserves are only 40% of the value that there was in 2000. Unless Members and Officers recognise that there is a cost to capital expenditure then there is a significant risk that the Council will eventually spend the remainder of its reserves.

Public expectations

12.3 The decisions of previous Councils over the past 30 years to provide an unsustainably high level of service to the public has made it difficult to manage public expectations. Once a certain level of service has been provided, regardless of whether it was ever really affordable, it cements the idea that Shetland has a "rich" Council.

12.4 Previous decisions to try and provide a similar levels of local service in the remote areas of Shetland as is available in Lerwick has also set an expectation that this is a normal situation. Despite the higher spending per head of population in the most remote parts of Shetland, there is a wide held belief in the community that the Council does not spend sufficiently in these areas because it focuses expenditure on Lerwick.

12.5 If public expectations of a "normal" level of service cannot be effectively managed over the long term, there is a risk that there will be community pressure upon Members to continue to sustain a level of public service which is unaffordable. If this happens the Council could eventually spend all of its reserves which would result in more severe budget reductions as a result of the lost annual investment income that the reserves can generate.

12.6 The table below sets out an estimate of how the Council is spending its 2014-15 revenue budget by geographic area within Shetland:

Area	Total Council Spending per Year by Area (£)	Population by Area	Annual Spending per Person (£)
Papa Stour	510,190	15	34,013
Foula	1,015,785	38	26,731
Skerries	1,908,702	74	25,793
Fair Isle	1,179,626	68	17,347
Fetlar	1,020,075	61	16,723
Yell	9,332,452	966	9,661
Unst	5,167,036	632	8,176
Whalsay	7,125,368	1,061	6,716
Bressay	2,136,496	368	5,806
Lerwick	35,745,439	7,755	4,609
North Mainland	12,223,365	2,658	4,599
West Mainland	7,872,608	1,765	4,460
South Mainland	11,403,634	3,148	3,623
Central Mainland	12,851,976	4,567	2,814
TOTAL	**109,492,751**	**23,176**	**4,724**

12.7 This clearly highlights that despite extraordinarily high levels of spending per person per year in some of the rural communities there is a disconnection with public perception which is that Lerwick residents are the best served by the Council.

Inability to Prioritise Capital Expenditure

12.8 If the Council is unable to prioritise its Asset Investment Plan due to a lack of clear asset information from asset management plans, or a lack of political priorities, there is a risk that future Councils will continue to set unaffordable plans for capital investment. This could result in a level of borrowing costs that adversely impacts upon the revenue budget for the services to the public and/or the Council reverts to using its reserves to fund the capital programme which results in the reserves being depleted.

Interest Rate Risk

12.9 If the Council plans on the basis that interest rates will remain low in the long term it could result in a Long Term Asset Investment Plan which becomes unaffordable. It is therefore important that the Council prioritises projects, so that it is clear on which ones would not be delivered if interest rates rise in the future.

Future Pension Liabilities

12.10 As highlighted in Section 8, future pension liabilities are a long term financial risk. If the Council's Pension Fund Investment Strategy does not start to narrow the gap between the pension fund assets and liabilities then there is a risk that the Council will be required to make larger Employer Contributions which would create a cost pressure on the revenue budget.

Long Term UK Economic Growth Rates

12.11 The financial modelling undertaken assumes that there will be a 2% real terms increase in government grant from 2020. If the UK economy is now on a new lower growth trajectory, which many people believe it is, where 1% real terms growth becomes the new average, it will mean more challenging settlements in the future. This is because if the UK Government holds public spending at around 40% of GDP, if the economy only grows 1% in real terms each year, then that means UK Government spending only increases by 1% in real terms each year.

Oil and Gas Income

12.12 The financial modelling that has been undertaken is similar to the Medium Term Financial Plan modelling in that it relies on the surpluses from the Harbour Account and the TOTAL income to fund services each year. The income that will be generated has a high degree of uncertainty because of factors such as the volatility of oil and gas prices, the unknown future levels of throughput through the Sullom Voe Terminal and TOTAL Gas Plant, as well as difficulties in trying to effectively engage with oil industry management around future forecasts. The forecast future cash-flows for the Sella Ness Port in particular are in the £100s of millions which is significant when compared to the size of the local authority as a whole. Therefore, relatively small changes in the oil industry sector and/or the terminal operators' plans could have a material impact on the Council's financial projections which increases the level of risk around financial planning.

Cost Control

12.13 Given the financial challenges that the Council is likely to face in the long term, particularly with regard to capital investment, it is important that general inflation allowances in future budgets are tightly controlled. The Council has a track record of allowing significant cost pressure budgets to be built into budgets which contributed to spending becoming too high. If the Council does not control cost pressures in a tightly managed way there is a risk that expenditure levels start to increase at levels that are not matched by available resources.

