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Director: Christine Ferguson

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If calling please ask for
Lynne Geddes
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Date: 13 September 2017

Dear Sir/Madam

You are invited to the following meeting:

Special Audit Committee
Council Chamber, Town Hall, Lerwick
Wednesday 20 September 2017 at 10.00am

Apologies for absence should be notified to Lynne Geddes at the above number.

Yours faithfully

Executive Manager – Governance and Law

Chair: Mr A Duncan
Vice-Chair: Ms C Hughson

AGENDA

(a) Hold circular calling the meeting as read.

(b) Apologies for absence, if any.

(c) Declarations of Interest - Members are asked to consider whether they have an interest to declare in relation to any item on the agenda for this meeting. Any Member making a declaration of interest should indicate whether it is a financial or non-financial interest and include some information on the nature of the interest. Advice may be sought from Officers prior to the meeting taking place.

Items

1. Annual Audit Report on the 2016/17 Audit – Shetland Islands Council and Zetland Educational Trust
   F-079

2. Annual Audit Report on the 2016/17 Audit – Shetland Islands Council Pension Fund
   F-080

	Agenda Item
Shetland Islands Council	1

Meeting(s):	Audit Committee Shetland Islands Council	20 September 2017
Report Title:	Annual Audit Report on the 2016/17 Audit – Shetland Islands Council and Zetland Educational Trust	
Reference Number:	F-079-F	
Author / Job Title:	Executive Manager – Finance	

1.0 Decisions / Action required:

1.1 That the Audit Committee:

a) NOTES the findings of the 2016/17 audit as contained in the external auditor's annual report at Appendix 1;

b) NOTES the agreed Action Plan as outlined in the Annual Report;

c) CONSIDERS a verbal report by the external auditor;

d) CONSIDERS the audited Annual Accounts for 2016/17 (Appendix 2) for Shetland Islands Council;

e) CONSIDERS the audited Annual Accounts for 2016/17 (Appendix 3) for Zetland Educational Trust; and

1.2 That Shetland Islands Council RESOLVES to:

a) NOTE the findings of the 2016/17 audit as contained in the external auditor's Annual Report at Appendix 1;

b) APPROVE the agreed Action Plan as outlined in the Annual Report;

c) APPROVE the audited Annual Accounts for 2016/17 (Appendix 2) for Shetland Islands Council for signature; and

d) APPROVE the audited Annual Accounts for 2016/17 (Appendix 3) for Zetland Educational Trust for signature.

2.0 High Level Summary:

2.1 The Local Authority Accounts (Scotland) Regulations 2014 (“the Regulations”) require the Council to prepare and publish annual accounts that are subject to external audit. The Council’s appointed external auditor is Deloitte LLP.

2.2 Section 10 of the Regulations requires the Council to consider any report made by the appointed auditor before deciding whether to sign the audited accounts.

2.3 International Standard on Auditing 260 (ISA 260) requires the external auditors to communicate significant findings from the audit, including:

- the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures;
- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to

correspondence with management;

- written representations requested by the auditor; and
- other matters which in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

2.4 Deloitte LLP's ISA260 findings are included in the Annual Audit Report at Appendix 1 and confirms their unmodified opinion, which means that the annual accounts are free from material misstatement and present a true and fair view of the Council's financial position at 31 March 2017.

2.5 The unaudited accounts for the year to 31 March 2017 were approved by Council on 28 June 2017 and there is no change to the accounting deficit or net assets in the audited annual accounts.

2.6 Deloitte LLP's Annual Audit Report (Appendix 1) includes an Action Plan relating to high and moderate level risks identified during the course of the audit. For 2016/17, only one high level risk has been highlighted, as detailed in paragraph 4.5 below.

2.7 The Annual Audit Report (page 19) also includes findings in relation to the audit of the Trustees' Annual Report and Financial Statements of Zetland Educational Trust. No issues were identified and no changes made to the unaudited statements.

3.0 Corporate Priorities and Joint Working:

3.1 The preparation and presentation of the Audited Annual Accounts is a key element of the Council's overall governance and reporting arrangements.

4.0 Key Issues:

4.1 The Council's accounts for the year to 31 March 2017 were submitted to Deloitte LLP by the statutory deadline of 30 June 2017. The external auditor was required to complete the audit by 30 September 2017 and to report on certain matters arising to those charged with governance.

4.2 The Annual Audit Report (Appendix 1) highlights three significant risk areas that auditors reviewed, as follows:

a) Recognition of grant income;

b) Valuation of property assets; and

c) Management override of controls.

4.3 Pages 13 to 17 of the report at Appendix 1 presents how, in each of these areas, the result of the audit control testing was satisfactory.

4.4 One error of £0.740m was discovered and corrected during the audit, as detailed on page 57 of Appendix 1. This was an overstatement of both Debtors and Creditors and therefore the correction had no impact on the net assets in the Balance Sheet.

4.5 Deloitte LLP present an agreed Action Plan at page 58 of Appendix 1, showing recommended improvements in certain Council processes for governance, compliance and efficiency purposes. These include recommendations that:

a) the Council reconsiders its priorities to ensure better alignment with outcomes;

b) the Council's lease register is reviewed to ensure that all agreements are signed by both parties, with all key terms clearly defined within;

c) processes around property valuations are improved in relation to specific points raised by Deloitte LLP's property specialists;

d) appropriate resources are put in place to ensure the National Fraud Initiative information is acted upon in a timely basis;

e) further supporting information is sought from the external valuer regarding the Council's fishing quota held; and

f) full year transaction listings are reconciled to the trial balance in advance of the audit commencing.

4.6 Only the first point is considered to be high priority by the external auditor.

4.7 As well as reviewing the annual accounts, the scope of the audit includes wider issues, such as governance, transparency and financial sustainability. Some of the key audit findings (detailed in Appendix 1) in these areas are:

- **Financial Sustainability:** The Council is moving in the right direction by placing a primary focus on reducing reliance on reserves, maximising other income streams and generating cost savings.
- **Financial Management:** The budgeting process is detailed and robust. We are satisfied the Council has strong financial monitoring arrangements.
- **Governance and Transparency:** We are satisfied that there are appropriate systems of internal control in place and no significant weaknesses have been identified.

5.0 Exempt and/or confidential information:

5.1 None.

6.0 Implications :

6.1 Service Users, Patients and Communities:	None
6.2 Human Resources and Organisational Development:	None
6.3 Equality, Diversity and Human Rights:	None
6.4 Legal:	The Local Authority Accounts (Scotland) Regulations 2014 require the Council to approve the audited Annual Accounts for signature no later than 30 September each year.
6.5 Finance:	None
6.6 Assets and Property:	None
6.7 ICT and new technologies:	None
6.8 Environmental:	None
6.9 Risk Management:	The Annual Audit Report includes the identification of key risks and internal control arrangements in place to manage those risks, together with any improvement actions required.

6.10 Policy and Delegated Authority:	The remit of the Audit Committee includes consideration of audit matters as well as overseeing and reviewing any action taken in relation to audit activity. The preparation and presentation of the Annual Accounts, is a key element of the Council's overall governance and reporting arrangements.
6.11 Previously considered by:	N/A

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4 September 2017

Appendices:
Appendix 1: Annual Audit Report 2016/17 for Shetland Islands Council (incorporating the Zetland Educational Trust)
Appendix 2: Audited Annual Accounts 2016/17 for Shetland Islands Council
Appendix 3: Audited Trustee's Annual Report and Financial Statements 2016/17 for the Zetland Educational Trust

Background Documents: *The Local Authority Accounts (Scotland) Regulations 2014*

Deloitte.

Shetland Islands Council

Final report to the Members of the Council and the Controller of Audit on the 2016/17 audit

20th September 2017

Contents

Director introduction
The key messages in this report

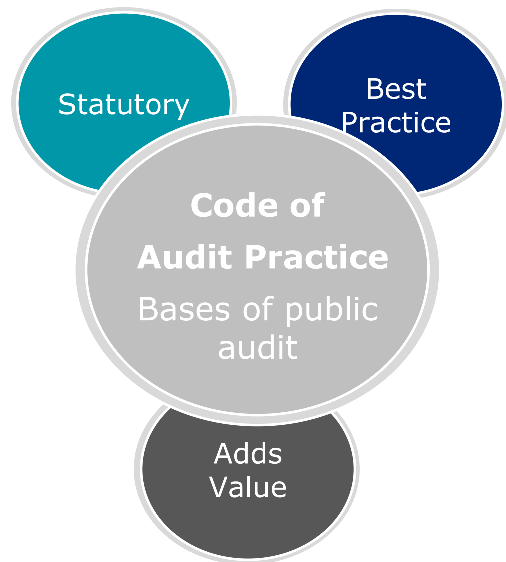
Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

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

I have pleasure in presenting our final report to the Audit Committee for the 2017 audit.

As detailed in our plan presented to the Audit Committee in February 2017, the new Code of Audit Practice, which came into force for the 2016/17 audits, sets out our responsibilities under core audit and wider scope requirements. A reminder of the requirements is set out below.

- *Opinion on the financial statements and regularity*
- *National performance audits and Best Value audits*



- *Opinion on management commentaries, remuneration reports and governance statements*

- *Public reporting and audit findings*
- *Wider scope reporting including Best Value*

Director introduction (continued)

The key messages in this report (continued)

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

Statutory audit	
Conclusions from our testing	• The significant risks, as identified in our audit plan, related to: - Recognition of grant income; - Valuation of property assets; and - Management override of controls. • A summary of our work on the significant risks is provided in the dashboard on page 11. • We have identified one audit adjustment from our procedures to date which has been adjusted for by management. This is detailed in the appendices. • Based on the current status of our audit work, we envisage issuing an unmodified audit opinion. • Our audit of Zetland Educational Trust is also complete, with an unmodified audit opinion.
Insight	• We have utilised Spotlight, Deloitte's patented analytics tool, to perform analytics on the journal entries posted in the year as part of our journal entry testing. • A number of additional insights have been identified throughout the audit procedures performed with reference to property valuations, fishing quota valuations and journal entry testing. These have been noted in the Action Plan as an appendix for management consideration.
Status of the audit	• The audit is substantially complete subject to the completion of the following principal matters: • Finalisation of short-term debtors substantive testing; • Finalisation of grants credited to services substantive testing; • Audit of WGA; • Finalisation of our internal quality control procedures; • Receipt of signed management representation letter; and • Our review of events since 31 March 2017.

Director introduction (continued)
The key messages in this report (continued)

Best Practice	

Overall conclusion	• We have reviewed the management commentary with reference to the statutory guidance set out in Regulation 8(2) of The Local Authority Accounts (Scotland) Regulation 2014 and Finance circular 5/2015 The Local Authority Accounts (Scotland) Regulations 2014 – management commentary. We have confirmed that the management commentary complies with the statutory guidance requiring local authorities to include in the management commentary those matters which companies are required to disclose in a strategic report, with some modification to interpret for local authorities.
	
	• As a new requirement in 2016/17, we are required to provide an opinion on whether:
	  • information given in the management commentary is consistent with the financial statements;
	  • the management commentary has been prepared in accordance with the statutory guidance;
	  • information given in the annual governance statement is consistent with the financial statements; and
	  • the annual governance statement has been prepared in accordance with proper practice.
	
	• Based on the current status of our audit work, we envisage issuing unmodified opinions on the above.
	
	• In addition to the opinion, we have read the management commentary and confirmed that the information contained is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading.
	
	• We have also audited the auditable parts of the remuneration report and confirmed that it has been prepared in accordance with the Regulation 8(2) of The Local Authority Accounts (Scotland) Regulation 2014.
	
	• We note that the Council makes some use of graphs, however, there is scope for this to be expanded in line with best practice to help the users understanding of the accounts.

Director introduction (continued)
The key messages in this report (continued)

Adds Value	
Financial Sustainability	Net expenditure on services of £112,901k was incurred in 2016/17, down 6% from £120,695k in 2015/16 largely as a result of an increase of £10,449k in Harbour Account net income. Overall, an underspend was reported against budget, with a net draw down on reserves of £5.751 million compared to a budgeted draw down of £16.329 million. This was achieved through underspends across revenue and capital. Financial balance has been forecasted for the short to medium term future and is expected. However an increasing reliance has been placed on General Fund and HRA reserves in recent years which is unsustainable going forward. Reducing General Fund drawdowns has been identified as the primary focus for the Council in the short to medium term. Annual drawdowns have been identified by Council management as unsustainable in the medium to long term, and as of 2018/19 there is a forecasted budget gap of £6,840k in the year, which is forecasted to increase to £19,461k by 2021/22. Amongst the other significant challenges facing the Council is the decreasing Scottish Government grant funding and increasing inflationary pressures on costs. The Council intends to address its overreliance on reserves by placing more focus on increasing Harbour Account and investment income, and by continuing to generate efficiencies in service delivery costs. Increasing council tax rates (for the first time since 2007) by 3% is another mechanism utilised by the Council to reduce reliance on reserves going forward. Given the size of the projected budget gaps facing the Council, and the past reliance and planned short-term future reliance on reserves (£12,024k drawdown forecasted in 2017/18), the Council will continue to rely on reserves in the medium term. However, over the longer term the Council plans to maximise other income streams and identify cost savings to fill the gap, with less reliance on reserves. Whilst the pace of change may fall short of the Council’s targets, it is our view that the Council is moving in the right direction by placing a primary focus on reducing reliance on reserves, maximising other income streams and generating service costs savings.

Director introduction (continued)

The key messages in this report (continued)

Adds Value	
Financial Management	Budgets have been relatively accurate in recent years, aided by contingencies in place within the short term budgets to protect against unplanned overspends. The budgeting process in place is detailed and robust. Service line budgets are approved at Directorate and Council level, and the Council prepares detailed short, medium and long term financial plans addressing income and cost challenges faced. Alternative solutions are evaluated to overcome funding gaps identified to be addressed at a later point. The incremental budgeting approach helps give efficiency targets credibility and aids a targeted priority-based approach in line with the Council’s strategic priorities. Internal Audit reports produced throughout the year did not raise any significant points from a management or audit perspective, and on the basis of our substantive procedures performed and assessment of the control environment we are satisfied with the financial management processes in place. We have found that whilst the Council has appropriate arrangements in place for the prevention and detection of fraud and corruption, the level of active participation in the National Fraud Initiative could improve through more appropriate prioritisation and resource allocation going forward. We understand that this is currently being addressed.

Director introduction (continued)

The key messages in this report (continued)

Adds Value	
Governance and transparency	Shetland Islands Council has governance arrangements that are appropriate and operating effectively. The Council is transparent in its decision making with reports discussed at committee meetings being made available on-line along with the minutes. Council Committees meet regularly to review the performance (financial and non-financial) of Shetland Islands Council. From review of committee meeting minutes, we are satisfied there is scrutiny and challenge by both elected members and management of Shetland Islands Council. From our attendance at Audit Committee meetings we have observed a good level of challenge and scrutiny by members and we are satisfied the Audit Committee is effective. The Audit Committee provides assurance to the Council on corporate governance and financial probity. From review of committee meeting minutes, we are satisfied the Audit Committee meets regularly to provide appropriate assurance to the Council. Internal Audit provides independent assurance to elected members and management that effective governance and internal control arrangements are in place across the Council. The internal audit plan for the year is agreed by the Audit Committee, with the aim of providing assurance over the adequacy, efficiency and effectiveness of the local governance, risk management and internal control framework. From review of internal audit reports in the year, we are satisfied internal audit provides effective, independent assurance.
Value for money	We have focussed primarily on assessing the Council's strategic and long-term priorities as well as its public performance reporting. We have found that whilst the processes in place for long-term planning are effective, the Council should set out clear medium term strategic priorities that have buy-in from local community partners. With regards to performance reporting, the Council has improved substantially on its weakest areas in recent years in particular Childrens' services and Environmental indicators, and we will continue to assess the Council's approach over the next 5 years. Additionally, we have considered the adequacy of the Council's arrangements for collecting, recording and publishing accurate and complete information in relation to the Statutory Performance Indicators and noted no significant issues.

Director introduction (continued)

The key messages in this report (continued)

Adds Value	
Strategic Audit Priorities	As part of our best value work, we have considered the five Strategic Audit Priorities agreed by the Accounts Commission and have undertaken a baseline analysis of the Council's arrangements in relation to these priorities. There is an element of cross-over between the Strategic Audit Priorities and the wider areas of financial sustainability and value for money. We have primarily focused on gaining an understanding of the Council's arrangements for demonstrating best value in financial and service planning, financial governance (as detailed in the wider scope work), resource management and its plans for transformation moving forward. We reviewed the Council Plan 2016–2020 and the Shetland Islands Community Planning Partnership (CPP) Local Outcome Improvement Plan (LOIP), which sets out how the Council and its partners will work together to provide better services with the aim of making sure that Shetland is the best place to live and work for the people and communities that live there. The number of different sets of outcomes, priorities and aims set out in the Council's plans create an unclear picture of where exactly the Council intends to focus in the medium term. We have suggested that the Council should consider adopting a single overarching vision shared by both the Council and community partners which is supported by a single high level set of priorities/aims in order to simplify this landscape, with KPIs that clearly link to these key priorities and measure improvement in outcomes. The Council have identified embracing new technology as a means of revolutionising how public services support everyone who lives and works in the Shetland community. The strategy for this shift towards more digitally focussed service delivery is outlined in the Council's Business Transformation Programme (BTP). Recognising that the BTP alone cannot deliver whole scale change, the Council have identified a programme of transformation change projects grouped under key workstreams. The Council is at the early stage of considering the BTP and the transformational projects required to allow it to achieve the recurring revenue reductions to maintain the sustainability of its services. This will be a key area that we will monitor over the course of the audit appointment, including how the Council ensure that projects deliver on time, on budget and most importantly, deliver the expected benefits for the citizens of Shetland.

Director introduction (continued)

The key messages in this report (continued)

Adds Value	
Strategic Audit Priorities	We reviewed the Council's arrangements for ensuring that Members and officers have the right knowledge, skills and time to lead and manage delivery of the Council priorities. We found that Shetland place a great deal of importance of building up strong relationships with Members and this was illustrated in the comprehensive induction programme. We will review how the needs of Members and officers are taken into consideration as the Council implements its BTP up to 2020. We would also expect to see the Members playing a very active role in the transformation and the Council will need to ensure it has the transformational infrastructure in place, including Programme Management Office (PMO), benefits realisation tools and templates and an effective change management strategy to deliver this transformational change. We reviewed how the Council engages with its citizens and we are satisfied that it places strong emphasis on encouraging community participation in Council decision making and has an aspiration that 1% of the Council's budget should be decided through Participatory Budgeting initiatives in the longer term . We will monitor how the Council will ensure that this current engagement approach plays a more significant part in making funding decisions moving forward and we would wish to see clear evidence of engagement directly impacting on Council strategy through the upcoming transformation of Council services through the implementation of the BTP and Service Redesign Programme.

Pat Kenny
Audit Director

Responsibilities of the Audit Committee

Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Audit Committee:

- Clearly communicate the planned scope of the financial statements audit
- Provide timely observations arising from the audit that are significant and relevant to the Audit Committee's responsibility to oversee the financial reporting process
- In addition, we seek to provide the Audit Committee with additional information to help them fulfil their broader responsibilities

As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of Audit Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit Committee in fulfilling its remit.

Oversight of external audit

- At the start of each annual audit cycle, ensure that the scope of the external audit is appropriate.

- Implement a policy on the engagement of the external auditor to supply non-audit services.

Integrity of reporting

- Impact assessment of key judgements and level of management challenge.

- Review of external audit findings, key judgements, level of misstatements.

- Assess the quality of the internal team, their incentives and the need for supplementary skillsets.

- Assess the completeness of disclosures, including consistency with disclosures on business model and strategy and, where requested by the Council, provide advice in respect of the fair, balanced and understandable statement.

Internal controls and risks

- Review the internal control and risk management systems (unless expressly addressed by separate risk committee).

- Explain what actions have been, or are being taken to remedy any significant failings or weaknesses.

Oversight of internal audit

- Consider annually whether there is a need for an internal audit function and make a recommendation accordingly to the Council.

- Monitor and review the effectiveness of the internal audit activities.

Whistle-blowing and fraud

- Ensure that appropriate arrangements are in place for the proportionate and independent investigation of any concerns that are raised by staff in connection with improprieties.

Our audit explained

Area dimensions

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

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

We have also considered the Strategic Audit Priorities set by Audit Scotland as well as covering the Best Value audit work.

Significant risks

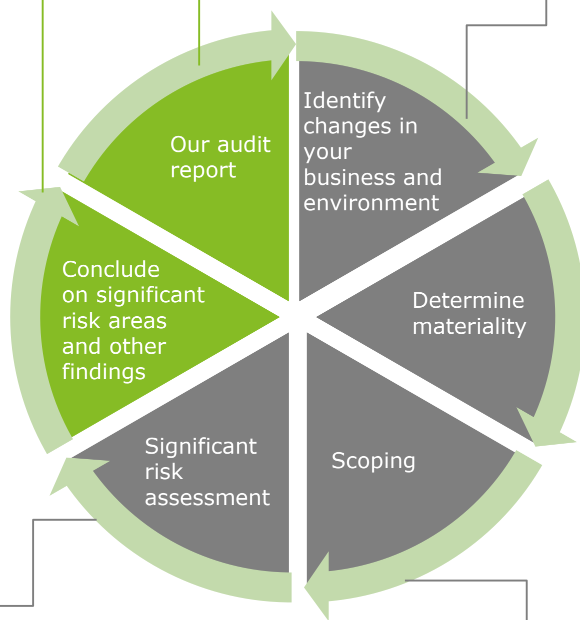
Our risk assessment process is a continuous cycle throughout the year. Page 11 provides a summary of our risk assessment of your significant risks.

Quality and Independence

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

Final audit report

In this report we have concluded on the audit risks identified in our planning report and any other key findings from the audit.



Key developments in your business

As noted in our planning report, the Council continued to face significant financial challenges due to an increase in costs whilst facing increased demand for services, and at the same time facing decreasing Scottish Government funding.

The integration of health and social care continued to be a challenge.

Materiality

The materiality of £3,028k and performance materiality of £2,271k has been based on the benchmark of gross expenditure.

We have used these as the basis for our scoping exercise and initial risk assessment. We have reported to you all uncorrected misstatements greater than £150k. These figures have changed only marginally from those identified in the planning paper as a result of final numbers.

Scope of the audit

We have audited the financial statements for the year ended 31 March 2017 of Shetland Islands Council.

Timeline 2017

November 2016 – February 2017
Meetings with management and other staff to understand the processes and controls.

9 February 2017
Presented planning paper to the Audit Committee

March 2017
Year end

July – August 2017
Review of draft accounts, testing of significant risk and performance of substantive testing of results.

22 August 2017
Audit close meeting

20 September 2017
Audit committee meeting

20 September 2017
Accounts sign off

Significant risks
Dashboard

Risk	Material?	Fraud risk identified?	Planned approach to controls testing	Controls testing conclusion	Consistency of judgements with Deloitte's expectations	Comments	Slide no.
Recognition of grant income	✓	✓	D+I	Satisfactory	●	Satisfactory	12
Valuation of property assets	✓	✗	D+I	Satisfactory	●	Satisfactory	13
Management override of controls	✓	✓	D+I	Satisfactory	●	Satisfactory	15

Overly prudent, likely to lead to future credit

Overly optimistic, likely to lead to future debit.

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

Significant risks (continued)
Recognition of grant income

Risk identified

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

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

Key judgements and our challenge of them

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

Deloitte response

We have performed the following:

- assessed management's controls around recognition of grant income; and
- tested a sample of capital grants and contributions and grant income credited to Service Income and confirmed these have been recognised in accordance with any conditions applicable.

Type of income	2016/17 (£m)	Significant risk
Taxation and Non-Specific Grant Income		
Council Tax income	8.5	
Non domestic rates	17.8	
Revenue support grant	64.5	
Capital grants and contributions	4.8	✓
Service Income		
Grant income (including Housing Benefit)	9.5	✓
Housing rent	6.8	
Trading services (Harbours)	28.9	
IJB Commission income	20.4	
Other Service Income	30.4	

Deloitte view

We have concluded that grant income has been recognised correctly in accordance with the requirements of the Local Authority Code of Audit Practice. Our testing of service income is ongoing.

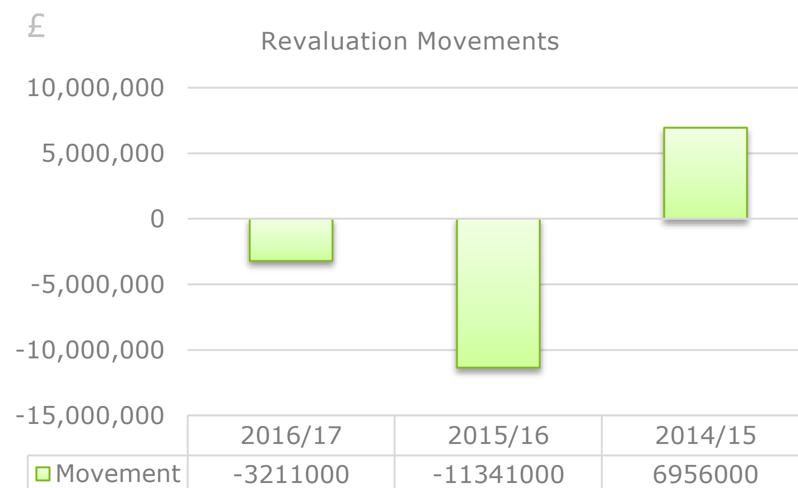
Significant risks (continued)
Valuation of property assets

Risk identified
The Council is required to hold property assets within Property, Plant and Equipment at a modern equivalent use valuation, with the exception of Council Dwellings which are required to be measured at existing use value – social housing. The valuations are by nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value.

Key judgements and our challenge of them

The Council held £201,622k of property assets at 31 March 2017. The financial year to 31 March 2017 will represent year 5 of a 5 year rolling programme in which 20% of the portfolio will be revalued along with 100% of Council dwellings.

The most significant movement (£4,377k) arose in the revaluation of the old Anderson High School, as would be expected given the replacement school being built. Deloitte understand a consultation on potential uses for the old Anderson High School is to be undertaken.



Significant risks (continued)
Valuation of property assets (continued)

Deloitte response

- We reviewed the revaluations performed in the year and assessed whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified independent individuals;
- We tested a sample of revalued assets and re-performed the calculation assessing whether the movement has been recorded through the correct line of the accounts;
- We reviewed the information that was provided to the valuer and tested the inputs to ensure that these were complete and included all Council property assets due for revaluation;
- We considered material changes in assets not subject to full revaluation during the year;
- We considered assets classified as surplus or held for sale to assess whether these have been valued and disclosed in line with IFRS; and
- We involved the use of our internal property specialists to review and challenge the assumptions and methodology adopted by the Council's internal valuation specialists, including sample testing of inputs to the valuation.

Deloitte view

We have concluded that the NBV of the land and buildings included within Property Plant and Equipment is not materially misstated. The Council's valuation assumptions are generally in line with other Councils and fall within the expected range as assessed by Deloitte Real Estate (DRE).

We understand that the Council is currently in the process of revising its approach to its revaluation procedures. A number of insights have been raised by DRE within their report as areas where the revaluation process could be more efficient and effective. A meeting has been held with both the finance and estates team to discuss the findings in detail and have agreed to take forward the recommendations.

Significant risks (continued)
Management override of controls

Risk identified
International Standards on Auditing requires auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports.

Deloitte view
- We have not identified any significant bias in the key judgements made by management.
- The control environment is appropriate for the size and complexity of the Council.

Deloitte response
We have considered the overall sensitivity of judgements made in preparation of the financial statements, and note that:
- Management judgements, with regard to manual journal postings, accounting estimates and uncertainties, do not show management bias or undue favourable subjectivity.
- Senior management's remuneration is not tied to particular financial results.

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

Journals
We have made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.
We have used Spotlight data analytics tools to test a sample of journals, based upon identification of items of potential audit interest. Our analysis covered the 1,216,653 journals posted in the year. No issues noted from our testing.

We have recommended that the full journal entry listing should be reconciled to the trial balance used to generate the financial statements to ensure completeness.

Accounting estimates
In addition to our work on key accounting estimates discussed above, our retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements completed with no issues noted.

We have recommended that management obtain further information to support the valuation provided in relation to fishing quotas to ensure that this is based on robust judgements.

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

Other matters
Defined benefits pension scheme

Background
The Council participates in two defined benefits schemes:

- Scottish Teachers' Pension Scheme, administered by the Scottish Government; and
- The Local Government Pension Scheme.

The net pension liability has increased from £143,129k in 2015/16 to £229,675k in 2016/17 largely as a result of an decrease in the discount rates applied, compounded by a slight increase in some inflation adjustments.

Deloitte response

- We obtained a copy of the actuarial report produced by Hymans Robertson, the scheme actuary, and agreed in the disclosures to notes in the accounts;
- We reviewed and challenged the assumptions made by Hymans Robertson;
- We assessed the reasonableness of the Council's share of the total assets of the scheme with the draft Pension Fund financial statements;
- We reviewed the disclosures within the accounts against the Code;
- We assessed the independence and expertise of the actuary supporting the basis of reliance upon their work; and
- We liaised with our in-house actuary regarding their assessment of the key assumptions.

	Council	Benchmark	Comments
Discount rate - LGPS	2.60%	2.55%	Reasonable
Retail Price Index (RPI) Inflation rate (% p.a.)	3.40%	3.20%	Reasonable, slightly prudent
Consumer Price Index (CPI) Inflation rate (% p.a.)	2.4%	2.2%	Reasonable, slightly prudent
Salary increase (over CPI inflation)	1.00%	Council specific	Optimistic
Pension increase in payment (% p.a.)	2.4%	2.2%	Reasonable, slightly prudent
Pension increase in deferment (% p.a.)	2.40	2.20	Reasonable, slightly prudent
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 65)	22.80	21.20	Reasonable
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 45)	24.90	23.00	Reasonable

Deloitte view
We have reviewed the assumptions and, overall, the set of assumptions is reasonable albeit prudent when compared with the Deloitte benchmarks. The assumptions have been set in accordance with generally accepted actuarial principles and are compliant with the accounting standard requirements of IAS19.

Other matters (continued)
Zetland Educational Trust

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

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

Deloitte response

We have assessed that the statement of receipts and payments and the statement of balances have been prepared in accordance with the Charities Accounts (Scotland) Regulations 2006 (the 2006 regulations). No issues have been noted.

	2016/17 £'000	2015/16 £'000
Statement of Receipts and Payment		
Total receipts	4	5
Total payments	2	2
Surplus for year	2	3
Statement of Balances		
Cash and bank	7	11
Market valuation of investments	660	655
Trust balance	667	666

Deloitte view
No issues noted from our testing of the charitable trust accounts in the year, which were found to be correctly accounted for in accordance with the Regulations.

Other significant findings
Internal control and risk management

ISA 315.12 (UK and Ireland) requires we obtain an understanding of internal control relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit. We do not test those controls we do not consider relevant to the audit. Below we provide a view, based on our audit procedures, on the effectiveness of your system of internal control relevant to the audit risks that we have identified.

Effectiveness of the process undertaken by the Council to assess and monitor the control environment and support their statement in the annual report that they have undertaken a robust assessment of the principal risks.

Our assessment of the internal audit function taking into account its scope and remit, independence, reporting lines and resourcing.

While the property valuations are not materially misstated in 2016/17, a number of procedural points need to be addressed to ensure that future year valuations are prepared on a robust basis.

Requires significant improvement

Acceptable but could be improved

No issues noted

Consideration of 'tone at the top' and importance given to internal control/ risk management by the Council, particularly in light of the new UK Corporate Governance Code requirement to monitor all material controls.

Deloitte view

In our view, the quality of papers prepared by management in support of key judgements are detailed enough and justify the choices made by management.

Other significant findings (continued)
Insights delivered (continued)

We welcome this opportunity to set out for the Audit Committee our observations from our substantive audit procedures. Below are other insights we have identified from our audit.

Insight	Deloitte response
From our property specialists review of the valuations performed in the year, a number of recommendations have been made in relation to the valuation process. A meeting has been held with both the finance and estates team of the Council to discuss the findings in detail and they have agreed to take forward the recommendations.	Following the meeting held in July, we have provided a comprehensive list of the points raised for management to action as a result of our audit work on the property valuations. These have not been repeated in full below however the key points noted are: • Duplicate of effort in valuations should be avoided and valuations should only be carried out after improvements/additions have been made, not both before and after. • The summary valuation is very basic. This should be more detailed and give further disclosure on the valuation considerations made. • Valuation of specialised assets should reflect Modern Equivalent Asset (MEA) considerations. • Valuer's consideration of obsolescence allowances should included functional and economic obsolescence, as well as age and condition of the assets.

Your annual report

We welcome this opportunity to set out for the Audit Committee our observations on the annual report. We are required to provide an opinion on the remuneration report, the annual governance statement and whether the management commentary has been prepared in accordance with the statutory guidance.

	Draft Annual Report	Deloitte response
Management Commentary	The Management Commentary comments on financial performance, strategy and performance review and targets. Deloitte note that the Management Commentary has been prepared in line with issued guidance. The commentary included both financial and non financial KPIs and made some use of graphs and diagrams. The council also focusses on the strategic planning context.	We have assessed whether the management commentary has been prepared in accordance with the statutory guidance. No exceptions were noted. We have also read the management commentary and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading. We note that the Council makes some use of graphs, however, there is scope for this to be expanded in line with best practice to help the users understanding of the accounts.
Remuneration Report	The remuneration report has been prepared in accordance with the 2014 Regulations, disclosing the remuneration and pension benefits of Senior Councillors and Senior Employees of the Council.	We have audited the disclosures of remuneration and pension benefit, pay bands, and exit packages and confirmed that they have been properly prepared in accordance with the regulations. No exceptions were noted.
Annual Governance Statement	The Annual Governance Statement reports that the Shetland Islands Council governance arrangements provide assurance, are adequate and are operating effectively.	We have assessed whether the information given in the Annual Governance Statement is consistent with the financial statements and has been prepared in accordance with the accounts direction. No exceptions were noted.

Wider scope requirements
Financial sustainability

Audit dimension

As part of the annual audit of the financial statements, we have considered the appropriateness of the use of the going concern basis of accounting. Going concern is a relatively short-term concept looking forward 12 to 18 months from the end of the financial year. Financial sustainability interprets the requirements and looks forward to the medium (two to five years) and longer term (longer than five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Areas considered

- The financial planning systems in place across the shorter and longer terms
- The arrangements to address any identified funding gaps
- The affordability and effectiveness of funding and investment decisions made

Deloitte response

We have monitored the Council's actions in respect of its short, medium and longer term financial plans to assess whether short term financial balance can be achieved, whether there is a long-term (5-10 years) financial strategy and if investment is effective.

As set out on pages 35 to 48, as part of our best value work and consideration of the Strategic Audit Priorities, we have also assess the Council's performance in undertaking transformational change, reliance on reserves and achievement of savings targets.

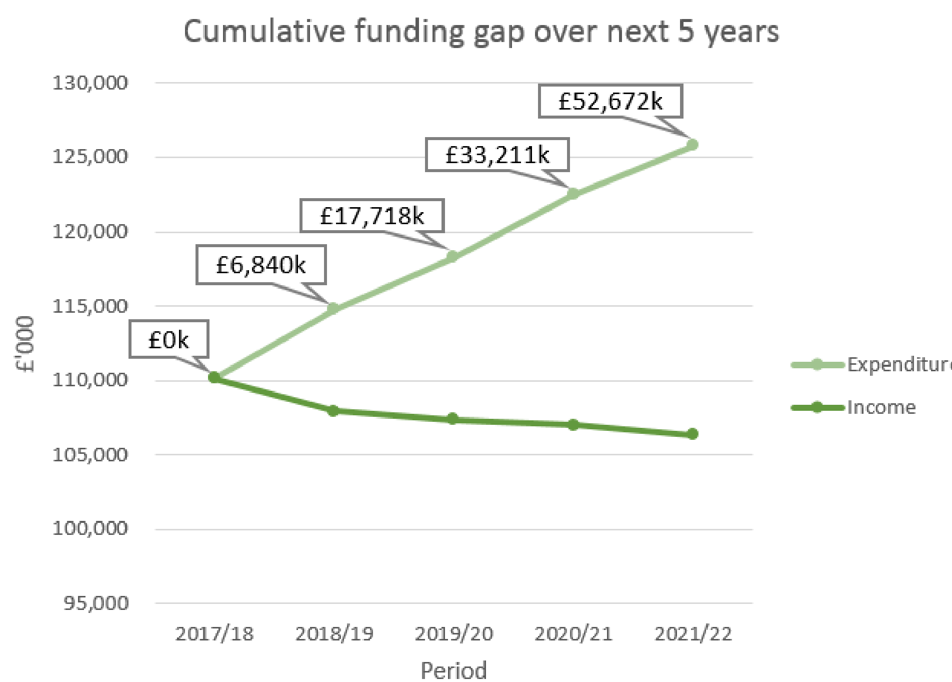
Wider scope requirements (continued)
Financial sustainability (continued)

Revenue budget

The approved **2017/18** budget shows net expenditure in the year of £110,136k which incorporates £3,187k in savings as part of the concerted effort to reduce reliance on General Fund drawdowns. A number of risks have been identified by the Council when compiling the budget, including, in particular, the threat to the current levels of Scottish Government funding and inflationary pressures on cost (salary costs in particular).

As part of developing this budget, the Council has established a Medium Term Financial Plan (MTFP) reflecting the Council's Strategic Priorities. The MTFP represents a more collaborative approach to financial planning across Services and a more structured view of the revenue and capital budgets and Council reserves, allowing the Council to plan the full financial impact of decisions taken now on future years' budgets. Draft annual budgets have been prepared up until 2021/22 as part of the MTFP showing that in 5 years' time the cumulative funding gap could reach £52,672k if the key risks to financial sustainability are not addressed.

A Long Term Financial Plan (LTFP) has also been established covering the period 2015-2050. This considers pressures on funding and costs at a much higher level, with key focus on the potential to maximise Council Tax Income and the increasing inflationary pressures on costs. Despite being relatively high level, it is much more detailed and considered than similar LTFPs produced at other Councils.



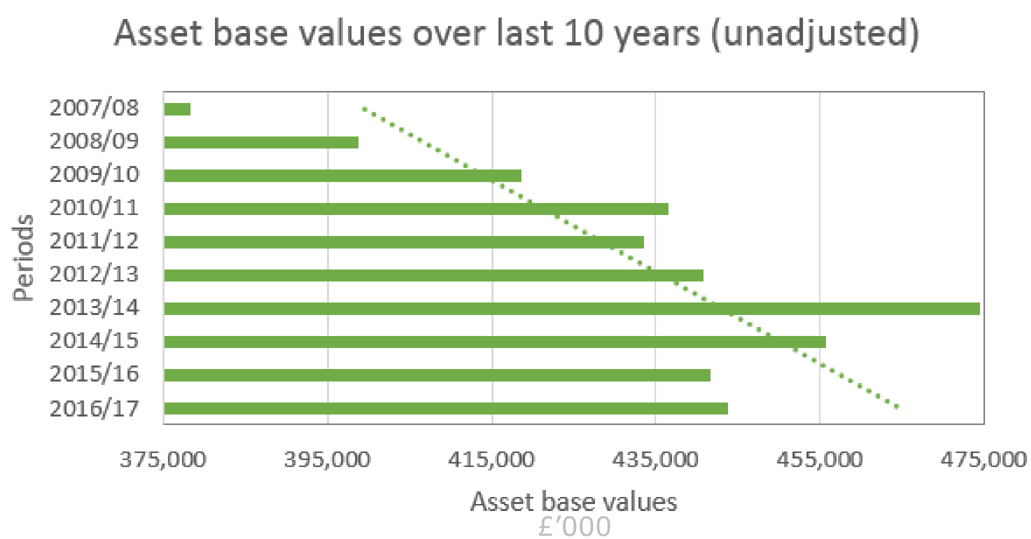
Wider scope requirements (continued)
Financial sustainability (continued)

Capital budget

A five year investment plan initiated at the start of 2016 showed an investment allocation of £73,768k to be spent over the five year period. This investment plan is funded largely by the Scottish Government capital grant with some partially funded by borrowings.

There has been a recognition within the MTFP that whilst the Council has historically viewed investment funded by reserves as a "free resource", greater focus is now being placed on the opportunity cost of this investment. Given the forecasted budget gaps and the need to address overreliance on reserves, the long term investment return sacrificed by investing reserves into capital expenditure is considered before any investments are made.

The LTFP has highlighted the burden carried by the Council as a result of its inflated asset base. The cost value of fixed assets held at the end of 2016/17 is £433,835k – this asset portfolio has expanded without due consideration given as to how it will be maintained in the medium to long term. The Council has a long term aim of shedding excess asset holdings. By reducing its asset base it will reduce maintenance/service costs and therefore reduce the pressure put on capital grant and reserve funding. This focus on reducing excessive capital spend and shrinking the asset base is part of the concerted effort to relieve the pressure on reserve funding.



Wider scope requirements (continued)
Financial sustainability (continued)

Reserves

The Council's Usable Reserves balance has increased by £2.196 million in the year to £244.425 million at 31 March 2017. This has been achieved mainly as a result of the underspend against budget of £10.6 million (as discussed on page 27).

Further consideration of the Council's reserves is discussed on page 39.

Deloitte view

As discussed further on pages 37 to 40, The Council has a clear process in place for long term financial and medium term planning that is undertaken on annual basis and ensure that the financial plan links to the Council's vision and priorities.

Given the Council's starting level of reserves, the planned use of reserves to meet the funding gap over the next 2 financial years is sustainable, however, going forward, the Council should ensure that such an approach is taken only in exceptional circumstances to avoid reducing revenue generation from long-term investments.

The Council has achieved significant savings over the last 6 years however due to increasing demand for services and the continuing restraint in relation to Council funding settlements, it will have to consider how it can transform service delivery through its Business Transformation Plan (2016-2020) in order to continue to meet citizen needs with reducing budgets.

Wider scope requirements (continued)
Financial management

Audit dimension

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

Areas considered

- Systems of internal control
- Budgetary control system
- Financial capacity and skills
- Arrangements for the prevention and detection of fraud

Deloitte response

We have review the budget and monitoring reporting to the Council during the year to assess whether financial management and budget setting is effective.

Our fraud responsibilities and representations are detailed on pages 21 and 22.

	Budget	Actual	Variance
	£'000	**£'000**	**£'000**
General Fund			
Expenditure	113,482	108,070	5,412
Core Funding	(91,200)	(91,237)	37
Funding from Reserves (A)	(22,282)	(16,833)	(5,449)
Harbour Account			
Expenditure	18,331	16,748	1,583
Core Funding	(29,356)	(28,866)	(490)
Funding from Reserves (A)	11,025	12,118	(1,093)
Housing Revenue Account			
Expenditure	6,042	4,704	1,338
Total Income	(6,946)	(6,771)	(175)
Contribution to Housing Repairs and Renewals Fund (A)	904	2,067	(1,163)
Total Revenue Draw Down (A)	**(10,353)**	**(2,648)**	**(7,705)**

The final outturn for 2016/17 was a £2.648m draw down on reserves, compared to a budgeted draw down of £10.353m. This, together with the draw down for capital expenditure resulted in overall draw down on reserves of £5.751m compared to a budget of £16.329m. This has been achieved through a combination of reduced service spending, particularly in relation to overall staffing costs, and increased income, in particular from economic development investments and recharges to other Council accounts. Both the Harbour Account and the Housing Revenue Accounts also exceeded the budgeted contributions through a combination of reduced spending, particularly in relation to the funding of capital expenditure from revenue and from increased income, an example being additional income received through the Shetland Gas Plant agreement.

Wider scope requirements (continued)
Financial management (continued)

Capital expenditure

A final capital expenditure outturn of £20.9 million was reported against a budget of £31.7 million. The underspend has arisen due to underspends on the halls of residence and Clickimin works due to payments not being drawn down as fast as originally anticipated (£5.1m) and on the Replacement Eric Gray Project due to work commencing on site later than planned (£2m). There were also underspends and tendering delays on Ports and Harbours Operations projects (£2.1m)

The key focus has been on maintaining the current asset base without expanding – this is in line with the long term strategic priority to prevent the asset base from bloating further, and to eventually reduce the asset base and thereby reduce associated service costs. The only significant addition in the year is the investment in the ongoing construction of Anderson High School.

Deloitte view

We have noted that whilst medium to long term financial targets set by the Council appear ambitious, short term budgets have been relatively accurate. Variances incurred are commonly the result of approved reallocations between capital and revenue spend, and short term funding gaps have been identified and addressed. We are satisfied the Council has strong financial monitoring arrangements which is robust enough to sufficiently capture any changes in the achievement of financial targets.

We have reviewed internal audit reports issued in the year. From this and from our testing throughout the audit we are satisfied that the Council has adequate systems of internal controls in place.

We have found that whilst the Council has appropriate arrangements in place for the prevention and detection of fraud and corruption, the level of active participation in the National Fraud Initiative could improve through more appropriate prioritisation and resource allocation going forward. We understand that this is currently being addressed.

Wider scope requirements (continued)
Governance and transparency

Audit dimension

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

Areas considered

- Governance arrangements
- Scrutiny, challenge and transparency on decision making and financial and performance reports
- Quality and timeliness of financial and performance reporting

Deloitte response

We have reviewed the financial and performance reporting to the Council during the year and noted no issues with the quality and timeliness of these reports.

We have reviewed the minutes of all Committee meetings to assess the effectiveness of the governance arrangements and the level of scrutiny and challenge. Our attending at the Audit Committees has also informed our work in this area.

We have reviewed the governance of the Medium Term Financial Plan and the benefit realisation process.

We have review the current arrangements and plans in relation to the IJB as it develops, sharing best practice.

Wider scope requirements (continued)

Governance and transparency (continued)

Internal Audit

The Council's Internal Audit function has independent responsibility for examining, evaluating and reporting on the adequacy of internal controls. During the year, we have reviewed all internal audits presented to the Audit Committee and the conclusions have helped inform our audit work, although no specific reliance has been placed on the work of internal audit.

The Public Sector Internal Audit Standards require that the Senior Manager (Internal Audit, Risk and Fraud) develops a Quality Assurance and Improvement Programme (QAIP). The purpose of this QAIP is to enable evaluation of the Internal Audit team's conformance with the Standards.

The Scottish Local Authorities Chief Internal Auditors' Group (SLACIAG) has developed an External Quality Assessment Framework to satisfy this requirement for five yearly external assessment.

We have found that during the year Internal Audit raised numerous non-significant findings across various service lines on areas such as expenditure, data security and reporting, as well as suggesting remedies. Deloitte will continue to assess whether issues raised in these reports are acted upon by the service lines involved.

Following the public pound

The statutory requirements to comply with the Following the Public Pound Code, in conjunction with the wider statutory duty to ensure Best Value, means that Councils should have appropriate arrangements to approve, monitor and hold third parties accountable for public funding provided to them.

We have considered the appropriateness of the Council's arrangements to meet their obligations to comply with the Code as part of our 'Value for Money' wider scope considerations.

Deloitte view

We confirm that we have reviewed the Council's governance and transparency arrangements and have identified no issues in this regard.

- From our review of the internal audit plan for 2016/17 and audit reports, we are satisfied that there are appropriate systems of internal control in place and no significant weaknesses have been identified. Appropriate disclosure has been made in the annual governance statement of issues identified from the work of internal audit and action being taken.
- We are comfortable with the fraud arrangements in place and confirm we have not been made aware of any financially significant frauds in the year.
- We have identified no issues with regard to the arrangements for maintaining standards of conduct and the prevention and detection of corruption.

Wider scope requirements (continued)
Value for money

Audit dimension

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

Areas considered

- Value for money in the use of resources
- Link between money spent and outputs and the outcomes delivered
- Improvement of outcomes
- Focus on and pace of improvement

Deloitte response

We have gained an understanding of the Council's self-evaluation arrangements to assess how it demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.

We have also considered the arrangements the Council has in place to monitor how it is achieving its targets and addressing areas of poor performance.

Performance management

The Council uses performance indicators to measure how they are doing. These are linked into groups indicators and local indicators (outlined in service delivery plans, statutory indicators and LOIP indicators).

We have considered this further as part of our work on the Strategic Audit Priorities at pages 45.

Deloitte view

There is a framework in place to ensure that Council performance is monitored and reported.

Performance information is readily available to Shetland citizens and the use of infographics allows this information to be presented in a way that is visually interesting.

We are satisfied that the performance is appropriately discussed within the Management Commentary in the Annual Accounts and management have introduced plans to address areas where progress has not been satisfactory.

Wider scope requirements (continued)

Value for money (continued)

Statutory performance indicators

The **Local Government Act 1992** lays a duty upon each council to ensure that it has in place such arrangements for collecting, recording and publishing performance information that will allow it to comply with a Direction from the Commission.

The appointed auditor's statutory duty in relation to the performance information is set out in the **Local Government (Scotland) Act 1973.** The auditor's duty is to be satisfied that the council "*has made adequate arrangements for collecting and recording information, and for publishing it as required for the performance of their duties".*

At its meeting in June 2015 the Commission agreed that its 2015 SPI direction needed to reflect the Commission's on-going commitment to sector-led benchmarking and improvement and its approach to the next iteration of the local government Best Value audit approach, in particular the tone of continuous improvement and outcomes.

On that basis, the Commission agreed to endorse a strategy incorporating the following principles:
- a longer-term Statutory Performance Indicator Direction;
- a recognition of the increasing maturity of, and the Commission's support for the further development of the Local Government Benchmarking Framework; and
- incorporating the assessment of council's approaches to public performance (PPR) as an integral element of the new approach to auditing Best Value, rather than undertaking separate annual assessments of this aspect of Council's performance.

The 2015 Direction was approved in December 2015 covering the financial years ending 31 March 2017-2019.

Deloitte view
We have considered the adequacy of the Council's arrangement for collecting, recording and publishing accurate and complete information and noted no issues.

Wider scope requirements (continued)
Health and social care partnership

2015/16 saw the first year of Health and Social Care Integration between Shetland Islands Council and NHS Shetland (NHSS). As part of our separate audit work of the IJB, we have reviewed the current arrangements and plans in place to develop the Health and Social Care Partnership with NHS Shetland. Our key findings are summarised below:

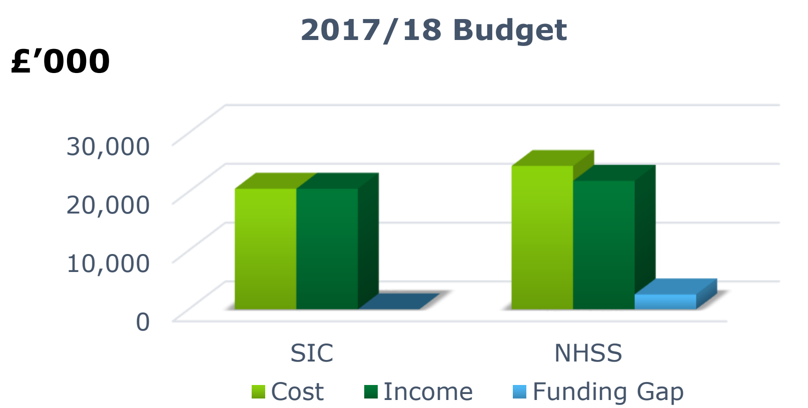
Financial sustainability

Total outturn net expenditure for 2016/17 was £44,389k, which was £939k over the approved budget, largely in relation to services commissioned from the NHS. NHS Shetland has agreed to fund the short term overspend on a non-recurring basis.

The biggest short-term risk currently facing the IJB is a projected overspend in 2017/18 of £2,529k. A report has recently been presented to the Board ('Bridging the Funding Gap 2017/18') to highlight the funding gap. This noted that SIC offer of funding matches their responsibility for the current service model and that NHSS are responsible for finding efficiencies in their services to close the gap. NHSS have committed to reducing this funding gap by £1,291k through redesigning services, leaving £1,238k of short-term spending currently unfunded.

The IJB has estimated that £5,368k of efficiencies are required in the next 3 years for the IJB to be sustainable.

It is critical that the funding gap is addressed on a Board wide perspective with the IJB working closely with both NHSS and SIC to focus on implementing recurring saving schemes to ensure long term financial sustainability. Shetland IJB faces some unique challenges being a small island Board therefore finds it is difficult to make savings. The Board should complete an exercise to fully evaluate demand drivers and the impact on costs going forward.



Financial management

From our review of internal audit reports issued in the year, both from the IJB itself and from the two partner bodies and from our testing throughout the audit, we note that the IJB has adequate systems of internal controls in place.

While the IJB reported an overall overspend for 2016/17, this was regularly reported to the board throughout the year in the management accounts that are produced quarterly. This supports the view that management can effectively forecast and has sound financial management procedures in place.

Wider scope requirements (continued)

Health and social care partnership (continued)

Governance and transparency

The IJB has governance arrangements that are appropriate and operating effectively. It is transparent in its decision making with reports discussed at Board meetings being made available on-line along with the minutes of the meetings. The Board meets once every quarter to review the performance (both financial and non-financial) of the IJB. From review of the board meeting minutes, we note there is scrutiny and challenge by both executive and non-executive members of the IJB.

Value for money

The IJB self-evaluates through Performance Reports, which are prepared annually and are reviewed by the Audit Committee. The IJB also self reviews every quarter as part of the management accounts.

The 2016/17 Performance Report shows a number of projects have no cause for concern and are on track to be completed in time with targets even being exceeded. There are a few cases that have cause for concern and the IJB is making good progress against the national indicators along with the indicators it has set for itself.

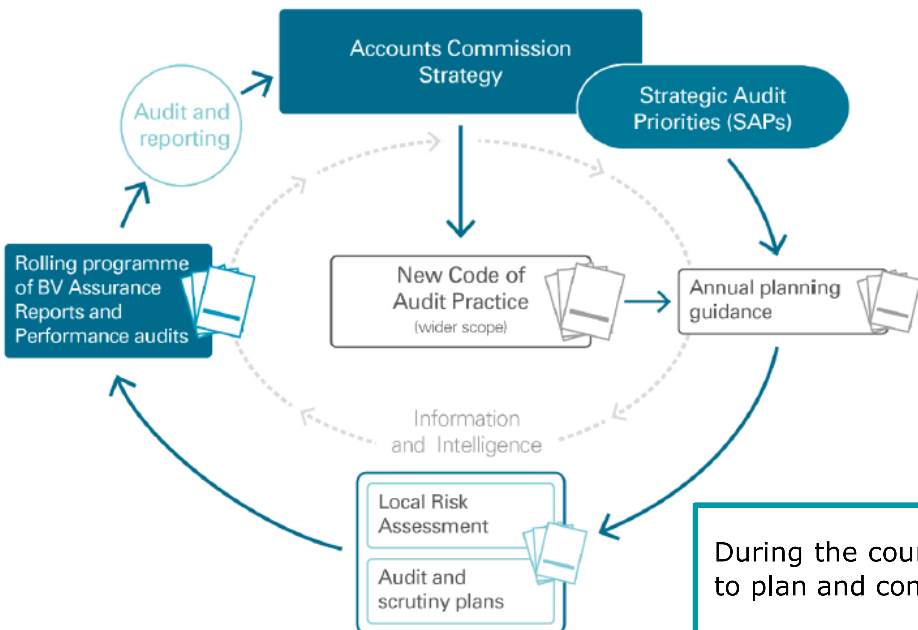
Deloitte view

Recognising the relatively early stage of the Board, it is positive to note the work done to date in developing the governance and performance arrangements. However, the long term financial sustainability of the Board is still a significant risk, particularly given the current projected position for 2017/18. It is therefore critical that the Board work closely with both the Council and NHS Shetland to agree mitigating actions to ensure that budgets are delivered in line with the resources available.

Wider scope requirements (continued)
Strategic audit priorities

The Accounts Commission agreed the overall framework for a new approach to auditing Best Value in June 2016. Best Value will be assessed over the five year audit appointment, as part of the annual audit work. In addition a Best Value Assurance Report (BVAR) for each council will be considered by the Accounts Commission at least once in this five year period. The BVAR report for Shetland Islands Council is planned for later in the five year programme.

This new approach fulfils the Commission's desire that it is proportionate, risk-based and outcome-focused, providing the Commission and the public with more regular assurance about the performance of Councils. Audit Scotland are bringing together audit work on Best Value, the annual financial audit and the multi-agency shared risk assessment process, and this will continue to support its work with its strategic scrutiny partners. The audit planning framework is set out below.