Failure to align available resources to service demand

12.14 It is forecast that Shetland is about to undergo a significant change in its age demographic profile over the next 25 years. This will result in a significantly larger proportion of the community's citizens being in the over 65 year old age category, with a reducing proportion of the population being aged 0-16 year old and 17-64 years old. It is likely that this will have an impact upon the levels of demand that the Council experiences for the services that it provides. If the Council fails to recognise and act upon this, by shifting resources from reducing areas of demand to increasing areas of demand, it will result in a significant cost pressure, as the Council will still have a duty to provide services to the areas with increasing demand. Given the scale of the challenge, a lack of shift of existing resources will result in significant new resources being required to meet the new demand in growing service areas. This could mean relying on reserves, which could result in them being depleted in the longer term.

13 Conclusions and Recommendations

The Long Term Financial Plan is an initial attempt to bring together the financial challenges that future Councils are likely to face, and how decisions taken now can impact upon the future.

The Plan sets out a number of recommendations for future pieces of work that will help to strengthen financial management within the organisation, as well as enhance Members' and Officers' understanding of the key financial issues to facilitate good decision-making into the future.

Overall Conclusions

13.1 Whilst the Council has successfully managed to bring its expenditure levels into line with its income, thus operating at a sustainable level, the organisation is not yet positioned to effectively manage the financial challenges in the longer term. This is mainly due to a lack of available information and/or application of information to inform decision-making and a lack of understanding in the relationship between capital and revenue expenditure.

13.2 An asset base has been built up over the past 35 years using oil revenues at a level from which the Council no longer benefits. There appears to have been no longer term thinking about how this asset base could be sustained into the future in light of falling oil revenues.

13.3 There is an estimated funding shortfall of over £200 million over the next 35 years on the level of capital expenditure required to maintain the existing asset base, whilst seeking to retain acceptable levels of revenue expenditure.

13.4 If future Councils continue to make similar financial decisions in the future as those in the past, particularly with regard to capital expenditure, it will become insolvent at some point over the next 30 years (assuming no central government intervention to take control of the Council).

13.5 In order for the Council to remain financially sustainable over the longer term it will have to:

- Reduce the size of its fixed asset base and prioritise future capital investment;
- Keep a tight control over future cost pressure allowances and constrain service growth;
- Ensure that resource allocation decisions reflect the changes in Shetland's demographic profile;
- Seek to increase existing income streams in the longer term, such as Council Tax, as well as creating new income streams (although at present there are no obvious sources available for this); and

- Manage the expectations of the Shetland public as to what is a sustainable level of service provision across Shetland.

13.6 For the Council to make sound financial decisions on its Asset Investment Plan it is critical that it recognises the relationship between capital expenditure and revenue spending. If the Council borrows money to maintain or replace an asset, it is very much like a mortgage in that it results in borrowing costs, and meeting those costs means not spending that money on providing day to day services. So there is a balance to be struck between the quality of the assets provided by the Council and the quality of the service that is provided using those assets.

13.7 There is a significant amount of uncertainty around the future of the Sella Ness Port operation which will need to be addressed. It is important that the Council views its ownership of the Port as a commercial operation instead of like the provision of a service to the public. The purpose of the Council owning the Port and investing in it, is that when it incurs capital expenditure is to make an investment return, the same as the way in which Council funds are invested with fund managers. With that in mind, if the Council is to retain the Port into the future it will need a clear business plan that sets out how it will achieve an investment return at least equal to that generated by the Council's fund managers.

Recommendations

13.8 The work undertaken on the Long Term Financial Plan has resulted in the following recommendations:

Recommendation 1

A Long Term Asset Investment Plan should be developed for the period 2015-2050, which averages £10m of capital expenditure per year over the period. It should be a Council prioritised plan, based on evidence such as condition and suitability of existing assets, service need, and linkages to corporate priorities.

Recommendation 2

Services who are the lead for managing assets must develop robust asset management plans for that asset class (e.g. vehicles, ICT, ferries etc.) that include information on condition, suitability, utilisation (against a policy target) lifespan and future investment requirement on those assets. This will ensure that there is robust information available to assist with the development of the Long Term Asset Investment Plan.

Recommendation 3

The Council should consider the impact of demographic changes in Shetland as part of the process for determining service priorities. Resources should be aligned to the areas where there is growing service demand, with resources taken away from areas with falling demand if the Council is to remain financially sustainable in the long term.

Recommendation 4

Further work should be undertaken on the financial modelling of the Sella Ness Port. Once completed the Council should take a strategic decision regarding whether to retain the Port and run it on commercial lines to make a sufficient investment return, or whether to seek to sell it and invest the sales proceeds with the Council's fund managers.

Recommendation 5

The Council should treat the Council's invested reserves as an Endowment Fund. This policy would mean that the Council would commit to preserving the capital value of the reserves over the lifetime of a Council, by following the Section 95 Officer's assessment as to what a sustainable draw on reserves each year equates to, and living within this limit. This approach would mean that a Council would become a custodian of the oil reserves with a duty to protect their value, rather than viewing them as a short term funding source to meet short term objectives.

Recommendation 6

It is recommended that the Council reviews the long term affordability of continuing to provide Compensatory Added Years in its Early Retirement and Redundancy Scheme.