The objectives of the new approach include:

- greater emphasis on driving continuous improvement in Councils;
- greater emphasis on the performance, outcomes and impact made by a Council;
- maintaining a proportionate and risk based approach;
- Performance Audit Best Value (PABV) and local auditors working together, and liaising with other scrutiny body representatives on an ongoing basis; and
- emphasising that it is first and foremost a Council's responsibility to demonstrate that it is meeting its statutory duties, and that its own self evaluation can accurately show its level of performance and that the pace, depth and continuity of its improvement is appropriate.

During the course of the year, we have worked work closely with PABV staff to plan and complete this work.

In addition, to inform the Controller of Audit's Annual Assurance and Risk Report to the Accounts Commission, we will submit a data return covering our audit work by 2 October 2017.

Wider scope requirements (continued)
Strategic audit priorities (continued)

As noted on the previous page, the Accounts Commission has reviewed its strategic planning arrangements and has agreed five Strategic Audit Priorities that we have be built into audit expectations. These are set out below.

Council priorities and long term planning
The clarity of Council priorities and quality of long-term planning to achieve these.

Service delivery
How effectively Councils are evaluating and implementing options for significant changes in delivering services.

Resource
How effectively Councils are ensuring members and officers have the right knowledge, skills and time to lead and manage delivery of the council priorities.

Citizen involvement
How effectively Councils are involving citizens in decisions about services.

Quality of public performance reporting
The quality of Council public performance reporting to help citizens gauge improvement.

Areas considered

The Best Value audit work carried out this year focused on the Council's arrangements for demonstrating Best Value in financial and service planning, financial governance and resource management. The findings of this work are reported as part of the above.

During the 2016/17 audit, we have worked with our colleagues in PABV to undertake a baseline assessment of the Council's position across these Strategic Audit Priorities. We will be able to use this baseline to monitor performance and improvement against these priorities across the next five years.

This basis for this assessment will include interviews with key Members, senior officers and other personnel across the Council, observance of committee meetings and review of documents such as Council Corporate Plan, Medium Term Financial Plan, Council communications, consultations and performance data.

Wider scope requirements (continued)
Council priorities and long term planning

Does the Council have clear priorities that set the strategic direction?

Shetland has achieved strong economic growth in recent years and has a high level of performance relative to many national comparisons and indicators. Despite this, the area faces a number of challenges including an aging population, geographic isolation and a need to maintain sustainable economic growth.

The Council has a Community Plan that sets out the aims of the Shetland Partnership over the long term. Partners have been drawn from across the public, private and third sectors in Shetland and includes organisations such as Police Scotland, ZetTrans and the Shetland Charitable Trust.

The Community Plan is supported by a Corporate Plan which outlines how the Council will work together with other members of the partnership to achieve some of the Community Plan aims over a four year period (2016 – 2020). Confusingly, different visions are set out in each of the plans which may prevent the Council and its partners speaking as one about a joint vision for the whole of Shetland.

Community Plan vision:

*'Community Planning in Shetland aims to make Shetland **the best place to live and work** by helping to create communities that are:*

- *Wealthier and Fairer*
- *Learning and Supportive*
- *Healthy and Caring*
- *Safe*
- *Vibrant and Sustainable*

Corporate Plan vision:

'By the end of this plan (2020) we want to be known as an excellent organisation that works well with our partners to deliver sustainable services for the people of Shetland'

In order to achieve the Corporate Plan, the Council has identified strategic priorities, aims and areas of focus for Council activity. These are underpinned by '20 things we aim to achieve by 2020' which sets out how the Council intends to deliver its priorities and are detailed overleaf.

The Council has also agreed five local Outcome Areas for the whole of Shetland with its community planning partners. Within each Outcome Area there are approximately three priorities. These outcomes and priorities are included in the LOIP.

In order to determine the strategic direction of Shetland, the Council undertook consultation with different bodies, partners and community members from across Shetland, carrying out activities such as:

- Scenario planning – a process that saw almost 700 people across Shetland taking part through interviews, workshops and an e-survey.
- LOIP development – a process involving 5 workshops themed around the 5 areas outlined in the Community Plan vision.

Deloitte view

There are similarities between the different sets of outcomes, priorities and aims set out in the Council's plans however the differing visions create an unclear picture of where exactly the Council intends to focus in the medium term. Audit Scotland advised in their recent review of Best Value arrangements at another Council that clarity around linking outcomes to a clear vision is a key enabler. Shetland should consider adopting a single overarching vision shared by both the Council and community partners which is supported by a single high level set of priorities/outcomes, with KPIs and funding decisions linked to these priorities.

Wider scope requirements (continued)

Council priorities and long term planning (continued)

Does the Council have clear priorities that set the strategic direction?

Shetland Islands Council's outcomes and priorities

Shetland Islands Council has multiple sets of outcomes, priorities and aims to deliver its vision, which is confusing residents and other stakeholders.

Local Outcome Improvement Plan key outcomes

a) Shetland is the best place for children and young people to grow up
b) We live longer healthier lives and people are supported to be active and independent throughout adulthood and in older age
c) Shetland is a safe place to live for all our people, and we have strong, resilient and supportive communities
d) Shetland has sustainable economic growth and all our people have the chance to be part of island life
e) We deliver all our services in an environmentally sustainable manner to safeguard and enhance our outstanding environment which underpins all our actions and our economic and social well-being

Supporting documents

- Five Directorate plans: Community Health & Social Care Services, Children's Services, Infrastructure Services, Development Services and Corporate and Executive Services.
- 5 – 6 service plans for each Directorate
- Medium and long term financial plans

Supporting strategies

- There are numerous supporting Council strategies including: Asset strategy, reserves strategy, workforce strategy and borrowing strategy.

Corporate Plan areas of focus

- Young people;
- Older people;
- Economy and housing;
- Community strength; and
- Connection and access

There are approximately five priorities aligned to each focus area. Five of these are highlighted as 'top priorities' for the Council:

- Complete and move into the new Anderson High School and Halls of Residence.
- Increase the supply of affordable housing in Shetland.
- Improve high-speed broadband and mobile connections throughout Shetland.
- Support older people across Shetland so they can get the services they need to help them live as independently as possible.
- Provide quality transport services within Shetland, and push for improvements in services to and from Shetland.

Deloitte view

While the Council has multiple sets of outcomes, priorities and aims to deliver its vision, we recommend that these be reconsidered to ensure better alignment with outcomes.

Wider scope requirements (continued)

Council priorities and long term planning (continued)

Does the Council demonstrate effective strategic planning to deliver its vision?

In addition to the supporting plans and strategies the Council has in place to deliver its visions, the LOIP identifies a number of indicators that the Partnership will use to monitor how well it is progressing towards achieving its key outcomes. The Council will monitor these quarterly and undertake an annual review in order to redefine targets and actions where required. Examples of these indicators are illustrated below and will be monitored for completion in subsequent audit years.

LOIP actions:

March 2016

Present draft 10 year plan to attract people to live, work, study and invest

(Implementation 2016 – 2025)

March 2018

Deliver the Corporate Parenting Strategy across the partnership.

March 2018

Reduce the harm caused by alcohol through the delivery of the Shetland Alcohol and Drugs Partnership Strategic Plan

April 2019

Support wellbeing and resilience in Partnership communities through physical activity and sport

April 2019

Develop Local Action Plan for recognised effects of climate change on Shetland using public consultation to define scope of actions needed

2020 targets

Indicator	2020 Target
% of children at P1 check at risk of overweight or obesity	12% at P1 check at risk of overweight
Alcohol related hospital admissions	300/100K
% of premises able to link to superfast broadband	100%
Carbon Emissions	42% reduction (34, 500 t CO2 (2007/8))

Deloitte view

In our review of the LOIP we identified that for several of the indicators linked to outcome a) 'Shetland is the best place for children and young people to grow up', baseline and 2020 targets appear to have not yet been identified.

We recommend that the Council ensure all indicators identified in the LOIP have a baseline and 2020 target clearly identified and documented, and that these targets are outcome focused. We will monitor how the Councils meets these targets over the period of our audit appointment.

Wider scope requirements (continued)

Council priorities and long term planning (continued)

Does the Council have a sound process in place for long term financial planning?

MTFP 2016/17

The Council has a Medium Term Financial Plan (MTFP) in place spanning the five year period from 2016/17 to 2021/22. The MTFP *'provides the financial planning framework for the delivery of services to the population of Shetland'.*

The 2016/17 MTFP is clearly aligned with the Council's vision and priorities, with explicit links made to both the Corporate Plan and the LOIP.

The MTFP links to a less detailed Long Term Financial Plan for the period 2015 – 2050.

Planning process

The planning process is cyclical and takes into account corporate priorities and vision, as outlined within the Corporate Plan, economic and political policy, social data available and known cost and demand pressures.

The initial MTFP was developed in 2012 and forecast the financial position of the Council through to 2017/18. In each subsequent year the original MTFP has been refreshed, taking into consideration the developing financial challenges and long term pressures faced by the Council.

The Council have been creative in involving the community in the planning process by carrying out 'Budget Building' exercises. This included a series of public meetings throughout Shetland and the use of an interactive on-line budget planning model, to gauge the views of the public on where the 2016/17 budget savings should be made. However, participation was low at approximately 1% and the Council have recognised that this should be expanded in the future.

Supporting strategies

The MTFP and LTFP are supported by several other strategies which provide a more in-depth insight into budget pressures and their potential long term consequences. Examples include:

- Borrowing Policy and Strategy 2013 – 2018
- Investment and Treasure Strategy
- Asset Investment Plan

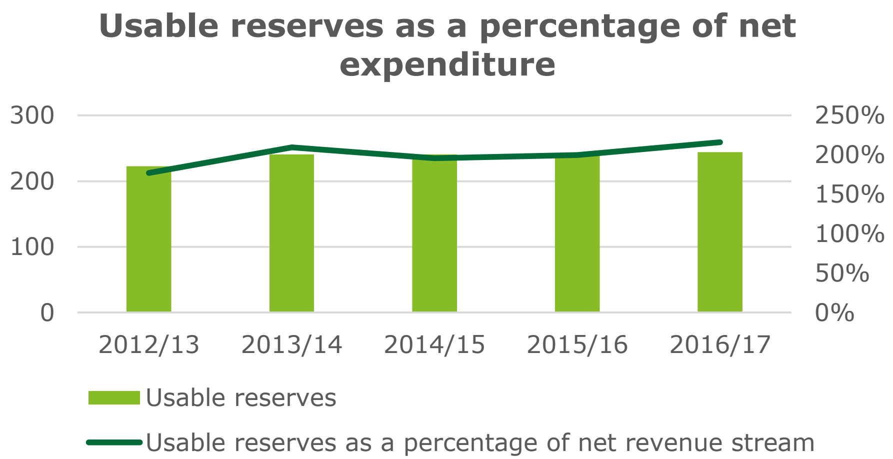
Deloitte view

The Council has a clear process in place for long term financial and medium term planning, albeit with a medium term reliance on reserves, that is undertaken on annual basis and ensures that the financial plan links to the Council's vision and priorities.

Wider scope requirements (continued)
Council priorities and long term planning (continued)

Does the Council have a sustainable policy in place for the use of reserves?

The Council outlines a reserves policy within the MTFP. The Council's strategy is to maintain the value of useable reserves in order to continue providing the capital on which long-term investments are based. Unlike many other Council's, Shetland's good historic financial performance, mainly arising from harbour and oil activities, have resulted in the Council having a high level of usable reserves. The Council uses these reserves to support the delivery of frontline services by generating income from long-term investments.



In 2016/17 the usable reserves balance increased by £2.195m. The Council plans to use reserves to finance the budgeted funding gap over the next two years, totalling a commitment of £3.76m.

Deloitte view

Given the Council's starting level of reserves, the planned use of reserves to meet the funding gap over the next 2 financial years is sustainable, however, going forward, the Council should ensure that if such an approach is taken moving forward, it should ensure it is only in exceptional circumstances to avoid reducing revenue generation from long-term investments.

Wider scope requirements (continued)

Council priorities and long term planning (continued)

Has the Council underpinned sustainability through the achievement of savings targets?

The Council has successfully made year on year savings over the last five years, as detailed below:

Year	Savings Achieved
2011/12	£11.5m
2012/13	£15m
2013/14	£12.5m
2014/15	£12.7m
2015/16	£2.1m

2016/17 Savings Target

£2.985m

The Council was required to find savings of £2.985m in 2016/17 to present a balanced budget. Savings identified included:

- 2% savings applied across all Directorates.
- General saving in relation to staff turnover broken down as follows: Community Health & Social Care £0.166m; Development £0.074m; Corporate & Executive £0.061m; and Children Services £0.024m.

The Council achieved this in-year savings target, as noted on page 27, where an overall underspend was achieved.

Deloitte view

The Council has achieved significant savings over the last 6 years however due to increasing demand for services and the continuing restraint in relation to Council funding settlements, it will have to consider how it can transform service delivery through its Business Transformation Plan (2016-2020) in order to continue to meet citizen needs with reducing budgets and to avoid relying on the approach of making cuts of 2% savings across the board, which is not sustainable.

Wider scope requirements (continued)

Service delivery (continued)

Does the Council have a Transformation Plan that links to the corporate priorities?

Business Transformation Plan (2016 – 2020)

The Council have identified embracing new technology as a means of revolutionising how public services support everyone who lives and works in the Shetland community. The strategy for this shift towards more digitally focussed service delivery is outlined in the Council's Business Transformation Programme (BTP), within which the aim of the programme is clearly stated:

'To implement a range of measures that will revolutionise how we work with and for our community, responding to and anticipating a digital cultural paradigm.'

The BTP is underpinned by the Council's '20 by 20' commitments featured in the Corporate Plan. These commitments describe how the Council will work within the community to deliver its priorities.

Service redesign programme

Recognising that the BTP alone cannot deliver whole scale change, the Council have identified a programme of transformation change projects grouped under eight key workstreams.

The expectation is that each work stream will identify its own deliverables and the timescales for activities. These will be supported by programme wide documents such as an overarching policy document and a programme delivery plan.

The success of the plan will be crucial to ensuring that the Council is able to maintain high quality service levels in the face of continuing cost pressures.

What does success look like?

£20m

Reduction in annual revenue budget by 2021

Deloitte view

The Council is at the early stage of considering the BTP and the transformational projects required to allow it to achieve the recurring revenue reductions to maintain the sustainability of its services. This will be a key area that we will monitor over the course of the audit appointment, including how the Council ensure that projects deliver on time, on budget and most importantly, deliver the expected benefits for the citizens of Shetland. We would also expect to see the Members playing a very active role in the transformation and the Council will also need to ensure it has the transformational infrastructure in place, including PMO, benefits realisation tools and templates and an effective change management strategy to deliver this transformational change.

Wider scope requirements (continued)

Members and officers knowledge, skills and resources

How do the Council ensure that Members and officers have the right knowledge, skills and time to lead and manage delivery of the Council priorities?

Members

This Council is made up of 21 independent elected Members and 1 SNP elected Member from seven wards across Shetland.

The Council has developed a comprehensive induction programme for new Members that was run following the 2017 local elections. The induction included overviews of all of the Council's key strategies, ways to avoid pitfalls and the support they receive in their role as Council Members. Members also received induction sessions on Business Transformation and Council Finances. All senior officers participated fully in the facilitation of the induction programme.

Induction activity does not stop after initial delivery of the programme:

- Induction programme assessment and Member satisfaction feedback;
- Programme of prioritised training; and
- Follow up discussions held with members to discuss personal development needs. From these discussions, a member training and development programme will be drafted.

Officers

The Council has a Workforce Strategy in place covering the period 2016 – 2020. The strategy has 10 key elements grouped within three themes: right shape, right skills and right culture. These are intended to support the Council's vision for the workforce:

'To have committed, enthusiastic, confident, skilled, flexible and customer focussed employees who deliver excellent services to the people of Shetland. To have a fair organisation which values, develops and appreciates its workforce in the provision of excellent services.'

The Council has not been immune to the UK wide issue of attracting high calibre staff into local government, and this is further exacerbated by the geographical isolation of the islands. The Workforce Strategy includes references to succession planning, with further detail given in Directorate Plans, for example succession planning is highlighted as a priority within the Executive and Corporate Services Directorate Plan (2016/17).

The Council also recognises the importance of ensuring that officers have the appropriate skills and knowledge to effectively fulfil their roles and have outlined several activities within the Workforce Strategy, such as continuing to offer the successful Leading for Outcomes Programme, to support this.

Deloitte view

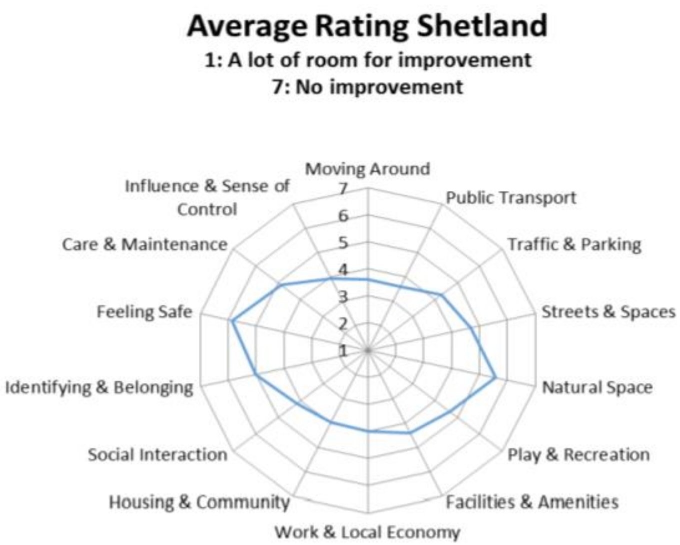
Shetland place a great deal of importance of building up strong relationships with Members and this was illustrated in the comprehensive induction programme. Member involvement in transformation is one of the keys to its success. We will review how the needs of officers and buy in of Members are taken into consideration as the Council implements BTP up to 2020.

Wider scope requirements (continued)
Citizen involvement

How does the Council involve citizens in decision making about its services?

The Council understands the importance of empowering its communities by involving them in decision making and has undertaken several exercises to better understand the preferences of those who live in Shetland.

A key example of one of these initiatives was the Shetland Place Standard (SPS) public consultation that took place in July 2016. The Council invited people to rank the place they live against 14 different themes. Over 900 people took part providing the Council with almost 5,000 individual comments constituting a significant public engagement exercise.



The Council is using the findings of the Place Standard consultation to inform key policies and strategies going forward including:

- Local Outcomes Improvement Plan;
- Local Development Plan;
- Shetland Local Housing Strategy;
- Shetland Transport Strategy; and
- Shetland Islands Health and Social Care Partnership: Joint Strategic Commissioning Plan.

The Council has also made use of exercises such as encouraging participation with the Budget Building tool, mentioned previously, Participatory Budgeting (PB) initiatives such as the case study detailed on the following page and though successful engagement with high school students to encourage participation in the democratic process for a young age.

Deloitte view

The Council places strong emphasis on encouraging community participation in Council decision making and has an aspiration that 1% of the Council's budget should be decided through PB initiatives in the longer term . We will monitor how the Council will ensure that this current engagement approach plays a more significant part in making funding decisions moving forward and we would wish to see clear evidence of engagement directly impacting on Council strategy through the upcoming transformation of Council services through the implementation of the BTP and Service Redesign Programme.

Wider scope requirements (continued)
Citizen Involvement (continued)

How does the Council involve citizens in decision making about its services?

Participatory Budgeting – Case Study

Participatory Budgeting (PB) events have taken place in Shetland since 2010, with seven small grants projects being delivered previously by local communities and community councils, and more than 700 people and 52 voluntary groups taking part in 2016.

In early 2017, the Council was successful in applying to the Scottish Government's Community Choices Fund for £50,000 to build on existing PB work. The Council matched this funding commitment and then in March 2017, it asked residents to discuss and prioritise how they'd like to see £100,000 spent on local services.

Residents were able to vote online, by post or in person at a 'market stall' type event to decide which projects to allocate funding to. The Council also provided £9,000 that has been match funded by the Scottish Government, to support three small grant projects in Skerries, Fetlar and Bressay.

More than 1,000 Shetland residents voted to fund projects in the initiative. A total of 5,730 votes were cast to decide which of twenty projects would receive a share of £100,000 of funding.

The successful projects are detailed in the adjacent table.

The Council Leader at the time of the event, Gary Robinson, indicated that "the aim in the long term is to have at least 1% of the Council's budget decided by a PB method and for increased community involvement to be a more routine way of working. This approach can really engage and empower the community in discussions on public budgets. The challenge remains for us to scale up the influence of the community over the mainstream money spent by the Council."

Bidder/Cause
Fair Food
Shetland Autism Awareness Raising Project
The Golden Girls
Workshops for Young People
'Da Sletts' Footpath Improvements
Zero Cost Coach and Volunteer Development
Brae High School Learning for Sustainability (part funding)

Wider scope requirements (continued)
Public performance reporting

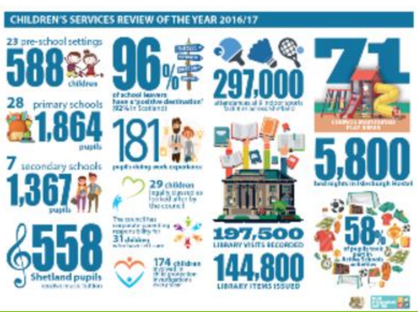
How does the Council monitor Performance and Outcomes?

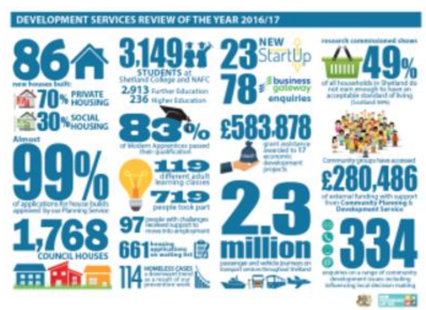
The Council uses performance indicators to measure how they are doing. These are linked into groups indicators and local indicators (outlined in service delivery plans, statutory indicators and LOIP indicators). Quarterly updates are provided on performance, the Corporate Plan and indicators from each of the five Directorates and these are reported to the relevant committee. Progress against planned actions is clearly monitored with a status indicator (green, amber or red) and an estimated progress percentage assigned allowing for swift appraisal of overall progress. In addition, an annual performance report is produced, giving community members a snapshot of Council performance during the year.

The year ended 2016/17 marked the first 12 months of the 2016-2020 LOIP and the Council's performance for the year was scrutinised by the Shetland Partnership Performance Group. The group clearly engaged with the report and identified several issues including:

- Overdue deadlines slipping behind actions with minimal commentary provided as explanation; and
- Varied consistency of performance reporting across thematic groups.

Performance reports and plans, including quarterly performance updates are available for the public to view on the Council's website and are easily found in the section 'Our Performance'. Performance infographics for each of the Directorates are also produced giving a visual representation of achievements and key statistics.





Deloitte view

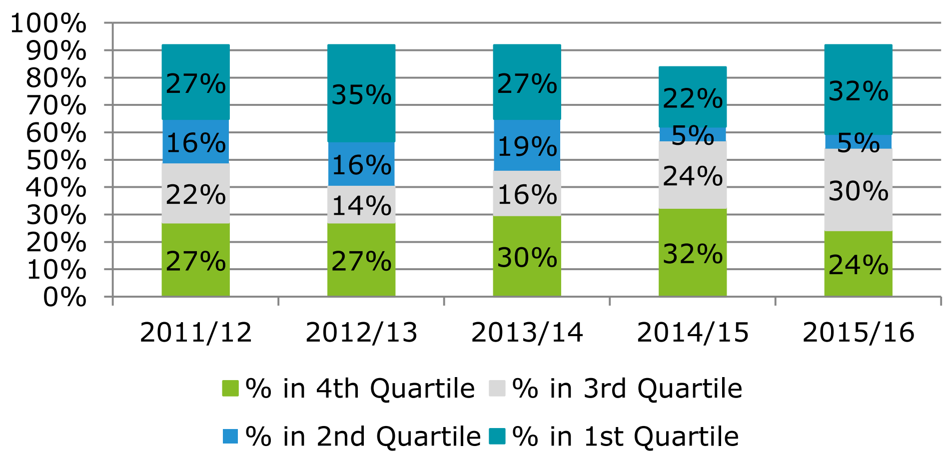
There is a framework in place to ensure that Council performance is monitored and reported. Performance information is readily available to Shetland citizens and the use of infographics allows this information to be presented in a way that is visually interesting.

Wider scope requirements (continued)
Public performance reporting (continued)

How well is the Council performing?

We have drawn on the Local Government Benchmarking Framework (LGBF) to make a high level assessment of the Council's performance, relative to all Scottish councils, in 2015/16 (the latest data available). The LGBF includes a number of indicators organised under common service areas. Performance is summarised in the below table*.

Shetland Islands Council LGBF Indicators in each quarter, 2011/12 – 2015/16



Deloitte view

The number of indicators in the first and second quartile initially improved over the last five years to 51% in 2012/13, before reducing slightly during 2015/16 to 37%. Over the next five years, we will develop a detailed understanding of the Council's performance, including:

- How priorities are agreed and reviewed and whether they link the Council's vision and Council Plan objectives;
- How the Council is performing against its key priorities and whether the Council is able to demonstrate that improvements in performance can be attributed to its actions (or actions undertaken with partners); and
- The role of elected members in scrutinising and challenging Council performance.

* The analysis is based on 37 of the LGBF indicators. It does not include indicators that relate to spend/cost, as these may not give a fair reflection of performance. For example, a higher than average spend on roads maintenance could reflect a policy decision to improve the existing condition of roads in the Council area.

Wider scope requirements (continued)
National Fraud Initiative

In accordance with Audit Scotland planning guidance, we are required to monitor the Council's participation in the National Fraud Initiative (NFI) and progress during 2016/17 and completed an NFI audit questionnaire by 6 July 2017.

A summary of the matches reported in the NFI system is provided in the table which notes that no frauds or errors have been identified from the matches processed to date.

	Total
Total matches flagged	2,482
Total recommended matches to be investigated	569
Total processed	1,628
Frauds	0
Errors	0
Savings	£993

Deloitte view

Evidence suggests the Council has engaged with the NFI exercise, however issues have been encountered during the process. Ultimately, a lack of priority given to the exercise by management has led to it being under-resourced and allocated to staff with insufficient authority to leverage the information required across the various service lines. This has been highlighted and discussed by the Council's finance management as an issue to be addressed in the short term future, recognising the fact that no frauds or errors have been identified to date.

We have also noted that the Council has not used the self-assessment checklist published with the 2014/15 Audit Scotland report. We would recommend that this is used by both the key NFI contact and the Audit Committee to help monitor planning and progress with the NFI exercise.

Wider scope requirements (continued)
Local Area Network

We continue to actively participate in the Local Area Network (LAN) and make positive contributions to the Local Scrutiny Plan. The LAN met in December 2016 to update the shared risk assessment, and the LAN Lead met with the Chief Executive in February 2017. The Local Scrutiny Plan 2017/18 was published by Audit Scotland in March 2017.

Conclusion

No specific risks were identified in the shared risk assessment this year. However, the LAN identified a number of areas which form part of the on-going oversight and monitoring work carried out by scrutiny partners. This work includes the following issues:

- **Long Term Financial Planning–** We have provided commentary on this risk on page 38 of this report.
- **Framework for monitoring performance –** We have provided commentary on this risk on page 45 of this report.
- **Shetland Integration Joint Board** – this has been considered as part of our separate audit of the Board.

Wider scope requirements (continued)
Grant claim work

As part of our audit procedures, we have completed our review of the following grant claims / returns by the audit deadlines set by Audit Scotland:

Grant	Deadline	Status	Issues
Education maintenance allowance	31 July 2017	**Completed**	**None**
Criminal justice social work services grant claim	30 September 2017	**On Target**	**None to date**
Non-domestic rates income return	9 October 2017	**On Target**	**None to date**
Housing benefit subsidy	30 November 2017	**On Target**	**None to date**

Conclusion

We are on target to complete all grant claim work in line with Audit Scotland deadlines.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

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

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

What we don't report

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

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

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

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

The scope of our work

Our observations are developed in the context of our audit of the financial statements.

We described the scope of our work in our audit plan and the supplementary "Briefing on audit matters" circulated to you earlier in the year.

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

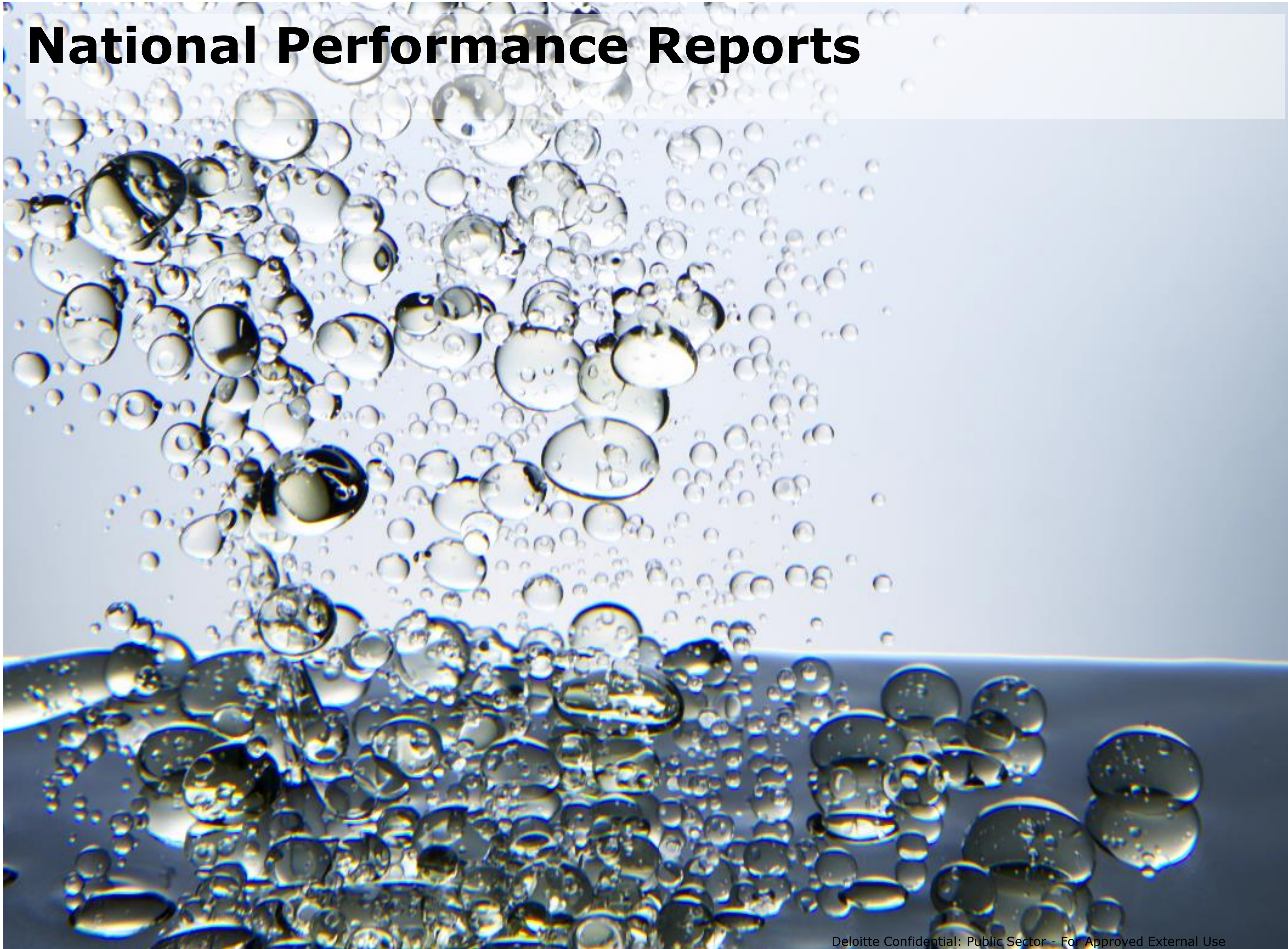
Deloitte LLP

Deloitte LLP

Glasgow

13 September 2017

National Performance Reports



National performance reports

Summary of reports issued over the past year

How councils work (HCW) – Roles and working relationships in Councils: Are you still getting it right?

Published November 2016

Headline messages

The Accounts Commission revisits the themes in its 2010 HCW report on roles and working relationships. It highlights issues that are important to the governance of Councils in the current climate.

The messages highlighted in this report centre on the main themes of the original HCW of:

- clear roles and responsibilities and arrangements for governance that are up to date
- effective working relationships, with councillors and officers demonstrating appropriate behaviours
- councillors having the skills and tools to carry out their complex and evolving role

Impact on Shetland Islands Council

The Council should consider how this report and the checklists will support councillors in their difficult and challenging role. It should also help councils to consider their current governance arrangements and make any necessary changes, including their preparations for the new intake of councillors following the May 2017 local government election.

Local Government in Scotland: Financial Overview 2015/16

Published November 2016

Headline messages

Councils have remained within their overall budgets, increased their reserves slightly and reduced their debt in 2015/16. Each Council has its own particular challenges but all Councils face financial shortfalls requiring further savings or using reserves. They need to change the way they work if they are to make the savings needed.

Impact on Shetland Islands Council

Throughout the report, Audit Scotland identify questions that Councillors may wish to consider to help them better understand their Council's financial position and to scrutinise financial performance. These are available in the self assessment tool for Councillors.

Local Government in Scotland: Performance and Challenges 2017

Published March 2017

Headline messages

Councils overall have maintained or improved their performance in the face of a long-term decline in Scottish Government real term funding and continued increasing pressures on services. However, public satisfaction is declining and complaints are increasing. Looking ahead, they need to better involve their communities in service design and delivery.

There are wide variations between Councils. Some have grasped the nettle in finding new ways to provide services more efficiently. Others have been slower off the mark. Councils have made savings by cutting jobs but half of them still don't have organisation-wide workforce plans.

Impact on Shetland Islands Council

The Council should consider the recommendations made in the report (copied here for reference), when setting priorities and budgets for future periods.

Recommendations

Councils should:

- Set **clear priorities** supported by **long-term strategies** and **medium-term plans** covering finances, services, performance and workforce. These plans should inform all council decision-making, service redesign, savings and investment decisions.
- Ensure that **budgets are clearly linked** to their medium-term financial plans and long-term financial strategies. Budgets should be revised to reflect true spending levels and patterns. This requires good financial management and real-time information to ensure spending is accurately forecast and monitored within the year.
- Have an **organisation-wide workforce plan** to ensure the Council has the people and skills to manage change and deliver services in the future.
- Ensure **workforce data** allows thorough analysis of changes to the workforce at an organisation-wide and departmental level. This will allow Councils to better assess the opportunities and risks in staff changes.
- Thoroughly **evaluate all options for change and service redesign**, including options for investing to save, and monitor the impact of change on Council priorities and desired outcomes
- **Support communities** to develop their ability to fully participate in setting Council priorities and making decisions about service redesign and use of resources.
- Ensure **councillors** get support to develop the right **skills and knowledge** to fulfil their complex and evolving roles
- Ensure there is clear **public reporting of performance** linked to council priorities to help communities gauge improvements and understand reduced performance in lower priority areas.
- Continue to work to understand the **reasons for variations in unit costs and performance,** and **collaborate** to identify and adopt good practice for each other.

Appendices

Audit adjustments

Summary of corrected and uncorrected misstatements and disclosure deficiencies

The following misstatements have been identified up to the date of this report which have been corrected by management. We nonetheless communicate them to you to assist you in fulfilling your governance responsibilities, including reviewing the effectiveness of the system of internal control.

		Debit/ (credit) Assets £m	Debit/ (credit) Liabilities £m	Debit/ (credit) Reserves £m	Debit/ (credit) CIES £m	If applicable, control deficiency identified
Investment Income	(1)	(0.74)	0.74			N/A
Total		**(0.74)**	**0.74**			

(1) The Council was informed by fund managers that investment income of £0.74m would be receivable in October 2016. The Council agreed, per the fund management agreements, that this would be immediately re-invested. This led to the recognition of both a debtor and a creditor for this amount. However, this was reversed incorrectly when the transaction took place in October 2016 resulting in a misstatement of the debtor and creditor amounts. This adjustment is to reverse the incorrect reversal and reverse the original journal in order to reach the correct year end position.

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

No uncorrected disclosure deficiencies have been noted from our audit work to date.

Action plan

Recommendations for improvement (1/3)

Area	Recommendation	Management Response	Responsible Person	Target Date	Priority
National Fraud Initiative	When completing the NFI Questionnaire, it was noted that various items were outstanding and that this arose due to resourcing and staffing issues. The Council should ensure that appropriate resources are put in place to address the NFI matches on a timely basis.	Additional resources are planned to be allocated to the completion of the NFI going forward.	Jonathan Belford, Executive Manager - Finance	31 March 2018	Moderate
PPE Valuations	The valuation carried out in the current year was relatively basic and a number of issues were identified with the approach taken. A number of recommendations have been made in review of the valuation exercise, undertaken by our property specialists. These points should be considered when preparing the valuation report in the coming year. Deloitte note that the Council is currently in the 5th year of the rolling revaluation programme and is midway through updating its valuation approach.	The valuers have noted all the points raised by Deloitte and have agreed that these points will be considered in valuations going forward.	Robert Sinclair, Executive Manager – Capital Programmes	31 March 2018	Moderate

Action plan
Recommendations for improvement (2/3)

Area	Recommendation	Management Response	Responsible Person	Target Date	Priority
Fishing quota valuation	The Council should request additional information regarding any assumptions used (e.g. if it references prices offered - these should be attached in an appendix to the valuation with evidence). It should also be made clear as part of the valuation letter how the valuer has satisfied themselves that the fishing quota allocation is accurate (i.e. by agreeing to the Government listing). This information should be requested so that the Council can satisfy itself that the valuation reached is appropriate and that the valuation has been carried out to an appropriate level.	Management have agreed to obtain additional documentation to back up the valuation is appropriate.	Jonathan Belford, Executive Manager - Finance	31 March 2018	Moderate
Journal Entry Listing	As part of year end reporting, the full journal entry listing should be reconciled to the trial balance used to generate the financial statements. The risk of not performing this reconciliation is two-fold: i) the trial balance may be incomplete if journals are missing and as a result the financial statements will be incorrect; and ii) as part of our audit procedures the journal listing we receive could be incomplete if it does not tie to the trial balance, raising the possibility that fraudulent journal entries are being posted that we do not have visibility over when performing our audit procedures.	Management has taken this on board and the finance team will produce a reconciliation in future periods.	Jonathan Belford, Executive Manager - Finance	31 March 2018	Moderate

Action plan
Recommendations for improvement (3/3)

Area	Recommendation	Management Response	Responsible Person	Target Date	Priority
Leases	As part of procedures on operating leases we noted that some leases were not signed by both parties, and other leases - although signed - were missing pivotal information (e.g. rent amount, the start and end date of the lease). These issues were noted in leases both where the Council is the lessor and where the Council is the lessee. All lease agreements should be signed by both parties, with all key terms clearly defined within.	Management accepts these points, noting that it is their intention and practice that these issues should not arise in the first instance and that going forward they will ensure these issues do not recur.	Robert Sinclair, Executive Manager – Capital Programmes	31 March 2018	Moderate
Strategic Priorities	While the Council has multiple sets of outcomes, priorities and aims to deliver its vision, we recommend that these be reconsidered to ensure better alignment with outcomes.	Agreed.	Mark Boden, Chief Executive	31 March 2018	High

Fraud responsibilities and representations
Responsibilities explained

Responsibilities:

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

Required representations:

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

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

Audit work performed:

In our planning we identified the risk of fraud in complying with recognition of grant income and management override of controls as a key audit risk for your organisation.

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

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

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

Concerns:

No issues have been identified through the fraud procedures performed throughout the audit.

Independence and fees

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

Independence confirmation	We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.
Fees	The audit fee for 2016/17 is £217,556 as detailed in our Audit Plan. No non-audit fees have been charged by Deloitte in the period.
Non-audit services	In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the company's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence. We are not aware of any relationships which are required to be disclosed.

Events and publications

Our events and publications to support the Council

Sharing our informed perspective

We believe we have a duty to share our perspectives and insights with our stakeholders and other interested parties including policymakers, business leaders, regulators and investors. These are informed through our daily engagement with companies large and small, across all industries and in the private and public sectors.

Recent publications relevant to the local authorities are shared opposite:

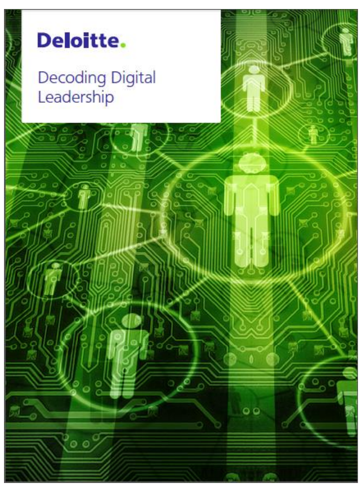
Perspectives: Health & Social Care - The great integration challenge

Bringing health and social care closer together has been a policy ambition for decades, yet it continues to be a challenge. This new piece discusses some of the key factors that affect integration and what can realistically be achieved. Read the full blog post here: http://www2.deloitte.com/uk/en/pages/public-sector/articles/the-great-integration-challenge.html

Perspectives: The public sector's talent retention challenge – How can a talent drain be avoided?

Although global governments are increasingly conscious of the value of skills, the UK's public sector workforce has been hit hard by austerity. Job losses, low morale and pay freezes have all fuelled concerns of a potential drain. Read the full blog here: http://www2.deloitte.com/uk/en/pages/public-sector/articles/public-sectors-talent-retention-challenge.html

Publications



Decoding Digital Leadership

Surviving Digital Transformation

Digital transformation is a hot topic in government. The 2010 Spending Review mentioned the word 'digital' only four times in its reform plans, while the 2015 Review mentioned it 58 times. With that context, are senior leaders across government setting their organisations up for digital success?

Digital transformation requires top to bottom organisational transformation, which requires leaders who are willing and able to leverage digital to innovate, fail fast and drive value in an ambiguous context. Are your leaders equipped to drive digital transformation?

Download a copy of our publication here:
http://www2.deloitte.com/uk/en/pages/public-sector/articles/decoding-digital-leadership.html

Shetland Islands Council

Securing the best for Shetland

Annual Accounts 2016/17

Photograph by Kevin Jones

Contents

Management Commentary

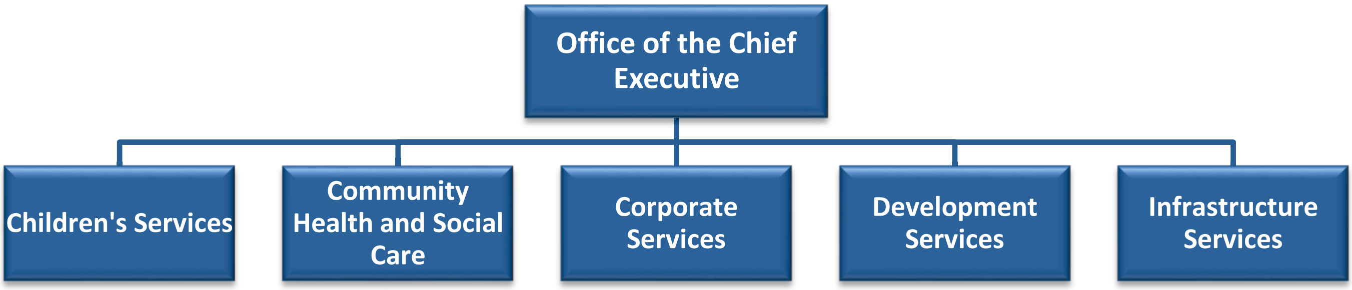
Introduction

This publication presents the financial statements of Shetland Islands Council for the year ended 31 March 2017.

The purpose of the Management Commentary is to present an overview of the Council's financial performance during the year 2016/17 and to help readers understand its financial position at 31 March 2017. In addition, it outlines the main risks and uncertainties facing the Council for the financial year 2017/18 and beyond.

Background

Shetland Islands Council is one of 32 local authorities in Scotland. It is governed by 22 independent elected members serving a population of approximately 23,000 people. The Council is organised to provide and deliver its services as follows:



These directorates provide services to the public such as schools, public transport, economic development, social care, environmental health, housing, ports and harbours and roads. Full details on the services provided can be found on the Council's website: www.shetland.gov.uk

Strategy and Performance Management

Corporate Plan

During the year, Shetland Islands Council's corporate plan was refreshed. Called 'Our Plan 2016-2020', it sets out the Council's vision as follows:

> **'By the end of this plan (2020), we want to be known as an excellent organisation that works well with our partners to deliver sustainable services for the people of Shetland'.**

The plan is monitored through the quarterly reporting cycle of service performance reports, as well as an annual update to elected members and the Corporate Management Team. The full plan can be found at: http://www.shetland.gov.uk/documents/OurPlan2016-20final.pdf.

The plan details five top political priority areas for 2016-2020, as follows:

- Complete and move into the new Anderson High School and Halls of Residence;
- Increase the supply of affordable housing in Shetland;
- Improve high-speed broadband and mobile connections throughout Shetland;
- Provide quality transport services within Shetland, and push for improvements in services to and from Shetland Community Planning; and
- Support older people across Shetland so that they can get the services they need to help them live as independently as possible.

Community Planning

The Council is a member of the Shetland Partnership, which is the local Community Planning Partnership for Shetland. Partners are drawn from across the public, private and third sectors in Shetland. The Community Plan sets out what the Partnership will try to do for Shetland over the long term.

Community Planning in Shetland aims to create communities that are:

- Wealthier and fairer
- Smarter (learning and supportive)
- Healthier (healthy and caring)
- Safer
- Greener

The Community Plan is linked to the Local Outcomes Improvement Plan (LOIP), which sets out the activity and priorities of the Shetland Partnership to deliver the Community Plan. The LOIP is drawn up between the partners and communities and is designed to bring together the efforts of the Community Planning partners to address inequality and resilience in surrounding communities.

Creating a LOIP for the local area is a responsibility that has been given to Community Planning Partnerships by the Community Empowerment (Scotland) Act 2015. This Act aims to empower community bodies through ownership or control of land and buildings, and by giving them more say in decisions about public services. The legislation has significant implications for the Shetland Partnership in helping to shape the development of the LOIP and guide the approach to securing community participation in Community Planning.

Using the five Community Planning themes the LOIP contains the following key outcomes:

- Shetland has sustainable economic growth and all our people have the chance to be part of island life;
- Shetland is the best place for children and young people to grow up;
- We live longer, healthier lives and people are supported to be active and independent throughout adulthood and in older age;
- Shetland is a safe place to live for all our people, and we have strong, resilient and supportive communities; and
- We deliver all our services in an environmentally sustainable manner to safeguard and enhance our outstanding environment which underpins all our actions and our economic and social well-being.

There are a number of indicators that the Partnership will use to monitor how well it is progressing towards delivering and achieving the above outcomes. These indicators will be monitored on a quarterly basis by the Shetland Partnership Performance Group and progress will be reviewed annually in order to redefine targets and actions where required.

More information can be found at:
http://www.shetland.gov.uk/communityplanning/community_planning.asp

Service Performance

The Council's service committees receive quarterly financial and service performance information from each of the directorates. The following table provides brief information on some of the achievements of the directorates during the year:

Directorate	Achievements during 2016/17
Children's Services	• New Anderson High School project progressed within budget and on time; • Funding secured for new posts under the Developing the Young Workforce initiative to provide opportunities for young people leaving school; • Collaborating with the Northern Alliance to progress improvement in literacy and numeracy to close the attainment gap.
Community Health and Social Care	• New Eric Gray Resource Centre build progressing well; • Significant progress made by the Intermediate Care Team towards shifting balance of care further to the home setting, where appropriate; • Continued decrease in delayed discharges during 2016/17 with length of any delays reducing; • Locality-based support procured for people diagnosed with dementia.
Development Services	• Led a public engagement process focusing on 'the place we live' and its effects on wellbeing, preparing a report on Shetland's Place Standard to inform a range of key Plans and Strategies, e.g. Local Development Plan; • Secured commitment from the Scottish Government for over £2.5m for investment in new affordable housing; • Developed and implemented a new commercial lending service, policy and fund; • Engaged, in conjunction with Orkney Islands Council, Transport Scotland and the Scottish Government on specification and fair funding requirements for the inter-island transport services; • Worked with colleagues from Orkney and Western Isles to develop a draft Islands Deal as part of the 'Our Islands Our Future' project; • Worked with Corporate Services to produce a planning brief for the Knab Site; • Delivered a programme of participatory budgeting and community choices projects, with engagement from more than 1,000 people.
Infrastructure Services	• Mill Brae, Scalloway footpath widened and improved using SUSTRANs funding to encourage active travel to Scalloway School; • External funding of almost £3m secured by the Energy Team for carbon reduction related projects to help alleviate fuel poverty for 150 households; • Fitted vehicle tracking system to 230 vehicles to improve the management of routes, lone worker and driver safety and reduce carbon emissions and fuel usage; • Completed ferry terminal upgrades, ensuring toilets and waiting rooms are more energy efficient, comfortable and accessible for disabled and elderly people.
Corporate Services	• Deployed business continuity plans to ensure that front-line and support services were operational within 24 hours of moving from 8 North Ness; • Continued to deliver strong and robust financial management arrangements across the organisation and completed a review of the medium and long-term financial planning assumptions; • Developed the Council's first set of Values and Behaviours and completed a corporate Viewpoint Plan in response to staff feedback; • Helped hundreds of people in financial hardship through the provision of benefits and supported those in immediate need with crisis and community care grants, benefiting the most vulnerable in the community; • Undertook the secretariat role for the three island authorities, working in partnership and assisting the development of legislation under the banner of 'Our Islands Our Future'; • Developed the Gateway Process for the management of capital projects using the 'Building Better Business Cases' methodology and supported capital projects, including the Anderson High School and Eric Gray Resource Centre.

More information can be found at:
http://www.shetland.gov.uk/about_performance/PerformanceReports.asp

Primary Financial Statements

The annual accounts summarise the Council's transactions for the year, its year-end position at 31 March 2017 and its cash flows. The annual accounts are prepared in accordance with the International Accounting Standards Board (IASB) Framework for the Preparation and Presentation of Financial Statements (the IASB Framework) as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom.

A description of the purpose of primary statements has been included immediately prior to the four single entity statements: the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement, Balance Sheet and Cash Flow Statement. These four statements are accompanied by notes to the accounts which set out the accounting policies adopted by the Council and provide more detailed analysis of the figures disclosed on the face of the primary financial statements.

The primary financial statements and notes to the accounts, including the accounting policies, form the relevant annual accounts for the purpose of the auditor's certificate and opinion.

Financial Performance in 2016/17

The Comprehensive Income and Expenditure Statement (CIES) presents the full economic cost of providing Council services in 2016/17. This differs from the budgeted outturn position that was reported to the Policy & Resources Committee of the Council on 19 June 2017 and is available on the Council's website. For financial year 2016/17 the reasons are two-fold:

(i) the application of appropriate accounting standards to ensure that corporate activities not included within operational budgets are identified and included in the accounts, as these costs require to be met from local taxation; and

(ii) the CIES includes accounting adjustments required to comply with proper accounting practice, but which under statute do not impact upon local taxation payers.

The final accounting position reflects only those costs that are required to be met from local taxation. Therefore the difference between the CIES and the actual outturn position is as a result of necessary accounting adjustments.

The Deficit on Provision of Services of £14.4m, disclosed on the CIES, has been reconciled to the outturn used for management decision making of £2.6m in the Expenditure and Funding Analysis on page 28.

The CIES for 2015/16 has been restated to reflect new reporting requirements for 2016/17. These remove the need for service segments to be presented in line with the CIPFA Service Reporting Code of Practice and instead shows income and expenditure in the normal structure of the Council.

The Council's day-to-day operations and the recording of its financial transactions (revenue income and expenditure) are charged to two primary reserves, which have been established by legislation: the General Fund and Harbour Account (classified as Other revenue / Statutory Funds on page 29). There is also a legal requirement to separately identify expenditure and income that relates to the operation of the Council housing stock; this is referred to as the Housing Revenue Account.

Capital investment expenditure is supported by a range of means including funding from revenue resources, external borrowing and use of retained reserves. Legislation enables the Council to retain capital reserves in order to support its long-term asset investment plans, an example being the Capital Fund.

The table below shows that the draw on reserves, excluding accounting practice adjustments, was £5.8m for 2016/17.

As a result of underspending and applying the Council's carry-forward scheme, a sum of £7.6m was committed for use in 2017/18.

Budget v Expenditure draw from / (contribution to) Reserves 2016/17	Revised Budget £m	Actual £m	Budget v Actual variance Under / (Over) £m	Carry forwards £m	Revised variance Under / (Over) £m
General Fund	21.282	16.833	4.449	2.413	2.036
Revenue Spend to Save	1.000	0.000	1.000	0.250	0.750
Housing Revenue Account	(0.904)	(2.067)	1.163	0.000	1.163
Harbour Account	(11.025)	(12.118)	1.093	0.000	1.093
Total Revenue Draw	**10.353**	**2.648**	**7.705**	**2.663**	**5.042**
Capital Spend to Save	0.597	0.491	0.106	0.196	(0.090)
Asset Investment Plan	5.379	2.612	2.767	4.708	(1.941)
Total	**16.329**	**5.751**	**10.578**	**7.567**	**3.011**

A reconciliation between the revenue draw on reserves of £2.6m and the deficit in the CIES of £14.4m can be found in the Expenditure and Funding Analysis on page 28.

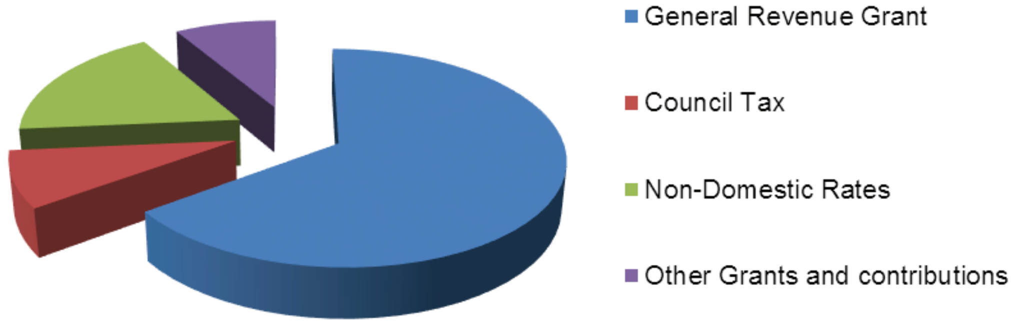
General Fund

Under the Local Government (Scotland) Act 1973, the Council is permitted to carry forward balances on the General Fund.

The General Fund expenditure for 2016/17 was £108.1m, which represented 95.2% of the Council's annual budget, resulting in a net underspend of £5.4m. This underspend can be attributed to a drive across services to reduce expenditure and increase income, as well as a number of one-off savings in year, mainly due to the number of staff vacancies within the Council.

In 2016/17 the Council's General Fund received the majority of its funding from the Scottish Government, which is made up of General Revenue Grant and National Non-Domestic Rates. The total funding breakdown is shown below:

General Fund - Sources of Funding 2016/17



The collection of Council Tax represents 8.6% of the Council's overall funding and the Council has achieved an in-year collection rate of 97% during 2016/17. The Council Tax bandings are due to change at 1 April 2017 and 2016/17 was the last year in which the Band D annual charge was frozen at £1,053.

The remainder of funding comes from Council's own reserves. This is set at a sustainable level, based on assumptions made about investment income and longer-term growth.

The resources deployed by the Council through its General Fund were used in the delivery and commissioning of services to the population of Shetland. As mentioned above, there have been some notable high-level achievements that have enabled the development and improvement of these services during 2016/17.

Given the current economic climate and the UK Government's financial objectives over the coming years, it is anticipated that there will be further reductions in the core revenue grant from the Scottish Government. At the same time, the Council must manage demographic and service delivery changes resulting from, for example, increasing demand for community care services, as well as having to manage cost pressures arising from inflation.

Harbour Account

The Zetland County Council Act 1974 empowers the Council to transfer surpluses arising on the Harbour Account to the Reserve Fund. The Harbour Account budgeted for an £11.0m contribution to the Reserve Fund in 2016/17. The actual contribution was £12.1m; the increase being due to a delayed capital programme, the replacement of the VTS Radar in particular, and an increase in income from the Shetland Gas Plant.

Housing Revenue Account

The Housing Revenue Account (HRA) is a separate account within the Council. The HRA budgeted for a £0.9m contribution to the HRA Reserve in 2016/17 which was exceeded by £1.2m, giving a total contribution of £2.1m in the year. The increase is mainly due to increased capital receipts which reduced the requirement to fund capital from rental income.

Despite this, the financial position of the HRA continues to be a challenge for the Council, due to a need to invest in current housing stock to meet national housing targets, as well as managing a high demand for new build housing.

A five-year business plan for the HRA was approved during the year, underpinned by a 30-year financial model to ensure affordability and sustainability over the long term.

At 31 March 2017 the HRA was responsible for 1,684 properties, a decrease of 41 since 31 March 2016. There has been a consistent reduction in housing properties due to a high level of housing sales through the tenants 'Right to Buy' scheme; however this scheme ended on 31 July 2016.

The Council continues to support Hjaltland Housing Association in its building programme to secure increased provision of affordable housing within Shetland.

Asset Investment Plan

In 2016/17 Shetland Islands Council incurred capital expenditure of £20.9m against a budget of £31.7m representing an underspend of £10.8m in the year. The main reason for this underspend is a revision to the timing of construction in relation to the Anderson High School, Halls of Residence and Eric Gray Resource Centre as well as underspends and tendering delays on Ports and Harbours projects. £10.7m will be carried forward to future years to enable the work to be completed.

The Balance Sheet

The Balance Sheet sets out the total net worth of Shetland Islands Council and is a snapshot of the position as at 31 March 2017. When comparing the net worth of the Council at 31 March 2017 to that of 31 March 2016, there has been an overall decrease in the net worth of the Council of £29.2m. This figure matches the total figure in the Comprehensive Income and Expenditure Statement, which captures all transactions during the financial year that led to the movement in the Council's net worth.

Material Transactions

Long-Term Investments

Financial investments are covered by the Council's Investment Strategy 2013-18, which seeks to provide financial support to the Council's Medium-Term Financial Plan, reduce fund manager fees as a proportion of the fund, and lower the risk of large negative returns while maintaining similar levels of return to that achieved in recent years. The Medium-Term Investment Strategy is supported by an Annual Investment and Treasury Strategy report.

As at 31 March 2017 the Council had £333.8m, invested with three external fund managers, an increase of £47.2m from the previous year. This increase is mainly attributable to excellent equity growth throughout the year and the fund managers' management of the investments. During the year the Council withdrew £20m from the investments to meet its cashflow requirements.

The Fund Management Annual Investment Report 2016/17 was presented to Council on 28 June 2017 and this summarised the performance of the Council's investments during the year. The report concluded that the Council's investments had strong returns of 22.9% during the year.

External Borrowing

External borrowing is covered by the Council's Borrowing Policy and Strategy 2013-18 which aims to secure Best Value in the financing of capital expenditure and maintain the level of reserves.

The Council's Capital Financing Requirement (CFR) is £33.7m as at 31 March 2017 and this represents the capital expenditure to be funded from borrowing. Whilst the CFR is a guide to the Council's underlying need to borrow, the Executive Manager – Finance can manage the Council's actual borrowing position by either borrowing to finance the CFR, choosing to utilise some temporary cashflow funds instead of borrowing (under-borrowing), or borrowing for future increases in the CFR (borrowing in advance of need).

As at 31 March 2017, external borrowing was £31.1m (£31.1m at 31 March 2016) and this is reflected on the Council's balance sheet on page 31.

Debt financing costs currently represent 2% of the Council's net revenue stream from general revenue grant (including NNDR), Council Tax, housing rents and harbour income. This provides an indication on the affordability of the Council's debt in terms of how much income can be directed to provide front-line service delivery rather than funding capital expenditure costs. Ongoing revenue implications of investment decisions will be managed within existing budgetary levels and the estimated cost of debt for 2017/18 is 2% of net revenue stream.

Pension

The Council is the administering authority for the Shetland Islands Council Local Government Pension Scheme, which has prepared a separate set of annual accounts for 2016/17.

The impact of the Local Government Pension Scheme and Teachers' Superannuation Scheme on the Council's accounts has been disclosed in Notes 22 and 23 to the accounts.

The pension liabilities continue to outstrip pension assets and as such the net pension liability for the Council is £229.7m as at 31 March 2017 (£143.1m at 31 March 2016). This figure represents the amount that actuaries estimate that Shetland Islands Council will have to pay out in future years for all pension entitlements earned by current and previous staff up and until 31 March 2017.

During 2016/17, the net pension liability has increased by £86.5m as a result of updated assumptions. The effects on the net pension liability of changes in individual assumptions can be measured. For instance, a 0.5% decrease in the discount rate assumption would result in an increase in the pension liability of £73.5m. The assumptions interact in complex ways, however, and are established for particular reasons.

The Council continues to monitor and measure its pension liability and make changes to cash contributions as part of the regular assessment made by an independent actuary. The next triennial valuation of the Pension Fund (as at 31 March 2017) will be prepared in 2017/18.

Highways Network Assets

At its meeting on 8 March 2017, CIPFA / LASAAC decided not to proceed with the introduction of the Highways Network Asset Code into the financial reporting requirements for local authorities. This means that there will be no change to accounting policy in respect of highways assets, as outlined in last year's Management Commentary.

Health and Social Care Integration

The Public Bodies (Joint Working) (Scotland) Act 2014 introduced significant changes to the provision of social and health care across Scotland. The legislation means changes to the law that require health boards and local authorities to integrate their services, resulting in more joined up, seamless and improved quality of health and social care provision.

Shetland Islands Council Integration Joint Board (IJB) was formally constituted on 27 June 2015 with voting members from both the Council and the Health Board.

In 2016/17, the Council contributed £19.6m to the IJB and received income from it of £20.4m, a result of some social care funding being channelled through the NHS Shetland financial settlement.

The Council's Reserves

The Council holds the following balances in reserves:

Reserves	Opening Balance at 1 April 2016 £m	Closing Balance at 31 March 2017 £m
General Fund Balance	(40,232)	(54,417)
Housing Revenue Account Balance	(13,143)	(15,614)
Harbour Reserve Funds	(61,622)	(63,518)
Capital Funds	(84,178)	(66,498)
Other Revenue / Statutory Funds	(43,054)	(44,378)
Total Usable Reserves	**(242,229)**	**(244,425)**

The overall level of usable reserves was £244.4m at 31 March 2017, an increase of £2.2m from the previous year. The movement on reserves differs from the outturn position reported. The reserves position is required to reflect a number of accounting adjustments for matters such as asset transfers, provisions and capital grants, which are not reflected in the reports to management during the year. The Movement in Reserves Statement (page 29) and associated notes provide further detail.

The reserves of the Council reflect the historic financial performance of the Council and decisions that have been taken to provide a financial foundation upon which to plan for the future delivery and provision of Council services.

Reserves are split between discretionary and earmarked reserves to recognise these decisions taken and also the availability of funds should any unplanned or unexpected liabilities or expenditure arise. The impact of various reserve movements and earmarking of funds is that the uncommitted General Fund reserve has increased by £11.6m to £24.3m as at 31 March 2017 from the previous year (see page 44). The uncommitted balance represents 21.2% of the Council's annual budgeted net expenditure and is considered sufficient to manage financial risks in the short term.

The Council uses its reserves on an annual basis to support delivery of frontline services. This is based on money being available from the anticipated income and growth achieved from the Council's long-term investments.

The value of the Council's long-term investments, which are quite separate from the usable reserves, represent the money that has been invested by the Council for long-term return. The increase in value is measured in terms of income generated by those investments and a change in their value reflected by unrealised gains, plus any injection of new money by the Council during the year. Usable reserves on the other hand reflect a level of resources that the Council has available to carry out its future business; these reserves can be applied to the provision of services. More information is outlined in the 'Long-Term Investments' section on page 6.

Group Accounts

The Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 requires the Council to prepare group accounts where the Council has interests in subsidiaries, associates and / or jointly controlled entities, subject to the consideration of materiality. The Council has interests in Orkney & Shetland Valuation Joint Board (OSVJB), Zetland Transport Partnership (ZetTrans) and the Integration Joint Board.

The interest in OSVJB is deemed to be not material and is therefore not consolidated in group accounts. The results of the remaining two bodies have a net nil impact on both the Comprehensive Income and Expenditure Statement and the Balance Sheet; therefore no Group Accounts are presented for 2016/17, as there is no financial impact and no qualitative benefit to readers.

2017/18 Budget and Medium-Term Financial Outlook

Medium-Term Financial Outlook

The Medium-Term Financial Plan (MTFP) is the Council's strategic finance document which focuses on the next five years. It is anticipated that there will be significant cash reductions in the general revenue grant from the Scottish Government over the forthcoming years and therefore an increasingly unaffordable cost of service delivery is inevitable. At the same time, the Council must manage increasing demand for services from areas such as community care, where the IJB will direct service development and adapt to these demands.

The revised MTFP was approved by the Council on 8 March 2017, covers a five-year period to March 2022 and is based on the following key principles:

- The Council will live within its means, and in doing so approve an annual budget that is balanced and affordable;
- The Council has agreed to use its long-term investments as an investment fund and draw a sustainable amount of the long-term anticipated return from those investments each year to support services;
- The cost of capital will be recognised by the Council and the cost of any borrowing undertaken will be borne by the revenue budget and met by the relevant service that will benefit from the capital investment;
- The Executive Manager – Finance will determine the costs associated with the management of significant corporate cost pressures, such as pay, pension and tax implications of national and local conditions of service. Where these cannot be applied to service budgets a central contingency will be retained and allocated to service budgets when required;
- A risk-based approach will be taken to areas of the budget that services identify to be uncertain in any single year and a central contingency will be retained and allocated to service budgets if required;
- The MTFP will identify the level of funding that can be made available for the delivery of services and estimate the gap between income and expenditure for which income generation, savings options and further efficiencies will have to be implemented.

Community Choices

Community Choices is the new term for participatory budgeting, which is high on the Scottish Government's agenda for local authorities. It is expected that over the short to medium term, local authorities will allocate up to 1% of their annual budgets through community participation and decision-making. In 2016/17 a pilot scheme was undertaken by Shetland Islands Council that saw projects totalling £0.1m being chosen by the public through a process of online voting as well as in-person participation at a one-day market stall style event.

The pilot was successful, with around 5% of the population taking part. The Council is currently examining ways of 'mainstreaming' this approach to increase public participation in future budget setting and decision-making.

2017/18 Budget

The Council's 2017/18 budget is a tactical financial plan that complements the strategic Medium-Term Financial Plan, to ensure that the Council delivers its strategic financial objectives and achieves its target outcomes.

The 2017/18 budget was prepared in line with the budget targets set out in the Council's MTFP 2015-2020.

The comparative figures for the 2017/18 settlement are shown in the following table. Although the revenue funding in Scotland reduced by 0.7% for 2017/18, the impact on Shetland was a reduction of 2.8%; a significantly different outcome for Shetland than the average change.

Note that 2016/17 figures have been restated in line with revised information from the Scottish Government (Circular 1/2017).

Scotland	2017/18 £bn	2016/17 £bn	Movement £bn	Movement %
Revenue	9.639	9.708	(0.069)	-0.7%
Capital	0.787	0.607	0.180	29.7%
Total Scotland Funding	**10.426**	**10.315**	**0.111**	**1.1%**
Shetland	**£m**	**£m**	**£m**	**%**
Revenue	80.366	82.695	(2.329)	-2.8%
Capital	7.208	6.831	0.377	5.5%
Total Shetland Funding	**87.574**	**89.526**	**(1.952)**	**-2.2%**

In addition to having a lower level of funding there are certain conditions that local authorities must meet, which bring further financial pressures. These conditions are:

- Teacher: pupil ratios to be maintained at 2016/17 national levels;
- £120m funding to support closing the attainment gap to be paid directly to schools and used for specific purposes;
- A further £107m funding for social care, allocated to Health for Integration Joint Boards, to be used for specific purposes; and
- Council Tax increases capped at 3%.

Following the announcement of the financial settlement for 2017/18 the Corporate Management Team considered the detail and agreed a revised budget strategy that was discussed with Councillors in seminars held in January 2017. A report on the settlement was also prepared and the Council considered this ahead of the formal budget-setting meeting.

The revised budget strategy drew upon funding that was allocated by the Scottish Government to the NHS and the IJB specifically for social care services and also took into account funding that was announced by the Scottish Government in early February 2017. This benefits Shetland to the value of £1.0m and means that an additional sum of £2.8m is to be drawn from reserves to balance the budget and support service delivery in 2017/18. The 2017/18 budget was formally approved by the Council on 15 February 2017.

Outlook - Projects and Initiatives

Business Transformation Programme

Shetland Islands Council approved its Business Transformation Programme as part of the budget setting process and adoption of the Corporate and Executive Services Directorate Plan in February 2017. This seeks to provide the framework to review and transform the services provided to the population of Shetland and the ways those services are delivered. There are eight groups of subject areas, known as ‘workstreams’, as follows:

- **Customer Focus:** including a review of complaints procedures, performance reporting to the public and a new Customer Charter;
- **Commissioning / Procurement Framework:** including a revised strategy for 2017/18 and an online system for tenders;
- **Asset Strategy:** including the consideration of a long-term Asset Investment Plan;
- **Workforce Strategy:** incorporating themes of Right Shape, Right Skills and Right Culture;
- **Broadband and Connectivity:** including the development of a Digital Strategy and lobbying for 100% high-speed broadband and 4G mobile coverage;
- **Digital Service Delivery:** incorporating a review of the Council’s website and consideration of self-service and open data;
- **Information Management & Improvement:** which considers information security, records management and business continuity; and
- **Paperless Council:** including a review of council meeting processes for officers and elected members.

Anderson High School

The Anderson High School project, which is substantially funded by the Scottish Government, reached financial close in July 2015, when all contracts and designs were completed and signed off. The project is being delivered by North Scotland Hub Co with the main contractor being Morrison Construction. The construction of both the school and halls of residence is progressing well and is due to be handed over in September 2017.

Eric Gray Resource Centre

The construction of a new Eric Gray Resource Centre to support adults with learning disabilities and complex needs commenced in August 2016, with the contract awarded to local contractor DITT Construction Limited. The building is due to be completed in 2018/19.

College Integration

As part of the review of tertiary education in Shetland, an Interim Joint Principal of Shetland College, Train Shetland and NAFC Marine Centre was appointed in May 2016 with the aim of developing the joint academic approach to the tertiary sector, as well as preparing the business plan for the future delivery of tertiary education in Shetland.

Other aspects of the work are: to integrate the governance between the organisations and to improve collaboration to achieve shared objectives.

Inter-Island Transport Study

Shetland Islands Council, in partnership with ZetTrans, the Highlands and Islands Transport Partnership (HITRANS), Orkney Islands Council and Transport Scotland, undertook a network-wide study of inter-island transportation in each of the archipelagos, in order to assess the appropriateness of service needs to outer islands in applying national standards and methodology.

This work has been the foundation for engaging with Transport Scotland and the Scottish Government in relation to fair funding for these services. Shetland Islands Council continues to push for the Scottish Government to deliver on its commitment for fair funding by providing the money that will support the revenue and capital requirements of the service on a permanent basis.

Workforce Management and Strategy

Workforce management priorities and performance are reported formally through a structured performance management framework that provides quarterly reporting to the Policy & Resources Committee.

The Council has continued to work on managing attendance, which has led to an improvement in our sickness absence figures:

Average days lost per	2016/17	2015/16
Local Government	9.0	10.7
Teachers	5.1	6.2

Outlook

In summary, the Council has had a financially successful year in 2016/17 and is moving forward with a number of exciting projects designed to improve its efficiency and effectiveness and to secure improved outcomes for the people of Shetland.

The continuing challenges that lie ahead will be addressed by the newly elected Council in line with the revised Medium-Term Financial Plan.

....

Cecil Smith
Leader of the Council
20 September 2017

Mark Boden
Chief Executive
20 September 2017

Jonathan Belford CPFA
Executive Manager – Finance
20 September 2017

Annual Governance Statement

Scope of Responsibility

Shetland Islands Council is responsible for ensuring that its business is conducted in accordance with the law and that public money is safeguarded, properly accounted for and used economically, efficiently and effectively. The Council also has a statutory duty to make arrangements to secure continuous improvement in the way it operates.

In discharging this accountability, the Council is responsible for establishing proper arrangements for the governance of its affairs, including arrangements for the management of risk.

The Council approved and adopted its code of governance in 2012. It is consistent with the principles of the CIPFA/SOLACE Framework *'Delivering Good Governance in Local Government'*. This statement explains how the Council has complied with the code.

The Governance Framework

The governance framework comprises the systems and processes, culture and values by which the Council is directed and controlled and the activities through which it engages with its community. It enables the Council to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate services and value for money.

The system of internal control is a significant part of the governance framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of Council's policies, aims and objectives, to evaluate the likelihood and potential impact of those risks being realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place for the year ended 31 March 2017 and up to the date of approval of the annual accounts.

The key elements of Shetland Islands Council's governance framework are:

- the legal powers, duties and functions of the Council, and roles and responsibilities of the people who take decisions on behalf of the community;
- the levels at which decisions can be made, referred to as the Scheme of Administration and Delegations;
- the Standing Orders and the rules around how committees are run and decisions are made;
- the Financial Regulations and rules about contracting with other parties;
- the Council's performance in relation to delivering services and securing value for money; and
- the process of internal control and checking that the Council's policies and procedures are being followed, through the work of the Internal Audit staff and others.

In March 2017, the Council approved a revised set of governance documents, including the Scheme of Delegation, Financial Regulations, Contract Standing Orders and Code of Corporate Governance. These documents can be found on the Council's website at: http://www.shetland.gov.uk/about_how_we_work/constitutionandgovernance.asp

Review of Effectiveness

The Council has responsibility for conducting, at least annually, a review of the effectiveness of its governance framework including the system of internal control. The review of effectiveness is informed by the work of the senior officers who have responsibility for the development and maintenance of the governance environment, the annual report of the Executive Manager – Audit, Risk & Improvement, and also by comments made by external auditors and other review agencies and inspectorates.

The effectiveness of the Council's governance framework has been evaluated as follows:

- Each **director** has reviewed the arrangements in their portfolio and certified their effectiveness to the Executive Manager – Finance. These assurances include internal financial controls and provide the opportunity to highlight any weaknesses or areas of concern. For 2016/17, no areas of weakness or concern were raised.

- The Council's **financial management** arrangements comply with the requirements of the CIPFA Statement on the Role of the Chief Financial Officer in Local Government (2010).
- The Council **committee structure** supports the organisational and management structure of the Council, incorporating a culture of accountability that has been developed throughout.
- The **Audit Committee** remains responsible for ensuring the effectiveness of the internal audit function and considering all reports prepared by the external auditor. Its remit ensures that the work of the Council, from both a control and performance perspective, is checked and scrutinised.
- A professional, independent and objective **internal audit** service is one of the key elements of good governance. The Council's internal audit function operates in accordance with the Public Sector Internal Audit Standards (PSIAS).
- The Council has a newly appointed **external auditor** for 2016/17, Deloitte LLP. They regularly report to the Audit Committee and their reports cover the annual accounts audit and wider scope requirements set out within the Code of Audit Practice.

We have been advised on the implications of the result of the review of the effectiveness of the governance framework by the Corporate Management Team and the Audit Committee and that arrangements continue to be regarded as fit for purpose in accordance with the governance framework. The areas already addressed and those to be specifically addressed with new actions planned are outlined below.

Significant Governance Issues

During the year, the Audit Committee received a range of reports produced by Internal Audit that enabled scrutiny and questioning of officers, such that the Committee gained assurance about any weaknesses identified as well as the actions being taken to address them.

The following issues and related action plans were highlighted in Internal Audit's annual report as specific areas of concern:

- inappropriate employment of relief workers and the processes surrounding the monitoring of hours worked by employees working in multiple locations within community care;
- corporate breaches of working time regulations and overtime requirements, inconsistencies and procedure not being followed in relation to preventing illegal working;
- recruitment process issues, including the appointment of candidates who have not met all of the essential criteria on the job specification and evidence of relevant qualifications not always being obtained;
- a lack of adequate control in the payment of adoption allowances;
- the lack of a Service Plan within Transport Planning; and
- procedural issues in relation to sales invoices, such as invoices not always being raised timeously or stating the quantity and unit costs accurately.

Follow-up work was carried out in relation to the issues highlighted in last year's Annual Governance Statement. Internal audit concluded that, aside from the areas still noted above, satisfactory progress had been made in addressing control weaknesses.

We propose over the coming year to take steps to address the above matters to further enhance our governance arrangements. We are satisfied that these steps will address the need for improvements identified in our review of effectiveness and will monitor their implementation and operation as part of our next annual review.

Conclusion

Overall, we consider that the governance and internal control environment operating in 2016/17 provides reasonable and objective assurance that any significant risks impacting on the achievement of our principal objectives will be identified, and actions taken to avoid or mitigate their impact.

....
Cecil Smith
Leader of the Council
20 September 2017

....
Mark Boden
Chief Executive
20 September 2017

Remuneration Report

The Remuneration Report is set out in accordance with the Local Government Accounts (Scotland) Regulations 2014. These Regulations require various disclosures on the remuneration and pension benefits of senior councillors and employees.

All information disclosed in the tables in this Remuneration Report has been audited by Deloitte LLP. The other sections of the Remuneration Report have been reviewed by Deloitte LLP to ensure that they are consistent with the financial statements.

The Code of Practice on Local Authority Accounting in the UK (the Code) also requires the disclosure of exit packages.

Remuneration Arrangements of Senior Councillors

The remuneration of councillors is regulated by the Local Governance (Scotland) Act 2004 and the (Remuneration) Regulations 2007 (as amended). The Regulations provide for the grading of councillors for the purposes of remuneration arrangements, as either the convener of a council, senior councillors or councillors. A senior councillor is a councillor who holds a significant position of responsibility in a council's political management structure, usually referred to as the chair or vice-chair of a committee, sub-committee or board.

When determining the level of remuneration for councillors the Scottish Ministers consider the recommendations of the Scottish Local Authority Remuneration Committee (SLARC). SLARC is an advisory Non-Departmental Public Body set up in 2005 to advise Scottish Ministers on the remuneration, allowances and expenses incurred by local authority councillors.

The salary that is to be paid to the Convener of the Council is set out in the amended Regulations SSI 2008/415, which came into effect on 10 February 2009 (later amended by the 2013 and 2015 Regulations). For 2016/17 the level of remuneration (including expenses) was £28.9k for the Leader (£28.2k in 2015/16), and £21.4k for the Convener (£20.9k in 2015/16).

The Regulations also set out the remuneration that may be paid to senior councillors and the total number of senior councillors a council may have. The maximum yearly amount that may be paid to a senior councillor is 75% of the total yearly amount payable to the leader of a council. The total yearly amount payable by the Council for remuneration of all of its Senior Councillors shall not exceed £171k in 2016/17 (£169k in 2015/16).

The Council is able to exercise local flexibility in the determination of the precise number of Senior Councillors and their salary within these maximum limits.

The senior councillor positions are:

- Chair of Education and Families Committee
- Chair of Integration Joint Board
- Chair of Development Committee
- Chair of Environment and Transport Committee
- Chair of Audit Committee
- Chair of Planning Committee
- Chair of Licensing Committee
- Chair of Harbour Board
- Chair of Shetland College Board

Excluding the Convener and the Leader, the total remuneration paid to these Councillors in 2016/17 was £171.0k (£169.8k in 2015/16).

The Regulations also permit the Council to pay contributions or other payments as required to the Local Government Pension Scheme, in respect of those Councillors who elect to become councillor members of the Local Government Pension Scheme.

The original policy, following the Regulations, which encompasses the salaries of all elected members, including the Convener, Leader and senior councillors, was agreed at a meeting of the Council on 8 February 2007 in a report entitled 'Review of Committee and Decision Making Structures'.

The Scheme was updated on 7 March 2011 to reflect amendments to the committee structure, including the positions that attract special responsibility allowances.

The Scheme was further updated at the Council meeting on 12 May 2011 with the new positions that attract those allowances, including the creation of the post of Leader, and the Council adopted the new political management framework with effect from 18 May 2011.

All reports are available from the Council's website at http://www.shetland.gov.uk/.

Local government elections were held in May 2017, resulting in changes to senior councillor posts. These changes will be reported in the Remuneration Report for the 2017/18 annual accounts.

Remuneration of Conveners and Vice-Conveners for Joint Boards

In addition to the senior councillors of the Council, the Regulations also set out the remuneration payable to councillors with the responsibility of a Convener or a Vice-Convener of a Joint Board, such as the Orkney and Shetland Valuation Joint Board. The Regulations require the remuneration to be paid by the Council of which the Convener or Vice-Convener (as the case may be) is a member. The Council is also required to pay any pension contributions arising from the Convener or Vice-Convener being a member of the Local Government Pension Scheme.

The Convener of the Orkney and Shetland Valuation Joint Board in 2016/17 was also a senior councillor of Shetland Islands Council.

The Council is reimbursed by the Orkney and Shetland Valuation Joint Board for the additional remuneration paid to the councillor in their role of the Convener of the Joint Board.

Remuneration of Senior Employees

Remuneration is the term used to describe the total payments made to employees and will include salary payments and allowances such as distant islands allowance and statutory duty allowances.

The salary of senior employees is set by reference to national arrangements and agreements. The Scottish Joint Negotiating Committee (SJNC) for Local Authority Services sets the salaries for the Chief Executives of Scottish Local Authorities. Circular CO/148 sets the amount of salary for the Chief Executive of Shetland Islands Council for the period 2015 to 2017. The salaries of the directors are based on a fixed percentage of the Chief Executive's salary, namely 80% of the value of the Chief Executive's salary. Executive managers fall into two bandings, the second reflecting the additional level of statutory responsibility held by the Monitoring Officer, the Section 95 Officer and the Chief Social Work Officer. These arrangements were agreed through approval of Report CE-30-F 'Management Restructuring' at a meeting of the Council on 14 June 2011.

The current senior management structure is:

- Chief Executive
- Director - Children's Services
- Director - Community Health and Social Care
- Director - Corporate Services
- Director - Development
- Director - Infrastructure
- Executive Manager - Children and Families (Chief Social Work Officer)
- Executive Manager - Finance (Section 95 Officer)
- Executive Manager - Governance and Law (Monitoring Officer)

In order to ensure that recruitment of senior employees is properly managed, a protocol for chief officer appointments is in place. The protocol applies to appointments to the chief officer posts of Chief Executive and Director. The protocol is designed to ensure that:

- the appointment is widely known and the best available candidates are attracted to apply;
- the best information is available to the Council about qualities, skills, experience and personal attributes of candidates; and
- information about candidates is assessed effectively and fairly during the assessment, selection and appointment process.

Allowances

Senior employees are entitled to a mobile phone and to claim mileage costs paid at rates recommended by HM Revenue & Customs.

General Disclosure by Pay Band

The Regulations require the Remuneration Report to provide information on the number of persons whose remuneration was £50k or more, disclosed in bands of £5k.

This table includes payments made in the year for salary, pension contributions, redundancy and compensatory added years of pension.

Bands that do not appear in the table had nil employees in both 2016/17 and 2015/16.

Number of Employees							
	As at 31 March 2016	As at 31 March 2017					
Remuneration Bands	Total	Children's Services	Infrastructure Services	Community Health and Social Care	Development Services	Corporate Services & Executive Services	Total
£50,000 - £54,999	51	21	34		2	1	58
£55,000 - £59,999	22	10	10	1	4	5	30
£60,000 - £64,999	18	6	8	2			16
£65,000 - £69,999	8	3	5		1		9
£70,000 - £74,999	5		7				7
£75,000 - £79,999	2	1	1			2	4
£80,000 - £84,999	1		1				1
£85,000 - £89,999	3	1	1		2	1	5
£90,000 - £94,999	0		1				1
£100,000 - £104,999	2					1	1
£105,000 - £109,999	0		1				1
£110,000 - £114,999	0		3				3
£115,000 - £119,999	1		1				1
£140,000 - £144,999	1		1				1
£150,000 - £154,999	1						0
£155,000 - £159,999	1						0
Total	**116**	**42**	**74**	**3**	**9**	**10**	**138**

The table above includes employees who terminated employment during 2015/16 and 2016/17. Some of the employees that left received remuneration packages that included compensation for loss of office (e.g. redundancy payment and/or enhanced pension payments), and, as a result, their total remuneration increased temporarily in those years.

Of the 42 staff (33 in 2015/16) in Children’s Services noted above, 29 were head teachers or senior teaching staff (22 in 2015/16).

Of the 74 staff (62 in 2015/16) in Infrastructure Services noted above, 67 worked in Ports and Harbours Operations or Ferry Operations (56 in 2015/16).

Exit Packages

The Regulations require the Remuneration Report to provide information on the number of exit packages awarded in bandings of £20k up to £100k, and thereafter in bandings of £50k, along with the total cost of the exit packages within each band. The Regulations also require disclosure of the number of compulsory redundancies and other agreed departures. The cost of exit packages must pay back within three years, with ongoing salary savings realised thereafter.

The total cost for 2016/17 of £0.222m (£0.345m in 2015/16) in the table includes £0.032m (£0.161m in 2015/16) for termination benefits agreed, accrued for and charged to the Comprehensive Income and Expenditure Statement (CIES) in the current year, comprising redundancy payments and pension strain costs. In addition, the table includes £0.190m (£0.184m in 2015/16) for the capitalised cost of compensatory added years, agreed in 2016/17, that will be charged to the CIES in future years.

Exit package cost band (including special payments)	(a) Number of compulsory redundancies		(b) Number of other departures agreed		(a+b) Total number of exit packages by cost band		Total cost of exit packages in each band	
	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16	2016/17 £000	2015/16 £000
£0 - £19,999	1	2	6	18	**7**	**20**	**18**	**81**
£20,000 - £39,999	0	0	2	1	**2**	**1**	**68**	**39**
£40,000 - £59,999	0	0	0	0	**0**	**0**	**0**	**0**
£60,000 - £79,999	0	0	0	0	**0**	**0**	**0**	**0**
£80,000 - £99,999	0	0	0	1	**0**	**1**	**0**	**90**
£100,000 - £149,999	0	0	1	1	**1**	**1**	**136**	**135**
Total	**1**	**2**	**9**	**21**	**10**	**23**	**222**	**345**

The table above details the number and cost of exit packages awarded in 2015/16 and 2016/17. Included in the cost of the exit packages are:

- Any termination payment, such as a redundancy payment;
- Strain on the fund cost (the amount payable by the Council to the pension fund because the employee has retired before the assumed retirement age);
- Any enhanced payments, such as compensatory added years;
- A capitalised value of the recurring compensatory added years payment. This is paid annually by the Council once an employee has left and is therefore a notional cost at 31 March 2017.

Summary of Remuneration paid to Councillors

The Council paid the following salaries, additional allowances (for senior councillors) and expenses in respect of all elected members:

	2016/17 £000	2015/16 £000
Salaries	372	368
Allowances	34	34
Expenses	84	94
Total	**490**	**496**

The annual return of Councillors' salaries and expenses for 2016/17 is available for any member of the public to view at the Finance Service, Montfield, 28 Burgh Road, Lerwick during normal working hours or on the Council's website at http://www.shetland.gov.uk/.

Disclosure of Remuneration for Senior Councillors

Councillor Name	Designation	2016/17			2015/16
		Salary, Fees and Allowances £	Taxable Expenses £	Total Remuneration £	Total Remuneration £
M Bell	Convener	21,118	238	**21,356**	**20,909**
P Campbell	Chair - Shetland College Board	18,555	216	**18,771**	**18,371**
A Cooper	Chair - Development Committee	19,568	248	**19,816**	**19,374**
A Duncan	Chair - Audit Committee	18,555	150	**18,705**	**18,371**
A Manson	Chair - Harbour Board	18,555	0	**18,555**	**18,371**
G Robinson	Leader of the Council	28,157	763	**28,920**	**28,206**
F Robertson	Chair - Planning Committee	18,555	735	**19,290**	**18,853**
C Smith	Chair - Integration Joint Board	19,568	150	**19,718**	**19,374**
G Smith	Chair - Licensing Committee	18,555	0	**18,555**	**18,371**
M Stout	Chair - Environment & Transport Committee	19,568	128	**19,696**	**19,374**
V Wishart	Chair - Education & Families Committee	19,568	0	**19,568**	**19,374**

Note:

Taxable expenses include telephone line rental / broadband costs.

Remuneration of Senior Employees of the Council

Name of Senior Official	Designation	2016/17			2015/16	Notes
		Salary, Fees and Allowances £	Taxable Expenses £	Total Remuneration £	Total Remuneration £	
M Boden	Chief Executive	103,562	0	**103,562**	**102,510**	
H Budge	Director - Children's Services	86,315	0	**86,315**	**85,433**	
C Ferguson	Director - Corporate Services	86,315	455	**86,770**	**85,503**	
N Grant	Director - Development Services	86,315	0	**86,315**	**85,433**	
M Sandison	Director - Infrastructure Services	86,315	0	**86,315**	**84,549**	
J Belford	Executive Manager - Finance (Section 95 Officer)	75,548	0	**75,548**	**0**	e)
H Leslie	Executive Manager - Children & Families (Chief Social Work Officer)	0	0	**0**	**10,488**	f)
M Nicolson	Executive Manager - Children & Families (Chief Social Work Officer)	67,163	0	**67,163**	**54,387**	g)
J Riise	Executive Manager - Governance & Law (Monitoring Officer)	75,548	0	**75,548**	**74,854**	
W Cameron	Marine Pilot	111,056	512	**111,568**	**153,786**	h)
S Polson	Marine Pilot	107,869	457	**108,326**	**157,842**	h)

Notes:

a) Remuneration includes ad-hoc elements that are part of the normal duties of the post, ie call-out and stand-by allowances;

b) Taxable expenses includes taxable mileage and / or expenses outwith HMRC's dispensation;

c) In addition to the above, the Executive Manager - Governance & Law received a payment of £6.5k for his Returning Officer duties in respect of the Scottish Parliamentary election and Scottish independence referendum (£2.6k in 2015/16);

d) The post of Director of Community Health & Social Care is held by S Boker-Ingram, who is employed by NHS Shetland; 50% of the cost of this post is funded by the Council. In 2016/17 the Council paid £59k (£59k for 2015/16) to NHS Shetland in respect of this post and his remuneration is disclosed in the Remuneration Report of the Integration Joint Board;

e) The post of Executive Manager - Finance (Section 95 Officer) was held by S Whyte who was employed by Aberdeen City Council until 31 March 2016. In 2015/16 the Council paid £69k to Aberdeen City Council in respect of this post. J Belford commenced employment on 1 April 2016;

f) H Leslie left on 31 March 2015, however final payments of call-out / standby and holiday pay were not made until May 2015;

g) M Nicolson commenced employment on 29 June 2016. The full year equivalent remuneration for 2015/16 was £66,912;

h) Marine Pilot remuneration is inclusive of non-contractual overtime payments and compensation payments.

Pension Benefits – Senior Councillors

The pension entitlements for Senior Councillors are shown in the table below, together with the contribution made by the Council to each Senior Councillor during the year.

Name of Councillor	Designation	In-Year Employer Pension Contributions		Accrued Pension Benefits			
				As at 31 March 2017		Difference from 31 March 2016	
		31 March 2017 £000	31 March 2016 £000	Pension £000	Lump Sum £000	Pension £000	Lump Sum £000
M Bell	Convener	4	4	2	0	1	0
G Robinson	Leader of the Council	6	5	4	2	(1)	0
C Smith	Chair - Integration Joint Board	4	4	5	2	1	0
P Campbell	Chair - Shetland College Board	4	3	2	0	1	0
A Cooper	Chair - Development Committee	4	4	4	2	1	0
A Duncan	Chair - Audit Committee	4	3	4	1	0	0
M Stout	Chair - Environment & Transport Committee	4	4	2	0	1	0
G Smith	Chair - Licensing Committee	4	3	2	0	1	0
A Manson	Chair - Harbour Board	4	3	2	0	1	0

Notes:

The table excludes F Robertson, Chair of the Planning Committee and V Wishart, Chair of the Education & Families Committee, as they are not members of the Local Government Pension Scheme.

Pension Benefits - Senior Employees

Name of Senior Official	Designation	In-Year Employer		Accrued Pension Benefits			
				As at 31 March 2017		Difference from 31 March 2016	
		31 March 2017	31 March 2016	Pension	Lump Sum	Pension	Lump Sum
		£000	£000	£000	£000	£000	£000
M Boden	Chief Executive	20	19	8	0	2	0
H Budge	Director - Children's Services	15	14	27	80	2	5
C Ferguson	Director - Corporate Services	17	16	44	95	2	1
N Grant	Director - Development Services	17	16	19	20	2	0
M Sandison	Director - Infrastructure Services	17	16	27	44	2	0
J Belford	Executive Manager - Finance	15	0	27	50	27	50
M Nicolson	Executive Manager - Children & Families	13	10	21	35	1	(1)
J Riise	Executive Manager - Governance & Law	16	14	34	66	2	0
W Cameron	Marine Pilot	16	15	39	83	3	3
S Polson	Marine Pilot	16	15	22	33	2	1

Notes:

a) The Executive Manager - Governance & Law also has pension benefits arising from Returning Officer (RO) duties in respect of Local Government, Scottish and European Parliamentary elections. A single disclosure of the pension benefits is detailed above and includes RO accrued pension benefits of £1.6k and £2.5k lump sum at 31 March 2017. In 2015/16, the comparative figures were £1.5k and £2.5k respectively;

b) Whilst 50% of remuneration costs of the Director of Community Health & Social Care are funded by the Council, the associated pension benefits are administered by NHS Shetland and disclosed in the Remuneration Report of the Integration Joint Board;

c) The pension benefits of the Executive Manager – Finance (Section 95 Officer) in 2015/16 (S Whyte) were administered by Aberdeen City Council.

Pension Benefits

Pension benefits for councillors and local government employees are provided through the Local Government Pension Scheme (LGPS), apart from teachers, whose pension benefits are provided through the Scottish Teachers Superannuation Scheme (STSS). The LGPS is a funded pension scheme that receives contribution payments from both Scheme members and participating employers.

Councillors' pension benefits to 31 March 2015 were based on career average pay. Councillors' pay for each year or part up to 31 March 2015 (other than the pay in the final year commencing 1 April 2014) is increased by the increase in the cost of living, as measured by the appropriate index (or indices) between the end of that year and the last day of the month in which their membership of the Scheme ends. The total of the revalued pay is then divided by the period of membership to calculate the career average pay. This is the value used to calculate the pension benefits up to 31 March 2015.

From 1 April 2015, the Pension Scheme moved to a career average related earnings scheme for all scheme members. Councillors and local government employees build up a pension at a rate of 1/49th of the amount of pensionable pay they receive in a scheme year. The amount of pension built up is increased in line with HM Treasury Orders at the end of each scheme year.

Benefits built up before 1 April 2015 will continue to be calculated on final pay for employees and average revalued pay for councillors.

The Scheme's normal retirement age for both councillors and employees is now linked to their own state pension age (with a minimum age 65).

From 1 April 2015 the five-tier employee pension contribution system still remains, with contributions from scheme members based on how much pay falls into each tier. This is designed to give more equality between the cost and benefits of Scheme membership. Prior to 2009 contribution rates were set at 6% for all non-manual employees.

Tiered contribution rates on whole time pay are as follows:	2016/17 %
On earnings up to and including £20,500	5.50
On earnings above £20,500 and up to £25,000	7.25
On earnings above £25,000 and up to £34,400	8.50
On earnings above £34,400 and up to £45,800	9.50
On earnings above £45,800	12.00

From April 2015, if a person works part-time, their contribution rate is worked out on their actual pay rate for the job and contributions are paid on actual pay earned. Prior to April 2015, the contribution rate was worked out on their whole-time equivalent rate of pay, with contributions paid on actual pay earned.

There is no automatic entitlement to a lump sum. Members may opt to give up (commute) pension for lump sum up to the limit set by the Finance Act 2004. From April 2015 pensions are built up at a rate of 1/49th of annual pensionable pay for that year. Prior to April 2015, the accrual rate guaranteed a pension based on 1/60th of final pensionable salary and years of pensionable service. (Prior to 2009 the accrual rate guaranteed a pension based on 1/80th and a lump sum based on 3/80th of final pensionable salary and years of pensionable service).

The value of the accrued benefits has been calculated on the basis of the age at which the person will first become entitled to receive a pension on retirement without reduction on account of its payment at that age; without exercising any option to commute pension entitlement into a lump sum, and without any adjustment for the effects of future inflation.

The pension figures shown relate to the benefits that accrued as a consequence of an individual's total Local Government Service, not just their current appointment. The figures also reflect any transfer of pension benefits from another pension fund or scheme.

……………………………………..
Cecil Smith
Leader of the Council
20 September 2017

……………………………………..
Mark Boden
Chief Executive
20 September 2017

Statement of Responsibilities for the Annual Accounts

The Council's Responsibility

The Council is required to:

- make arrangements for the proper administration of its financial affairs and to secure that the proper officer has the responsibility for the administration of those affairs (section 95 of the Local Government (Scotland) Act 1973). In this Council the proper officer is the Executive Manager - Finance;
- manage its affairs to secure economic, efficient and effective use of resources and to safeguard its assets;
- ensure the annual accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014) and, so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003); and
- approve the annual accounts for signature.

I can confirm that these annual accounts were approved for signature by the Council on 20 September 2017.

Signed on behalf of Shetland Islands Council.

....

Cecil Smith
Leader of the Council
20 September 2017

The Executive Manager - Finance's Responsibilities

The Executive Manager - Finance is responsible for the preparation of the Council's annual accounts in accordance with proper practices as required by legislation and as set out in the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code).

In preparing the annual accounts, the Executive Manager - Finance has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- complied with legislation; and
- complied with the local authority Accounting Code (in so far as it is compatible with legislation).

The Executive Manager - Finance has also:

- kept adequate accounting records which were up to date;
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

I certify that the annual accounts give a true and fair view of the financial position of the Council at the reporting date and the transactions of the Council for the year ended 31 March 2017.

....

Jonathan Belford
Executive Manager - Finance
20 September 2017

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

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice approved by the Accounts Commission, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the annual accounts of Shetland Islands Council for the year ended 31 March 2017 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Comprehensive Income and Expenditure Statement, Expenditure and Funding Analysis, Movement in Reserves Statement, Balance Sheet, Cash Flow Statement, Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement, the Council Tax Income Account, and the Non-domestic Rate Account and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the 2016/17 Code).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2016/17 Code of the state of affairs of the Shetland Islands Council as at 31 March 2017 and of its or deficit on the provision of services for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2016/17 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Basis of opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the council in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standards for Auditors, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Executive Manager - Finance for the financial statements

As explained more fully in the Statement of Responsibilities, the Executive Manager - Finance is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Executive Manager - Finance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s responsibilities for the audit of the financial statements

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require us to comply with the Financial Reporting Council’s Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the council and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Executive Manager - Finance; and the overall presentation of the financial statements.

Our objectives are to achieve reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK&I) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Other information in the annual accounts

The Executive Manager - Finance is responsible for the other information in the annual accounts. The other information comprises the information other than the financial statements and our auditor’s report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission to the extent explicitly stated later in this report.

In connection with our audit of the financial statements in accordance with ISAs (UK&I), our responsibility is to read all the financial and non-financial information in the annual accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Report on other requirements

Opinions on other prescribed matters

We are required by the Accounts Commission to express an opinion on the following matters.
In our opinion, the auditable part of the Remuneration Report has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014.

In our opinion, based on the work undertaken in the course of the audit

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003; and
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016).

Matters on which we are required to report by exception

We are required by the Accounts Commission to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the auditable part of the Remuneration Report are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- there has been a failure to achieve a prescribed financial objective.

We have nothing to report in respect of these matters.

…………………………………………………………….

Pat Kenny, CPFA (for and on behalf of Deloitte LLP)
110 Queen Street
Glasgow
G1 3BX
United Kingdom

20 September 2017

Primary Financial Statements

Comprehensive Income and Expenditure Statement for year ended 31 March 2017

This statement shows the accounting cost in the year of providing services in accordance with generally accepted accounting practices, rather than the amount to be funded from taxation. Councils raise taxation to cover expenditure in accordance with regulations; this may be different from the accounting cost. The taxation position is shown in both the Movement in Reserves Statement and the Expenditure and Funding Analysis.

The Net Cost of Services for 2015/16 has been restated to reflect the internal reporting structure of Shetland Islands Council in accordance with new reporting requirements for 2016/17.

2015/16 Net Expenditure £000		Notes	2016/17 Gross Expenditure £000	2016/17 Gross Income £000	2016/17 Net Expenditure £000
5,626	Chief Executive and Cost of Democracy		2,160	(5)	2,155
46,243	Children's Services		52,053	(4,216)	47,837
20,965	Community Care Services		48,029	(27,284)	20,745
5,610	Corporate Services		16,862	(5,549)	11,313
13,943	Development Services		21,958	(7,153)	14,805
31,706	Infrastructure Services		43,185	(16,119)	27,066
(1,043)	Housing Revenue Account		5,406	(6,767)	(1,361)
(2,355)	Harbour Account		19,203	(28,862)	(9,659)
120,695	**Net Cost of Services**		**208,856**	**(95,955)**	**112,901**
4,378	Other operating income and expenditure	6	0	(572)	(572)
2,527	Financing and investment income and expenditure	7	7,607	(9,447)	(1,840)
(103,601)	Taxation and non-specific grant income	8	0	(96,055)	(96,055)
23,999	**Deficit on Provision of Services**		**216,463**	**(202,029)**	**14,434**
	Items that will not be reclassified to the (surplus) or deficit on the provision of services				
3,322	(Surplus) / Deficit on revaluation of property, plant and equipment assets	9			(4,529)
(8,689)	Surplus on revaluation of available for sale financial assets	9			(61,891)
(49,419)	Remeasurement of the net defined benefit liability	9			79,290
(54,786)					**12,870**
	Items that may be reclassified to the (surplus) or deficit on the provision of services				
15,441	Amounts recycled from the AFSFI reserve upon derecognition	9			1,868
(39,345)	**Other Comprehensive Income and Expenditure**				**14,738**
(15,346)	**Total Comprehensive Income and Expenditure**				**29,172**

Expenditure and Funding Analysis

The objective of the Expenditure and Funding Analysis is to demonstrate to council tax and rent payers how the funding available to the authority (ie government grants, rents, council tax and business rates) for the year has been used in providing services in comparison with those resources consumed or earned by authorities in accordance with accounting practices. It also shows how this expenditure is allocated for decision-making purposes between the council's directorates. Income and expenditure accounted for under generally accepted accounting practices is presented more fully in the CIES.

2015/16					2016/17			
Net Expenditure chargeable to the General Fund and HRA £000	Adjustments between the Funding and Accounting Basis £000	Present-ational Adjustments £000	Net Expenditure in the CIES £000		Net Expenditure chargeable to the General Fund and HRA £000	Adjustments between the Funding and Accounting Basis £000	Present-ational Adjustments £000	Net Expenditure in the CIES £000
2,266	(19)	3,379	5,626	Chief Executive and Cost of Democracy	1,754	(642)	1,043	2,155
41,295	(5,259)	10,207	46,243	Children's Services	39,954	(5,775)	13,658	47,837
19,274	(1,812)	3,503	20,965	Community Care Services	18,323	(1,470)	3,892	20,745
7,107	(9,238)	7,741	5,610	Corporate Services	10,562	(5,988)	6,739	11,313
13,411	(550)	1,082	13,943	Development Services	13,815	(1,623)	2,613	14,805
18,620	(12,440)	25,526	31,706	Infrastructure Services	19,725	(5,652)	12,993	27,066
(1,429)	(592)	978	(1,043)	Housing Revenue Account	(2,067)	(648)	1,354	(1,361)
(3,136)	14,945	(14,164)	(2,355)	Harbour Account	(12,118)	(2,468)	4,927	(9,659)
97,408	**(14,965)**	**38,252**	**120,695**	**Net Cost of Services**	**89,948**	**(24,266)**	**47,219**	**112,901**
(95,544)	(3,288)	2,136	(96,696)	Other income and expenditure	(87,300)	4,746	(15,913)	(98,467)
1,864	**(18,253)**	**40,388**	**23,999**	**(Surplus) or Deficit**	**2,648**	**(19,520)**	**31,306**	**14,434**
				General Fund and HRA balances				
52,067				**Opening balance at 1 April**	**53,375**			
1,864				Add Surplus in the year	2,648			
(556)				Add other items not charged to the Surplus / Deficit	14,008			
53,375				**Closing balance at 31 March**	**70,031**			

Movement in Reserves Statement

This statement shows the movement in the year on the different reserves held by the Council, analysed into ‘usable reserves’ (i.e. those that can be applied to fund expenditure or reduce local taxation) and other ‘unusable’ reserves. This statement shows how the movements in year of the Council’s reserves are broken down between gains and losses incurred in accordance with generally accepted accounting practices and the statutory adjustments required to return to the amounts chargeable to council tax or rents for the year. The Net Increase / Decrease line shows the statutory General Fund Balance and Housing Revenue Account Balance movements in the year following those adjustments.

Opening balances have been adjusted for the rationalisation / reclassification of usable reserves explained in Note 6: Transfers to / (from) Earmarked Reserves on page 44.

	General Fund Balance £000	Housing Revenue Account £000	Capital Receipts Reserve / Capital Funds £000	Capital Grants Unapplied £000	Other Revenue/ Statutory Funds £000	Total Usable Reserves £000	Unusable Reserves £000	Total Authority Reserves £000
Balance at 31 March 2016	**(15,250)**	**0**	**(85,173)**	**(53)**	**(141,753)**	**(242,229)**	**(265,862)**	**(508,091)**
Restatement of opening balance	(24,982)	(13,143)	1,048	0	37,077	**0**	0	0
Balance at 1 April 2016	**(40,232)**	**(13,143)**	**(84,125)**	**(53)**	**(104,676)**	**(242,229)**	**(265,862)**	**(508,091)**
Movement in reserves during the year:								
Total Comprehensive Income and Expenditure	16,385	(1,951)	0	0	0	**14,434**	14,738	29,172
Adjustments between accounting basis & funding basis per regulations (Note 5)	(18,999)	(520)	1,562	7	0	(17,950)	17,950	0
Net (Increase)/Decrease before Transfers to Statutory Reserves	**(2,614)**	**(2,471)**	**1,562**	**7**	**0**	**(3,516)**	**32,688**	**29,172**
Net Transfers to/(from) Other Statutory Reserves	(11,571)	0	16,113	(2)	(3,220)	1,320	(1,320)	0
(Increase)/Decrease in year	**(14,185)**	**(2,471)**	**17,675**	**5**	**(3,220)**	**(2,196)**	**31,368**	**29,172**
Balance at 31 March 2017	**(54,417)**	**(15,614)**	**(66,450)**	**(48)**	**(107,896)**	**(244,425)**	**(234,494)**	**(478,919)**

Comparative movements in 2015/16	General Fund Balance	Housing Revenue Account	Capital Receipts Reserve / Capital Funds	Capital Grants Unapplied	Other Revenue/ Statutory Funds	Total Usable Reserves	Unusable Reserves	Total Authority Reserves
	£000	£000	£000	£000	£000	£000	£000	£000
Balance at 1 April 2015	**(14,446)**	**0**	**(73,840)**	**(643)**	**(152,026)**	**(240,955)**	**(251,790)**	**(492,745)**
Movement in reserves during the year:								
(Surplus) or deficit on the provision of services	25,117	(1,118)	0	0	0	**23,999**	0	23,999
Other Comprehensive Income and Expenditure	0	0	0	0	0	**0**	(39,345)	(39,345)
Total Comprehensive Income and Expenditure	**25,117**	**(1,118)**	**0**	**0**	**0**	**23,999**	**(39,345)**	**(15,346)**
Adjustments between accounting basis & funding basis per regulations (Note 5)	(17,661)	(592)	(7,610)	590	0	(25,273)	25,273	0
Net (Increase)/Decrease before Transfers to Statutory Reserves	**7,456**	**(1,710)**	**(7,610)**	**590**	**0**	**(1,274)**	**(14,072)**	**(15,346)**
Net Transfers to/(from) Other Statutory Reserves	(8,260)	1,710	(3,723)	0	10,273	0	0	0
(Increase)/Decrease in year	**(804)**	**0**	**(11,333)**	**590**	**10,273**	**(1,274)**	**(14,072)**	**(15,346)**
Balance at 31 March 2016	**(15,250)**	**0**	**(85,173)**	**(53)**	**(141,753)**	**(242,229)**	**(265,862)**	**(508,091)**

Balance Sheet as at 31 March 2017

This shows the value as at the Balance Sheet date of the assets and liabilities recognised by the Council. The net assets of the Council (assets less liabilities) are matched by the reserves held by the Council. Reserves are reported in two categories. The first category of reserves is usable reserves, i.e. those reserves that the Council may use to provide services, subject to the need to maintain a prudent level of reserves and any statutory limitations on their use (for example the Capital Receipts Reserve that may only be used to fund capital expenditure or repay debt). The second category of reserves is those that the Council is not able to use to provide services. This category of reserves includes reserves that hold unrealised gains and losses (for example the Revaluation Reserve), where amounts would only become available to provide services if the assets are sold, and reserves that hold timing differences shown in the Movement in Reserves Statement line 'Adjustments between accounting basis and funding basis under regulations'.

As at 31 March 2016 £000		Notes	As at 31 March 2017 £000
374,296	Property, Plant and Equipment	10	371,052
4,925	Heritage Assets	11	4,854
19,043	Intangible Assets	12	25,114
286,632	Long-term Investments	13	333,784
5,680	Long-term Debtors	13	4,316
29	Other Long-term Debtors	15	77
690,605	**Long-Term Assets**		**739,197**
654	Assets held for Sale	16	1,355
4,564	Inventories	19	4,511
21,833	Short-term Debtors	15	37,869
2,520	Cash and Cash equivalents	17	3,909
29,571	**Current Assets**		**47,644**
(24,458)	Short-term Creditors	18	(39,453)
(6,177)	Short-term Provisions	20	(634)
(40)	Grant Receipts in Advance - Revenue	8	(24)
(30,675)	**Current Liabilities**		**(40,111)**
(31,093)	Long-term Borrowing	13	(31,075)
(143,129)	Pension Liability	22	(229,675)
(1,282)	Long-term Provisions	20	(1,230)
(5,906)	Other Long-term Liabilities	13	(5,831)
(181,410)	**Long-Term Liabilities**		**(267,811)**
508,091	**Net Assets**		**478,919**
(242,229)	Usable Reserves	24	(244,425)
(265,862)	Unusable Reserves	9	(234,494)
(508,091)	**Total Reserves**		**(478,919)**

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Jonathan Belford CPFA
Executive Manager – Finance
Shetland Islands Council
20 September 2017

Cash Flow Statement for year ended 31 March 2017

This statement shows the changes in cash and cash equivalents of the Council during the reporting period. The statement shows how the Council generates and uses cash and cash equivalents by classifying cash flows as operating, investing and financing activities. The amount of net cash flows arising from operating activities is a key indicator of the extent to which the operations of the Council are funded by way of taxation and grant income, or from the recipients of services provided by the Council. Investing activities represent the extent to which cash outflows have been made for resources which are intended to contribute to the Council's future service delivery. Cash flows arising from financing activities are useful in predicting claims on future cash flows by providers of capital (i.e. borrowing) to the Council.

2015/16 £000		2016/17 £000
	Operating activities	
23,999	Net deficit on the provision of services	14,434
(49,028)	Adjustment to net surplus or deficit on the provision of services for non-cash movements (Note 25)	(35,382)
17,073	Adjustments for items included in the net surplus or deficit on the provision of services that are investing and financing activities (Note 25)	8,959
(7,956)	**Net cash flows from Operating Activities**	**(11,989)**
8,204	Investing activities (Note 26)	10,488
55	Financing activities (Note 27)	112
303	**Net increase in cash and cash equivalents**	**(1,389)**
2,823	Cash and Cash Equivalents at 1 April	2,520
(303)	Net movement of Cash and Cash Equivalents during the year	1,389
2,520	**Cash & Cash Equivalents at 31 March**	**3,909**

Housing Revenue Account

Introduction and Statutory Background

The Housing (Scotland) Act 1987 provides the statutory framework for the housing accounts of Scottish local authorities. Part X of the 1987 Act requires a local authority to keep a Housing Revenue Account (HRA) of the income and expenditure for each year in respect of the houses, buildings and land specified in Part I of Schedule 15.

Part X of the 1987 Act and Schedule 15 thereto make significant provisions relevant to the preparation of the financial statements:

- Section 203(1) – housing authorities have a duty to keep an HRA;
- Section 203(5) – the HRA must be kept in accordance with Part II of Schedule 15 regarding debits, credits and supplementary provisions;
- Section 204 – the Scottish Government has the power to limit General Fund contributions to HRA;
- Schedule 15 – housing authorities have a duty to avoid a deficit in the HRA but if there is a deficit, a General Fund contribution must be made equal to the deficit;
- Schedule 15 – the Scottish Government may decide that items of income or expenditure, either generally or of a specific category, shall be included or excluded from the HRA;
- Schedule 15 – with the consent of the Scottish Government, a housing authority may exclude or include any items of income or expenditure in the HRA; and
- Schedule 15 – the Scottish Government may direct rectification of the account if it is of the opinion that items of income or expenditure have not been, or have been improperly, credited or debited in the HRA.

The operation of the HRA in terms of statutory debits and credits is governed by Part II of Schedule 15 of the 1987 Act and will include income (dwelling rents, services and other charges, Housing Support Grant) and expenditure (repairs, maintenance and management, capital financing costs, bad debts and voids).

In parallel with the treatment for the Council's wider operations, the transactions relating to the HRA have been separated into two statements:

- the HRA Income and Expenditure Statement;
- the Movement on the HRA Statement.

As the Movement on the HRA Statement incorporates the Surplus or Deficit on the HRA Income and Expenditure Statement, it effectively meets the statutory requirement to include the HRA as a single statement in the annual accounts.

The HRA Income and Expenditure Statement

The HRA Income and Expenditure Statement shows the economic cost in the year of providing housing services in accordance with generally accepted accounting practices, rather than the amount to be funded from rents and government grants. Councils charge rents to cover expenditure in accordance with the legislative framework; this may be different from the accounting cost. The increase or decrease in the year, on the basis of which rents are raised, is shown in the Movement on the HRA Statement.

Housing Revenue Account Income and Expenditure Statement

2015/16 £000		2016/17 £000
	Expenditure	
2,751	Repairs and maintenance	2,055
568	Supervision and management	670
2,220	Depreciation and impairment of non-current assets	2,395
32	Movement in the allowance for bad debts	48
137	Other expenditure	175
5,708	**Total expenditure**	**5,343**
	Income	
(6,534)	Dwelling rents	(6,552)
(187)	Non-Dwelling rents	(190)
(30)	Other Income	(25)
(6,751)	**Total income**	**(6,767)**
(1,043)	**Net income of HRA services as included in the CIES**	**(1,424)**
54	HRA services' share of Corporate and Democratic Core	63
(989)	**Net Income of HRA Services**	**(1,361)**
	HRA share of operating income and expenditure included in the CEIS	
0	Taxation and non-specific grant income	(128)
(581)	Gain on sale of HRA non-current assets	(766)
632	Interest payable and similar charges	624
(281)	Interest and investment income	(404)
101	Pension interest cost and expected return on pension assets	84
(129)	**Net HRA share of operating expenditure**	**(590)**
(1,118)	**Surplus for the year on HRA services**	**(1,951)**

Movement on the Housing Revenue Account Statement

2015/16 £000		2016/17 £000
0	**Balance on the HRA at 1 April**	0
	Transfer from Housing Repairs & Renewals Account	(13,143)
(1,118)	Surplus on the HRA Income and Expenditure Statement	(1,951)
(592)	Adjustment between accounting basis and funding basis under statute	(520)
(1,710)	**Decrease in year on the HRA**	**(2,471)**
1,710	Transfers to reserves	0
0	**Balance on the HRA at 31 March**	**(15,614)**

The adjustments between accounting basis and funding basis under regulations are shown in disclosure note 5 and transfers to or from other Statutory Reserves are shown in disclosure note 6.

Notes to the Housing Revenue Account

a) Number and Types of Dwellings

The following table shows the stock movements by apartment size:

2015/16 Number	Housing Stock	2016/17 Number
104	1 Apartment	87
411	2 Apartment	407
533	3 Apartment	527
637	4 Apartment	626
37	5 Apartment	34
1	6 Apartment	1
2	8 Apartment	2
1,725	**Total**	**1,684**

b) Amount of Rent Arrears

The table below summarises the rent arrears position for HRA dwellings. The trend shown below is a slight increase in the amount of arrears per property.

2015/16 £000		2016/17 £000
221	Total value of rent arrears	227

2015/16		2016/17
437	Number of properties in arrears	547
25.3%	Properties in arrears as share of total stock (%)	32.5%
£506	Average amount per property in arrears (£)	£415

c) Provision for Bad Debts

The following table summarises the movements on the bad debt provision during 2016/17:

2015/16 £000		2016/17 £000
(49)	**Balance as at 1 April**	**(39)**
31	Bad rent debt written off: Under £1,000	20
(18)	**Total bad debt written off**	**20**
11	Transfer of provision to cover general fund rents	14
(32)	Contribution to/(from) Housing Revenue Account	(48)
(39)	**Balance as at 31 March**	**(53)**

Council approval is required to write off bad debts with a value over £5k.

d) Void Rents

The following table summarises the income lost due to voids in 2016/17. These amounts are included in the other expenditure line of the Housing Revenue Account Income and Expenditure Statement.

2015/16 £000		2016/17 £000
59	General needs void rents and charges	66
29	Sheltered housing void rents and charges	30
88	**Total**	**96**

Council Tax Income Account

Statutory Background

The Council Tax Income Account (Scotland) shows the gross income raised from Council Taxes levied and deductions made under statute. The resultant net income is transferred to the Comprehensive Income and Expenditure Account.

Council Tax is payable on any dwelling which is not an exempt dwelling (prescribed by an order made by the Scottish Government). The amount of Council Tax payable depends on the valuation band of the dwelling.

Council Tax Income Account

2015/16 £000		2016/17 £000
(10,333)	Gross Council Tax levied and contributions in lieu	(10,435)
616	Council Tax Reduction Scheme	623
1,167	Other discounts and reductions	1,208
32	Write-offs of uncollectable debts	35
26	Adjustment to previous years' Community Charge and Council Tax	27
(8,492)	**Transfer to General Fund**	**(8,542)**

a) Council Tax Base

Overleaf is the analysis of the Council Tax base used to set the 2016/17 charges. The analysis sets out the number of chargeable dwellings in each valuation band, before and after adjustment for exemptions and discounts, with all figures also shown after conversion to band D equivalents.

b) Charge Setting

The analysis then sets out the tax yield and the charge per property in each band for the General Fund.

c) Deductions

The gross charge to a given property may be affected by the following deductions:

- **Council Tax Reduction Scheme -** The Welfare Reform Act of 2012 abolished Council Tax Benefit with effect from 31 March 2013. In Scotland the Council Tax Reduction (Scotland) Regulations 2012 provide for a scheme to replace Council Tax Benefit with a Scotland wide scheme.
- **Exemptions -** Council Tax will be payable on almost all houses. A few, however, will be exempt. Houses where all the residents are students, or are under 18 years old, or are persons with a severe mental impairment, will be exempt. So will some classes of empty property, although in many cases only for a limited period.
- **Discounts -** Council Tax bills can be reduced by discounts for dwellings with fewer than two adults. If only one adult lives there, the bill may be cut by 25%. If the property is unoccupied and is no-one's sole or main residence, the bill may be cut by up to 50%. If the property is a second home or long-term empty, the discount will only be 10%. Certain persons will not be counted when establishing the number of residents, these being students, student nurses, apprentices, Youth Training trainees, persons with a severe mental impairment, adults for whom Child Benefit is still payable, people absent in nursing homes or hospitals, prisoners, care workers and members of religious communities.
- **Reliefs -** If a house has been structurally altered for a disabled person, the Council Tax bill may be set at the next band lower in value than that shown in the Valuation List. A reduction is also available for properties in Band A.

Council Tax Valuation Bands 2016/17	Band A Subject to Disabled Relief	Band A £0 to £26,999	Band B £27,000 to £34,999	Band C £35,000 to £44,999	Band D £45,000 to £57,999	Band E £58,000 to £79,999	Band F £80,000 to £105,999	Band G £106,000 to £211,999	Band H £212,000 upwards	Total
Council Tax Weighting per Band	5	6	7	8	9	11	13	15	18	
Total Properties per Register (Number)	0	2,974	1,827	2,752	1,791	1,350	265	61	1	**11,021**
Gross Tax Base (Properties x Weighting)	0	17,844	12,789	22,016	16,119	14,850	3,445	915	18	**87,996**
Adjusted number of properties (Band D equivalents)	**0**	**1,988**	**1,417**	**2,432**	**1,765**	**1,622**	**373**	**98**	**2**	**9,697**
Number of vacant properties:										
Mandatory Standard Exemptions	0	(120)	(55)	(66)	(33)	(13)	(3)	(3)	(1)	**(294)**
Chargeable Dwellings subject to Disabled Reduction	0	(11)	(4)	(10)	(9)	(4)	(1)	(1)	0	**(40)**
Number of dwellings effectively subject to tax by virtue of:										
Disabled Relief (Number)	11	4	10	9	4	1	1	0	0	**40**
Class 18 (MoD) Dwellings (Number)	0	0	0	0	0	0	0	0	0	**0**
Total number of properties	**11**	**2,847**	**1,778**	**2,685**	**1,753**	**1,334**	**262**	**57**	**0**	**10,727**
Types of Property (Number):										
Single Discount (25%)	4	1,120	712	952	385	193	25	9	0	**3,400**
Double Discount (50%)	0	340	99	98	57	36	4	3	0	**637**
No Discount (0%)	7	1,387	967	1,635	1,311	1,105	233	45	0	**6,690**
Total number of properties	**11**	**2,847**	**1,778**	**2,685**	**1,753**	**1,334**	**262**	**57**	**0**	**10,727**
Properties Subject to Council Tax (Number)	10	2,397	1,551	2,398	1,628	1,268	254	53	0	**9,559**
Net Tax Base (Properties x Weighting)	50	14,382	10,857	19,184	14,652	13,948	3,302	795	0	**77,170**
Adjusted Properties (Band D Equivalents)	**6**	**1,598**	**1,206**	**2,132**	**1,628**	**1,550**	**367**	**88**	**0**	**8,575**
2015/16										
Properties Subject to Council Tax (Number)	12	2,405	1,546	2,369	1,602	1,248	245	53	0	**9,480**
Net Tax Base (Properties x Weighting)	60	14,430	10,822	18,952	14,418	13,728	3,185	795	0	**76,390**
Adjusted Properties (Band D Equivalents)	**7**	**1,603**	**1,202**	**2,106**	**1,602**	**1,525**	**354**	**88**	**0**	**8,487**

Non-Domestic Rate Income Account

Statutory Background

Occupiers of non-domestic property pay rates based on the valuation of property within the valuation roll for the area. The non-domestic rate poundage is determined by the Scottish Government.
The Non-Domestic Rate Account (Scotland) is an agent's statement that reflects the statutory obligation for billing authorities to maintain a separate Non-Domestic Rate Account. The statement shows the gross income from the rates and deductions made under statute. The net income is paid to the Scottish Government as a contribution to the national non-domestic rate pool.

Non-Domestic Rate Income Account

2015/16 £000		2016/17 £000
22,438	Gross rates levied and contributions in lieu	27,279
(4,901)	Reliefs and other deductions	(3,779)
(7)	Write-offs of uncollectable debts	1
17,530	**Net non-domestic rate income**	**23,501**
(76)	Adjustment to previous years' national non-domestic rates	(242)
17,454	**Contribution to non-domestic rate pool**	**23,259**
(16,882)	Distribution from non-domestic rate pool	(17,822)
(16,882)	**Transfer to Comprehensive Income & Expenditure Statement**	**(17,822)**

Analysis of Rateable Value

The table below sets out the number of subjects liable for General Rates and the rateable values at the start of the year.

Category	Number of Subjects	Rateable Value £000
Commercial	564	7,538
Industrial	497	34,865
Other	937	13,090
Total	**1,998**	**55,493**

The amount paid for non-domestic rates is determined by the rateable value agreed by the Assessor multiplied by the rate per £ (rate poundage) that is announced annually by the Scottish Government.

The national non-domestic rate poundage set for 2016/17 is 48.4p (up from 48.0p in 2015/16) with a large business supplement of 2.6p (up from 1.3p in 2015/16) for all subjects with a rateable value above £35k.

The large business supplement contributes to the cost of the Small Business Bonus Scheme which was introduced by the Scottish Government from 1 April 2008, replacing the Small Business Rate Relief Scheme, and applies to properties with a rateable value of £18k or less.

Notes to the Financial Statements

Note 1: Accounting Standards Issued not Adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued, but not yet adopted. This applies to the adoption of the following new or amended standards within the 2017/18 Code:

- Amendment to the reporting of pension fund scheme transaction costs; and
- Amendment to the reporting of investment concentration.

The Code requires implementation in the accounts of pension funds from 1 April 2017 and there is therefore no impact on the Council's 2016/17 financial statements.

Note 2: Material Items of Income and Expenditure

The CIES includes an actuarial loss on pension liability of £79.2m (see Note 10: Unusable Reserves).

Note 3: Assumptions Made About the Future and Other Major Sources of Estimation Uncertainty

The annual accounts contain estimated figures that are based on assumptions made by the Council about the future, or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. Because balances cannot be determined with certainty, however, actual results could be materially different from the assumptions and estimates.

The items in the Council's Balance Sheet at 31 March 2017 for which there is a significant risk of material adjustment in the forthcoming financial year are shown in the following table:

Item	Uncertainties	Effect if actual results differ from assumptions
Pension Liability	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the Council with expert advice about the assumptions to be applied.	The effects on the net pensions liability of changes in individual assumptions can be measured. For instance, a 0.5% decrease in the discount rate assumption would result in a decrease in the pension liability of £73.5m; however, the assumptions interact in complex ways.
Fair Value Measurement	When the fair value of financial assets and liabilities cannot be measured based on quoted prices in active markets (i.e. Level 1 inputs), their fair value is measured using valuation techniques. Where possible, the inputs to these valuation techniques are based on observable data, but where this is not possible judgement is required in establishing fair values. These judgements typically include considerations such as uncertainty and risk. The Council holds Available-for-Sale financial assets (investments) and Financial Guarantees at fair value.	This will be different in each case, but changes in any assumptions used in all asset valuation could affect the values disclosed in the accounts.

Item	Uncertainties	Effect if actual results differ from assumptions
Arrears	At 31 March 2017, the Council had a balance on short-term sundry debtors of £5.4m. A review of significant balances suggested that an allowance for impairment of doubtful debts of £0.2m is appropriate in the current economic climate. Council Tax collection does not impose a significant impairment risk as historically, less than 0.5% of charges levied are ever written off.	If sundry debtor collection rates were to deteriorate, for example if the amount of doubtful debts doubled, an additional £0.2m would require to be set aside as an allowance. It is estimated that no more than £0.05m will eventually be written off from Council Tax charges of £8.5m levied during 2016/17.
Property, Plant and Equipment	Assets are depreciated over useful lives that are dependent on assumptions about the level of repairs and maintenance that will be incurred in relation to individual assets. Any reduction in anticipated spending on repairs and maintenance may reduce the useful lives assigned to assets.	If the useful life of an asset is reduced, depreciation accelerates and the carrying value of the asset falls. It is estimated that the annual depreciation charge for buildings would increase by £0.6m for every year that useful lives were reduced.
Fishing Quota	Fishing quota held by the Council were valued at £24.150m by an independent broker at 31 March 2017. The price that quota attract is affected by the quantity of Fixed Quota Allocation Units (FQAs) in the market. There is a possibility, though this is currently uncertain, that Brexit will have an impact on the quantity of FQAs in the market.	The effect will vary depending on market conditions at the time of valuation; it is not quantifiable at this time.

Note 4: Expenditure and Income Analysed by Nature

This note details the subjective analysis of the gross income and expenditure reported in the CIES and, in conjunction with the new Expenditure and Funding Analysis and related note, replaces the previous 'Amounts Reported for Resource Allocation Decisions' note.

2015/16 £000	Expenditure and Income Analysed by Nature	2016/17 £000
	Expenditure	
94,228	Employee expenses	101,760
68,448	Other service expenses	92,679
26,555	Depreciation, amortisation and impairment	19,681
3,643	Interest payments	2,343
4,378	Loss on disposal of non-current assets	0
197,252	**Total Expenditure**	**216,463**
	Income	
(55,047)	Fees, charges & other service income	(86,824)
(7,036)	Interest and investment income	(9,447)
(8,492)	Income from Council Tax	(8,542)
(102,678)	Government grants and contributions	(96,644)
0	Gain on disposal of non-current assets	(572)
(173,253)	**Total Income**	**(202,029)**
23,999	**Deficit on the provision of services**	**14,434**

Note 5: Adjustments between Accounting Basis and Funding Basis under Regulations

This note details the adjustments that are made to the CIES, recognised by the Council in the year in accordance with proper accounting practice, to the resources that are specified by statutory provisions as being available to the Council to meet future capital and revenue expenditure.

The following sets out a description of the reserves that the adjustments are made against:

General Fund Balance

The General Fund is the statutory fund into which all the receipts of the Council are required to be paid and out of which all liabilities of the Council are to be met, except to the extent that statutory rules might provide otherwise. These rules can also specify the financial year in which liabilities and payments should impact on the General Fund balance, which is not necessarily in accordance with proper accounting practice. The General Fund balance therefore summarises those resources that the Council is statutorily empowered to spend on its services or on capital investment (or the deficit of resources that the Council is required to recover) at the end of the financial year. The balance is not available to be applied to fund Housing Revenue Account services.

Housing Revenue Account Balance

The Housing Revenue Account balance reflects the statutory obligation to maintain a revenue account for local authority council housing provision in accordance with Part X of the Housing (Scotland) Act 1987. It contains the balance of income and expenditure as defined by the 1987 Act that is available to fund future expenditure in connection with the Council's landlord function or (where in deficit) that is required to be recovered from tenants in future years.

Capital Receipts Reserve

The Capital Receipts Reserve holds the proceeds from the disposal of land or other assets which are restricted by statute from being used other than to fund new capital expenditure or to be set aside to finance historical capital expenditure. The balance on the reserve shows the resources that have yet to be applied for these purposes at the year-end.

Capital Grants Unapplied

The Capital Grants Unapplied Account (reserve) holds the grants and contributions received towards capital projects for which the Council has met the conditions that would otherwise require repayment of the monies, but which have yet to be applied to meet expenditure. The balance is restricted by grant terms as to the capital expenditure against which it can be applied and/or the financial year in which this can take place.

2016/17	Usable Reserves				
	General Fund Balance £000	Housing Revenue Account £000	Capital Receipts Reserve £000	Capital Grants Unapplied £000	Unusable Reserves £000
Adjustments primarily involving the Capital Adjustment Account:					
Reversal of items charged to the CIES:					
Charges for depreciation and impairment of non-current assets	(15,993)	(2,107)	0	0	18,100
Revaluation losses on property, plant and equipment	(249)	(265)	0	0	514
Amortisation of intangible assets	(1,044)	(23)	0	0	1,067
Capital grants and contributions applied	4,652	128	0	45	(4,825)
Amounts of non-current assets written off on disposal or sale as part of the gain/loss on disposal to the CIES	(538)	(1,462)	0	0	2,000
Capital repayment in respect of finance leases	94	0	0	0	(94)
Insertion of items not charged to the CIES:					
Statutory provision for the financing of capital investment	244	1,086	0	0	(1,330)
Capital expenditure charged against the General Fund and HRA balances	1,512	45	0	0	(1,557)
Adjustments primarily involving the Capital Grants Unapplied Account:					
Capital grants and contributions unapplied credited to the CIES	38	0	0	(38)	0
Application of grants to capital financing transferred to the Capital Adjustment Account	0	0	0	0	0
Adjustments primarily involving the Capital Receipts Reserve:					
Transfer of cash sale proceeds credited as part of the gain/loss on disposal to the CIES	344	2,228	0	0	(2,572)
Use of the Capital Receipts Reserve to finance new capital expenditure	0	0	1,562	0	(1,562)
Adjustments primarily involving the Financial Instruments Adjustment Account:					
Amount by which finance costs charged to the CIES are different from finance costs chargeable in the year in accordance with statutory requirements	(72)	0	0	0	72
Adjustments primarily involving the Pensions Reserve:					
Reversal of items relating to retirement benefits charged to the CIES	(18,830)	(316)	0	0	19,146
Employer's pensions contributions and direct payments to pensioners payable in the year	11,717	173	0	0	(11,890)
Adjustment primarily involving the Employee Statutory Adjustment Account:					
Amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements	(875)	(7)	0	0	882
Total Adjustments	**(19,000)**	**(520)**	**1,562**	**7**	**17,951**

Comparative movements in: 2015/16	Usable Reserves General Fund Balance £000	Housing Revenue Account £000	Capital Receipts Reserve £000	Capital Grants Unapplied £000	Unusable Reserves £000
Adjustments primarily involving the Capital Adjustment Account:					
Reversal of items debited or credited to the CIES:					
Charges for depreciation and impairment of non-current assets	(15,464)	(2,151)	0	0	17,615
Revaluation losses on property, plant and equipment	(7,768)	(44)	0	0	7,812
Amortisation of intangible assets	(1,103)	(25)	0	0	1,128
Capital grants and contributions applied	7,996	0	0	0	(7,996)
Income in relation to donated assets	0	0	0	0	0
Amounts of non-current assets written off on disposal or sale as part of the gain/loss on disposal to the CIES	(12,451)	(1,093)	0	0	13,544
Capital repayment in respect of finance leases	89	0	0	0	(89)
Insertion of items not debited or credited to the CIES:					
Statutory provision for the financing of capital investment	11,542	1,200	0	0	(12,742)
Capital expenditure charged against the General Fund and HRA balances	0	0	0	0	0
Adjustments primarily involving the Capital Grants Unapplied Account:					
Capital grants and contributions unapplied credited to the CIES	45	0	0	(45)	0
Application of grants to capital financing transferred to the Capital Adjustment Account	0	0	0	635	(635)
Adjustments primarily involving the Capital Receipts Reserve:					
Transfer of cash sale proceeds credited as part of the gain/loss on disposal to the CIES	7,492	1,674	(9,166)	0	0
Use of the Capital Receipts Reserve to finance new capital expenditure	0	0	1,556	0	(1,556)
Adjustments primarily involving the Financial Instruments Adjustment Account:					
Amount by which finance costs charged to the CIES are different from finance costs chargeable in the year in accordance with statutory requirements	482	0	0	0	(482)
Adjustments primarily involving the Pensions Reserve:					
Reversal of items relating to retirement benefits debited or credited to the CIES	(21,452)	(369)	0	0	21,821
Employer's pensions contributions and direct payments to pensioners payable in the year	12,471	198	0	0	(12,669)
Adjustment primarily involving the Employee Statutory Adjustment Account:					
Amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements	460	18	0	0	(478)
Total Adjustments	**(17,661)**	**(592)**	**(7,610)**	**590**	**25,273**

Note 6: Transfers to / (from) Earmarked Reserves

This note sets out the amounts transferred to and from General Fund and Housing Revenue Account balances and other earmarked reserves to meet General Fund and Housing Revenue Account expenditure in 2016/17.

	Balance at 31 March 2016 (restated) £000	Transfers out £000	Transfers in £000	Balance at 31 March 2017 £000
General Fund Balance	(12,718)	18,699	(30,267)	**(24,286)**
Council Tax Second Homes Receipts	(1,009)	0	(155)	**(1,164)**
Welfare Reform Fund	(202)	0	(6)	**(208)**
Hansel Funds	(153)	0	(8)	**(161)**
School Funds	(242)	0	(41)	**(283)**
Shetland College	(221)	156	(115)	**(180)**
Central Energy Efficiency Fund	(196)	79	0	**(117)**
Equalisation Fund	(15,587)	0	(480)	**(16,067)**
Community Care Funds	(510)	52	(34)	**(492)**
Local Investment Fund	(9,394)	0	(2,065)	**(11,459)**
Total General Fund Balance	**(40,232)**	**18,986**	**(33,171)**	**(54,417)**
Capital Fund	(84,178)	21,860	(4,180)	**(66,498)**
Repairs & Renewals Fund	(42,817)	0	(1,317)	**(44,134)**
Housing Revenue Account	(13,143)	0	(2,471)	**(15,614)**
Harbour Account Reserve Fund	(61,622)	12,117	(14,013)	**(63,518)**
Insurance Fund	(237)	0	(7)	**(244)**
Total Statutory Reserves	**(201,997)**	**33,977**	**(21,988)**	**(190,008)**
Total Usable Reserves	**(242,229)**	**52,963**	**(55,159)**	**(244,425)**

General Fund Reserves

Under the Local Government (Scotland) Act 1973, the Council is permitted to carry forward balances on the General Fund. The **General Fund Balance** Reserve was established to defray General Fund expenditure. It now incorporates the former Financial Risk Reserve and Revenue Spend to Save reserve.

The **Council Tax Second Homes Receipts**, for the receipts from reducing the discount on second homes' Council Tax, was set up to fund affordable housing expenditure.

Welfare Reform Fund has been set up to earmark income received from Government grants to fund initiatives relating to Welfare Reform and the introduction of Universal Credit.

The **Hansel Funds** are held for the benefit of residents in care establishments.

The **School Fund** is an earmarked General Fund reserve set up to contribute to the good of the schools of Shetland or enhance educational or social activities for children.

The **Shetland College Reserve** is an earmarked General Fund reserve which holds the reserves relating to Shetland College.

The **Central Energy Efficiency Fund** was set up to fund the reduction in energy consumption and carbon emissions.

The **Equalisation Fund** was created to accumulate realised returns that exceed the long-term average rate of return, and these can be released in future years.

The **Community Care Fund** is an earmarked General Fund reserve which holds the balances relating to the Integrated Joint Board.

The **Local Investment Fund** has been set up to earmark income from Shetland Development Trust for investment in local businesses and distributing any investment income to Shetland Charities.

Other Statutory Reserves

The **Capital Fund** was established under the Local Government (Scotland) Act 1975. This fund may be used to defray certain items of capital expenditure and for the repayment of the principal of loans. It also incorporates funds established to facilitate the capital costs associated with implementing future savings plans; and the holding of capital grants and receipts to finance subsequent capital expenditure.

The **Repairs and Renewals Fund** was established under the provisions of the Local Government (Scotland) Act 1975 for the purpose of defraying expenditure in repairing, maintaining, replacing and renewing any buildings, works, plant, equipment or articles belonging to the Council. This now incorporates the former Quarry Repairs and Renewals Fund.
The **Insurance Fund** may be used to make good loss or damage suffered by the Council as a result of an occurrence against the risk of which the Council can insure. It can also be used in paying premiums on a policy of insurance against the risk.

The **Housing Revenue Account** carries forward balances generated by the HRA and represents an uncommitted balance.

The **Harbour Account Reserve Fund** was established under Section 67(i) of the Zetland County Council Act 1974. This Act empowers the Council to transfer to the fund surpluses arising on the Harbour Account. The fund may be used to defray certain expenditure on the harbour undertaking and for any other purpose that is solely in the interest of the County and its inhabitants. It now incorporates the former Harbour Contingency and Pilot Boat Renewal Funds.

Note 7: Other Operating Income and Expenditure

2015/16 £000		2016/17 £000
4,378	(Gains)/losses on the disposal of non-current assets	(572)
4,378	**Total**	**(572)**

Note 8: Financing and Investment Income and Expenditure

2015/16 £000		2016/17 £000
3,643	Interest payable and similar charges	2,343
5,920	Pensions interest cost and expected return on pensions assets	5,264
(1,403)	Interest receivable and similar income	(2,361)
(2,821)	Other investment income	(2,749)
(2,329)	Realised gains in relation to available for sale financial assets	(3,739)
(483)	Income from transferred SDT financial instruments	(598)
2,527	**Total**	**(1,840)**

Note 9: Grant Income

The Council credited the following grants, contributions and donations to the CIES in 2016/17:

2015/16 £000		2016/17 £000
	Credited to Taxation and Non-Specific Grant Income	
(70,155)	Revenue Support Grant	(64,873)
(16,882)	Non-domestic Rates	(17,822)
(8,492)	Council Tax	(8,542)
(8,040)	Capital Grants and Contributions	(4,818)
(32)	Donated assets	0
(103,601)	**Total**	**(96,055)**
	Credited to Services	
(3,004)	Housing Benefit funding	(3,072)
(98)	Sports Development and Facilities funding	(2,051)
(2,059)	FE and HE funding	(1,653)
(331)	Criminal Justice grant	(352)
(353)	Skills Development Scotland	(350)
(263)	EU grants	(286)
(214)	Active Schools funding	(199)
0	Housing grants	(184)
(65)	Social Care funding	0
(80)	Fisheries funding	0
(99)	Department of Work and Pensions funding	(155)
(218)	Energy grants	(146)
(160)	NHS grants	(134)
(54)	Transport grants	(101)
(72)	Education Maintenance Allowance funding	(83)
(100)	Youth Music funding	(70)
(40)	Employability funding	(51)
(12)	Educational attainment / inequality funding	(50)
(67)	Electric Vehicle funding	(38)
(45)	Community development funding	(32)
(18)	Languages funding	(23)
(65)	Other grants and contributions	(22)
0	Self Directed Support	(20)
0	WW1 Battlefield funding	(17)
0	Youth Legacy Programme	(15)
(10)	Milk Subsidy	(17)
(10)	Duke of Edinburgh Programme	0
(132)	Training grants	(10)
(7,569)	**Total**	**(9,131)**

(40)	**Value of grants received in advance not recognised**	**(24)**

Note 10: Unusable Reserves

Reconciliation of Unusable Funds to the Balance Sheet

2015/16 £000		2016/17 £000
(91,109)	Revaluation Reserve	(89,850)
(38,677)	Available for Sale Financial Instruments Reserve	(98,700)
(2,001)	Financial Instruments Adjustment Account	(1,929)
143,129	Pensions Reserve	229,675
(279,503)	Capital Adjustment Account	(276,871)
2,299	Employee Statutory Adjustment Account	3,181
(265,862)	**Total Unusable Reserves**	**(234,494)**

Revaluation Reserve

The Revaluation Reserve contains the gains made by the Council arising from increases in the value of its property, plant and equipment (and intangible assets). The balance is reduced when assets with accumulated gains are:

- revalued downwards or impaired, and the gains are lost;
- used in the provision of services and the gains are consumed through depreciation; or
- disposed of, and the gains are realised.

The Reserve contains only revaluation gains accumulated since 1 April 2007, the date that the Reserve was created. Accumulated gains arising before that date are consolidated into the balance on the Capital Adjustment Account.

2015/16 £000		2016/17 £000
(100,372)	**Balance at 1 April**	**(91,109)**
3,322	(Surplus) or deficit on revaluation of non-current assets not posted to the CIES	(4,529)
	Amounts written off to the Capital Adjustment Account:	
5,023	Difference between fair value depreciation and historical cost depreciation	4,731
918	Assets sold or scrapped	1,057
(91,109)	**Balance at 31 March**	**(89,850)**

Available for Sale Financial Instruments Reserve

The Available for Sale Financial Instruments Reserve contains the gains made by the Council arising from increases in the value of its investments that have quoted market prices or otherwise do not have fixed or determinable payments. The balance is reduced when investments with accumulated gains are: revalued downwards or impaired and the gains are lost; or disposed of and the gains are realised.

2015/16 £000		2016/17 £000
(45,429)	**Balance at 1 April**	**(38,677)**
(8,689)	Revaluation of assets	(61,891)
15,441	Removal of previously unrealised gains in relation to assets sold	1,868
(38,677)	**Balance at 31 March**	**(98,700)**

Financial Instruments Adjustment Account

The Financial Instruments Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for income and expenses relating to certain financial instruments and for bearing losses or benefiting from gains per statutory provisions.

2015/16 £000		2016/17 £000
(1,519)	**Balance at 1 April**	**(2,001)**
(482)	Amount by which finance costs charged to the CIES are different from the finance costs chargeable in the year in accordance with statutory requirements	72
(2,001)	**Balance at 31 March**	**(1,929)**

Pensions Reserve

The Pensions Reserve absorbs the timing differences arising from the different arrangements for accounting for post-employment benefits, and for funding benefits in accordance with statutory provisions. The Council accounts for post-employment benefits in the CIES as the benefits earned by employees accruing years of service, updating the liabilities recognised to reflect inflation, changing assumptions, and investment returns on any resources set aside to meet the costs.

However, statutory arrangements require benefits earned to be financed as the Council makes employer's contributions to pension funds or eventually pays any pensions for which it is directly responsible. The debit balance on the Pensions Reserve therefore shows a substantial shortfall in the benefits earned by past and current employees and the resources the Council has set aside to meet them. The statutory arrangements will ensure that funding will have been set aside by the time the benefits come to be paid.

2015/16 £000		2016/17 £000
183,396	**Balance at 1 April**	**143,129**
(49,419)	Actuarial (gains) and losses on pensions assets and liabilities	79,290
21,821	Reversal of items relating to retirement benefits debited or credited to the Deficit on the Provision of Services in the CIES	19,146
(12,669)	Employer's pensions contributions and direct payments to pensioners payable in the year	(11,890)
143,129	**Balance at 31 March**	**229,675**

Employee Statutory Adjustment Account

This Account absorbs the differences that would otherwise arise on the General Fund Balance from accruing for compensated absences earned but not taken in the year, e.g. annual leave entitlement carried forward at 31 March. Statutory arrangements require that the impact on the General Fund Balance is neutralised by transfers to or from the Account.

2015/16 £000		2016/17 £000
2,777	**Balance at 1 April**	**2,299**
(2,777)	Settlement or cancellation of accrual made at the end of the preceding year	(2,299)
2,299	Amounts accrued at the end of the current year	3,181
2,299	**Balance at 31 March**	**3,181**

Capital Adjustment Account

The Capital Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for the consumption of non-current assets and for financing the acquisition, construction or enhancement of those assets under statutory provisions. The Account is debited with the cost of acquisition, construction or enhancement as depreciation, impairment losses and amortisations are charged to the CIES (with reconciling postings from the Revaluation Reserve to convert fair value figures to a historical cost basis) and credited with the amounts set aside by the Council as finance for the costs of acquisition, construction and enhancement.

The Account contains accumulated gains and losses on investment properties, gains recognised on donated assets that have yet to be consumed by the Council, and revaluation gains accumulated on property, plant and equipment before 1 April 2007, the date that the Revaluation Reserve was created to hold such gains.

2015/16 £000		2016/17 £000
(290,643)	**Balance at 1 April**	**(279,503)**
	Reversal of items relating to capital expenditure debited or credited to the CIES:	
17,615	Charges for depreciation and impairment of non-current assets	18,100
7,812	Revaluation losses on property, plant and equipment	514
1,128	Amortisation of intangible assets	1,067
(89)	Repayment of capital on finance leases	(94)
12,626	Amounts of Non-Current assets written off on disposal or sale as part of the gain/loss on disposal to the CIES	2,000
0	Prior year disposal of asset transferred to stock	175
(5,023)	Adjustment amounts written out of the Revaluation Reserve	(5,787)
	Capital financing applied in the year:	
(1,556)	Use of the Capital Receipts Reserve to finance new capital expenditure	(4,134)
(7,996)	Capital grants and contributions credited to the CIES that have been applied to capital financing	(4,780)
(635)	Application of grants to capital financing from the Capital Grants Unapplied Account	(1)
(12,742)	Statutory provision for the financing of capital investment charged against the General Fund and HRA balances	(1,330)
0	Capital expenditure charged against the General Fund and HRA balances	(1,557)
0	Capital Fund Reserve	(1,541)
(279,503)	**Balance at 31 March**	**(276,871)**

Note 11: Note to the Expenditure and Funding Analysis

The following note details material reconciling items in the adjustments between the accounting and funding basis shown on the face of the Expenditure and Funding Analysis:

2015/16				Adjustments from the General Fund and HRA to arrive at the CIES amounts	2016/17			
Adjustments for capital £000	Adjustment for pensions net change £000	Other adjustments £000	Total adjustments £000		Adjustments for capital £000	Adjustment for pensions net change £000	Other adjustments £000	Total adjustments £000
(19)	0	0	(19)	Chief Executive and Cost of Democracy	(376)	(266)	0	(642)
(5,443)	191	(7)	(5,259)	Children's Services	(5,471)	102	(406)	(5,775)
(731)	(1,328)	247	(1,812)	Community Care Services	(410)	(928)	(132)	(1,470)
(3,083)	(6,150)	(5)	(9,238)	Corporate Services	(655)	(5,161)	(172)	(5,988)
(576)	(12)	38	(550)	Development Services	(1,429)	(148)	(46)	(1,623)
(12,300)	(327)	187	(12,440)	Infrastructure Services	(5,014)	(572)	(66)	(5,652)
(439)	(171)	18	(592)	Housing Revenue Account	(498)	(143)	(7)	(648)
16,300	(1,355)	0	14,945	Harbour Account	(2,275)	(140)	(53)	(2,468)
(6,291)	**(9,152)**	**478**	**(14,965)**	**Net Cost of Services**	**(16,128)**	**(7,256)**	**(882)**	**(24,266)**
(3,770)	0	482	(3,288)	Other income and expenditure	4,818	0	(72)	4,746
(10,061)	**(9,152)**	**960**	**(18,253)**	**Total adjustments between accounting basis and funding basis**	**(11,310)**	**(7,256)**	**(954)**	**(19,520)**

Note 12: Property, Plant and Equipment

	Council Dwellings £000	Other Land & Buildings £000	Vehicles, Furniture, Plant & Equipment £000	Infra-structure Assets £000	Community Assets £000	Surplus Assets £000	Assets Under Construction £000	Total Property, Plant and Equipment £000
Cost or Valuation								
Opening Balance at 1 April 2016	**65,771**	**148,948**	**47,040**	**163,813**	**6,920**	**251**	**8,901**	**441,644**
Additions	2,507	2,731	3,518	2,478	0	0	9,372	20,606
Donated assets	0	0	0	0	0	0	0	0
Revaluation increases/(decreases) recognised in the Revaluation Reserve	(4,494)	(4,065)	(707)	0	0	(62)	0	(9,328)
Revaluation increases/(decreases) recognised in the Surplus/Deficit on the Provision of Services	(302)	(5,751)	(140)	0	0	(39)	0	(6,232)
Derecognition – disposals	(787)	(469)	(274)	(67)	(1)	0	0	(1,598)
Derecognition – other	0	0	0	0	0	0	0	0
Assets reclassified (to)/ from Assets held for sale	(399)	(538)	(300)	0	0	(19)	0	(1,256)
Other movements in cost or valuation	(137)	3,406	(1,434)	1,214	0	124	(3,174)	(1)
Closing Balance at 31 March 2017	**62,159**	**144,262**	**47,703**	**167,438**	**6,919**	**255**	**15,099**	**443,835**
Accumulated Depreciation and Impairment								
Opening Balance at 1 April 2016	**0**	**(6,326)**	**(14,804)**	**(46,179)**	**(8)**	**(31)**	**0**	**(67,348)**
Depreciation charge	(2,040)	(7,362)	(4,715)	(3,967)	8	(9)	0	(18,085)
Depreciation written out to the Revaluation Reserve	1,962	3,892	770	0	0	7	0	6,631
Depreciation written out to the Surplus/Deficit on the Provision of Services	49	5,533	118	0	0	19	0	5,719
Derecognition – disposals	24	25	241	22	0	0	0	312
Derecognition – other	0	0	0	0	0	0	0	0
Assets reclassified (to)/ from Assets held for sale	0	0	0	0	0	0	0	0
Other movements in depreciation or impairment	5	(561)	(747)	1,299	0	(8)	0	(12)
Closing Balance at 31 March 2017	**0**	**(4,799)**	**(19,137)**	**(48,825)**	**0**	**(22)**	**0**	**(72,783)**
Net Book Value								
As at 31 March 2017	**62,159**	**139,463**	**28,566**	**118,613**	**6,919**	**233**	**15,099**	**371,052**
As at 31 March 2016	**65,771**	**142,622**	**32,236**	**117,634**	**6,912**	**220**	**8,901**	**374,296**

Movement in 2015/16 (restated)	Council Dwellings £000	Other Land & Buildings £000	Vehicles, Furniture, Plant & Equipment £000	Infra-structure Assets £000	Community Assets £000	Surplus Assets £000	Assets Under Construction £000	Total Property, Plant and Equipment £000
Cost or Valuation								
Opening Balance at 1 April 2015	**71,630**	**155,096**	**49,838**	**161,719**	**6,921**	**1,689**	**8,596**	**455,489**
Additions	1,540	1,119	1,014	254	0	0	3,396	7,323
Donated assets	0	0	0	0	0	0	0	0
Revaluation increases/(decreases) recognised in the Revaluation Reserve	(3,278)	(5,732)	(4,913)	0	0	(94)	0	(14,017)
Revaluation increases/(decreases) recognised in the Surplus/Deficit on the Provision of Services	(95)	(8,072)	(1,298)	0	0	(84)	0	(9,549)
Derecognition – disposals	(587)	(137)	(2,436)	(560)	(1)	0	0	(3,721)
Derecognition – other	0	(592)	0	0	0	0	0	(592)
Assets reclassified (to)/ from Assets held for sale	(201)	(156)	0	0	0	0	0	(357)
Other movements in cost or valuation	(3,238)	7,422	4,835	2,400	0	(1,260)	(3,091)	7,068
Closing Balance at 31 March 2016	**65,771**	**148,948**	**47,040**	**163,813**	**6,920**	**251**	**8,901**	**441,644**
Accumulated Depreciation and Impairment								
Opening Balance at 1 April 2015	**(29)**	**(2,903)**	**(19,402)**	**(42,647)**	**(8)**	**(32)**	**0**	**(65,021)**
Depreciation charge	(2,054)	(7,858)	(3,582)	(4,038)	0	(71)	0	(17,603)
Depreciation written out to the Revaluation Reserve	1,996	3,659	4,805	0	0	28	0	10,488
Depreciation written out to the Surplus/Deficit on the Provision of Services	51	724	957	0	0	5	0	1,737
Derecognition – disposals	16	8	2,418	506	0	0	0	2,948
Derecognition – other	0	103	0	0	0	0	0	103
Assets reclassified (to)/ from Assets held for sale	0	0	0	0	0	0	0	0
Other movements in depreciation or impairment	20	(59)	0	0	0	39	0	0
Closing Balance at 31 March 2016	**0**	**(6,326)**	**(14,804)**	**(46,179)**	**(8)**	**(31)**	**0**	**(67,348)**
Net Book Value								
As at 31 March 2016	**65,771**	**142,622**	**32,236**	**117,634**	**6,912**	**220**	**8,901**	**374,296**
As at 31 March 2015	**71,601**	**152,193**	**30,436**	**119,072**	**6,913**	**1,657**	**8,596**	**390,468**

Depreciation

The following useful lives have been used in the calculation of depreciation:

Type of Asset	Useful Life
Council Dwellings	30 years
Other Land and Buildings	1-120 years
Vehicles, Plant, Furniture & Equipment	1-50 years
Infrastructure	5-60 years

Community Assets

The Council held £6.919m of Community Assets at 31 March 2017. This is comprised of various land assets and therefore not subject to depreciation.

Capital Commitments

At 31 March 2017 the Council had entered into a number of contracts for the construction or enhancement of Property, Plant and Equipment in 2017/18 and future years, budgeted to cost £10.998m. Similar commitments at 31 March 2016 were £15.457m. The major commitments are:

- New Halls of Residence £4.331m
- Eric Gray Replacement £4.012m
- Town Hall Conservation £0.658m
- Housing Quality Standard £0.445m

Revaluations

The Council carries out a rolling programme that ensures that all Property, Plant and Equipment required to be measured at fair value is revalued at least every five years. All valuations in the year were carried out internally. Valuations of land and buildings were carried out in accordance with the methodologies and bases for estimation set out in the professional standards of the Royal Institution of Chartered Surveyors. Surplus Assets were valued using fair value in accordance with the CIPFA Code of Practice. Valuations of vehicles, plant, furniture and equipment are based on current prices where there is an active second-hand market or latest list prices adjusted for the condition of the asset.

The significant assumptions applied in estimating the fair values are:

- the properties are all freehold with the exception of the Waste to Energy Plant which is held on a ground lease;
- that no high alumina cement, concrete or calcium chloride addition or other potentially deleterious material was used in the construction of the properties, and that none has been subsequently incorporated;
- that the properties are not subject to any unusual or especially onerous restrictions, encumbrances, or outgoings and that good title can be shown;
- that the properties and their values are unaffected by any matters which would be revealed by a local search or inspection of any register and the use and occupation are both lawful;
- that the inspection of those parts which have not been inspected would not cause the valuation to be altered;
- that the land and properties are not contaminated;
- that no statutory or other grants are available to carry out any improvements or repairs; and
- that there are no outstanding statutory notices affecting any of the properties.

Revaluation Rolling Programme

This statement shows the annual asset valuations within the rolling programme. The Asset and Properties Unit carries out valuations for operational and non-operational land and building assets. Officers of the Council with relevant expertise carry out valuations for all other assets. The basis of valuation is set out in the statement of accounting policies.

	Council Dwellings £000	Other Land & Buildings £000	Vehicles, Furniture, Plant & Equipment £000	Infra-structure Assets £000	Community Assets £000	Surplus Assets £000	Assets Under Construction £000
Carried at historic cost	-	-	-	163,813	6,920	-	8,901
Valued at fair value at:							
2016/17	-	54,125	399	-	-	-	-
2015/16	68,939	18,155	47,040	-	-	104	-
2014/15	-	75,092	-	-	-	965	-
2013/14	-	25,050	-	-	-	524	-
2012/13	-	14,486	-	-	-	70	-

Note 13: Heritage Assets

Net Value	Historic Buildings £000	Museum Collection £000	War Memorial £000	Total Assets £000
Opening Balance at 1 April 2016	1,599	3,269	57	**4,925**
Depreciation	(14)	0	(1)	**(15)**
Other movements	0	0	(56)	**(56)**
Closing Balance at 31 March 2017	**1,585**	**3,269**	**0**	**4,854**

2015/16	Historic Buildings £000	Museum Collection £000	War Memorial £000	Total Assets £000
Opening Balance at 1 April 2015	**1,404**	**3,269**	**57**	**4,730**
Revaluations	207	0	0	**207**
Depreciation	(12)	0	0	**(12)**
Closing Balance at 31 March 2016	**1,599**	**3,269**	**57**	**4,925**

There were no purchases of heritage assets during the current or prior financial years. There were no donations, disposals, revaluations or impairments in the same period. The War Memorial asset has been written off in the current year, as it is not a Council asset.

Historic Buildings

The two historic buildings classified as heritage assets are the Dunrossness Crofthouse Museum and the Bod of Gremista. The Dunrossness Crofthouse Museum is a restored 19th century crofthouse with thatched roof, outbuildings and a watermill.

The property is open for public viewing during the months of May to September.

The Bod of Gremista is a two storey rectangular house built around 1790 to provide family accommodation and a store for fishing and fish curing activities. The property is open for public viewing during the months of May to September.

Museum Collection

The Council's museum collections are on display at the Shetland Museum and Archives, open to the public all year.

Note 14: Intangible Assets

The intangible assets included on the Balance Sheet are in respect of fishing quota, fishing licences and software.

A fishing quota is the right to fish species over a defined period, usually one year. Quotas are held by Government and distributed to the fishing industry through Producer Organisations. The Fishing Quota was originally purchased by the Shetland Development Trust to enable long-term access to a strategically important resource. The quota was transferred to the Council on 31 December 2014 as part of the wind up of the Shetland Development Trust. The market value at 31 March 2017 is £24.150m. This is amortised on a straight-line basis over a 20-year period.

Fishing licences provide authority for a registered fishing vessel to fish for sea fish, subject to limitations stated in the licence. The licences were transferred to the Council on 31 December 2014 as part of the wind-up of the Shetland Development Trust. There was a part-disposal in 2016/17 resulting in proceeds of £0.148m. The market value as at 31 March 2017 is £0.076m. This is amortised on a straight-line basis over a 10-year period.

Software is accounted for to the extent that it is not an integral part of a particular IT system, rather part of the hardware item of property, plant and equipment. All software is given a finite useful life, based on assessments of the period that the software is expected to be of use to the Council.

The carrying amount of intangible assets is amortised on a straight-line basis. Amortisation of £1.067m was charged directly to the Net Cost of Services in the CIES for 2016/17.

There are no items of capitalised software that are individually material to the financial statements and there are no outstanding contractual commitments for the acquisition of intangible assets.

Useful lives assigned to the major software suites used by the Council are:

Purchased Licences	Years
Webroster GIS Innogistic System Encryption/ Web Filter Software	3
Payroll/ HR/ Pension Systems Libraries Systems Building/ DLO Stores System Council Tax/ Housing Benefits/ Rents	5
Financial Management Systems Risk Assessment Software	10
Capita Open Housing Management	12
Occupational Therapy Stock Control Facility Management System Planning Systems Client Records System Microsoft Licenses	20

The movement on Intangible Asset balances during the year is as follows:

As at 31 March 2016 £000		As at 31 March 2017 £000
	Balance at 1 April:	
22,103	Gross carrying amounts	22,101
(1,930)	Accumulated amortisation	(3,058)
20,173	**Net carrying amount at start**	**19,043**
0	Purchases	295
(2)	Other disposals	(103)
(1,128)	Amortisation for the period	(1,067)
0	Other changes	6,946
19,043	**Net carrying amount at end**	**25,114**
	Comprising:	
22,101	Gross carrying amounts	29,239
(3,058)	Accumulated amortisation	(4,125)
19,043	**Balance at 31 March**	**25,114**

Note 15: Financial Instruments

Categories of Financial Instruments

The following categories of financial instrument are carried in the Balance Sheet:

As at 31 March 2016 (restated)			As at 31 March 2017	
Long-Term £000	Current £000		Long-Term £000	Current £000
		Financial Assets		
		Investments:		
286,632	0	Available for sale financial assets	333,784	0
286,632	**0**	**Total Investments**	**333,784**	**0**
		Debtors:		
5,680	779	Loans and receivables	4,316	581
5,680	**779**	**Total Debtors**	**4,316**	**581**
		Financial Liabilities		
		Borrowing:		
(31,093)	(18)	Financial liabilities at amortised cost	(31,075)	(18)
(31,093)	**(18)**	**Total Borrowing**	**(31,075)**	**(18)**
		Creditors:		
(5,906)	(94)	Financial liabilities at amortised cost	(5,831)	(99)
0	(402)	Accrued interest liability	0	(397)
(5,906)	**(496)**	**Total Creditors**	**(5,831)**	**(496)**
		Provisions:		
0	(139)	Financial guarantees	0	(116)
0	**(139)**	**Total Provisions**	**0**	**(116)**

Soft Loans

An interest-free loan of £0.060m was provided to support Community and Drugs and Alcohol Services Shetland in 2015/16 in support of the Council's corporate priorities relating to community strength, vulnerable and young people

The Community and Drugs and Alcohol Services Shetland went into liquidation and was wound up during 2016/17. The Council, as a secured debtor, received repayment of £0.059m. The balance of the loan, along with notional interest due for 2016/17 were written off in the year. The write-off amounted to £1,529.

As at 31 March 2016 £000		As at 31 March 2017 £000
0	**Balance at start of year:**	**57**
60	Nominal value of new loans granted in the year	0
(3)	Fair value adjustment in year	1
0	Loans repaid	(59)
0	Other adjustments	1
57	**Total Investments**	**0**

Income, Expense, Gains and Losses

As at 31 March 2016					As at 31 March 2017			
Financial Assets: Loans and Receivables £000	Financial Assets: Available for Sale £000	Financial Liabilities: Amortised Cost £000	Total £000		Financial Assets: Loans and Receivables £000	Financial Assets: Available for Sale £000	Financial Liabilities: Amortised Cost £000	Total £000
0	0	1,228	**1,228**	Interest expense	0	0	1,303	**1,303**
0	965	15	**980**	Fee expenses	0	1,040	0	**1,040**
0	**965**	**1,243**	**2,208**	**Total expense in (Surplus)/Deficit on the Provision of Services**	**0**	**1,040**	**1,303**	**2,343**
(248)	(3,259)	0	**(3,507)**	Interest & dividend income	(306)	(5,402)	0	**(5,708)**
0	(2,329)	0	**(2,329)**	Gains on de-recognition	0	(3,739)	0	**(3,739)**
(248)	**(5,588)**	**0**	**(5,836)**	**Total income in (Surplus)/Deficit on the Provision of Services**	**(306)**	**(9,141)**	**0**	**(9,447)**
0	(8,689)	0	**(8,689)**	Gains on revaluation	0	(61,891)	0	**(61,891)**
0	15,441	0	**15,441**	Amounts recycled	0	1,868	0	**1,868**
0	**6,752**	**0**	**6,752**	**(Surplus)/Deficit arising on revaluation of financial assets in CIES**	**0**	**(60,023)**	**0**	**(60,023)**
(248)	**2,129**	**1,243**	**3,124**	**Net (Gain)/Loss for the year**	**(306)**	**(68,124)**	**1,303**	**(67,127)**

There were gains for available for sale financial assets on revaluation of £61.9m as at 31 March 2017 (£8.7m at 31 March 2016) and therefore no impairment has been identified and the Council did not carry out an impairment review.

Fair Values of Assets and Liabilities

Financial liabilities and assets represented by loans, receivables and long-term debtors and creditors are carried in the Balance Sheet at amortised cost. Their fair value can be assessed by calculating the present value of the cash flows that will take place over the remaining term of the instruments.

In terms of the fair value measurement hierarchy financial instruments measured at fair value are considered to be Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities that can be accessed at the measurement date.

The Fair Value calculations have been made using the following assumptions and are shown in the table below:

- no early repayment or impairment is recognised;
- where an instrument will mature in the next 12 months, the carrying amount is assumed to approximate to fair value; and
- the fair value of trade and other receivables is taken to be the invoiced or billed amount.

As at 31 March 2016			As at 31 March 2017	
Carrying Amount £000	Fair Value £000		Carrying Amount £000	Fair Value £000
6,459	6,459	Loans and receivables	4,897	4,559
(37,110)	(41,260)	Financial liabilities at amortised cost	(37,023)	(43,549)

Available for sale assets and assets and liabilities at fair value through profit or loss are carried in the Balance Sheet at their fair value. These fair values are considered to be Level 2 inputs – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Short-term debtors and creditors are carried at cost as this is a fair approximation of their value.

Note 16: Nature and Extent of Risks arising from Financial Instruments

The Council's investments and financial activities expose it to a variety of financial risks:

- Credit risk – the possibility that other parties might fail to pay amounts due to the Council;
- Liquidity risk – the possibility that the Council might not have funds available to meet its commitments to make payments; and
- Market risk – the possibility that financial loss might arise for the Council as a result of changes in such measures as interest rates and stock market movements.

The Council's overall risk management focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the resources available to fund services. Risk management is carried out by the Treasury Section, under policies approved by the Council in the Annual Investment and Treasury Strategy Statement.

Credit Risk

Credit risk arises from deposits with banks and financial institutions, as well as credit exposures to the Council's customers. This risk is minimised through the Annual Investment Strategy, which requires that deposits are not made with financial institutions unless they meet one of the following categories:

- a bank or building society with at least an A- long-term Fitch IBCA rating;
- Bank of Scotland – Council's own bank;
- any bank which is a wholly owned subsidiary of the above; or
- any local authority.

The 'A-' long-term rating is defined by Fitch IBCA (International Bank Credit Association) as: "High credit quality with a low expectation of default risk. The capacity for payment of financial commitments is considered strong".

The Annual Investment Strategy also imposes a maximum sum to be invested with a financial institution. This states that the Council cannot lend more than £3.0m of its surplus balances to any single organisation at any one time, apart from the Council's own bank. No deposits were placed with any financial institutions outwith the

Council's own bank during the financial year 2016/17.

The Council has a policy of lending to local businesses to maximise the benefit to the economy and enhance future prosperity in Shetland. Lending assists in sustainable economic growth with good employment opportunities, making Shetland a good place to live and work. In pursuing this policy, the Shetland Investment Fund was established on 18 April 2016 to provide a sustainable lending service of up to £15m.

As at 31 March 2017, £4.6m of this balance was loaned to local businesses, leaving £10.4m available for future lending. The majority of Shetland Investment Fund lending is secured against assets, minimising the risk of default.

As at 31 March 2016 £000	Shetland Investment Fund	As at 31 March 2017 £000
6,459	Less than three months	4,559
6,459	**Total**	**4,559**

The following analysis summarises the Council's potential maximum exposure to credit risk at 31 March 2017, based on experience of default and uncollectability, adjusted to reflect current market conditions:

	Amount at 31 March 2017 (a) £000	Historical experience of default expressed as % of (a) 31 March 2017 (b) %	Historical experience adjusted for market conditions at 31 March 2017 (c) %	Estimated maximum exposure to default and uncollectability at 31 March 2017 (a) x (c) £000	Estimated maximum exposure at 31 March 2016 £000
Deposits with Banks	3,941	0%	0%	0	0
Shetland Investment Fund	4,559	1%	1%	32	71
Customers	256	25%	25%	64	36

No credit limits were exceeded during the reporting period, and the Council does not expect any losses from non-performance by any of its counterparties in relation to deposits and local authorities.

The Council does not generally allow credit for customers, such that £2.0m of the £5.4m balance of sums owing at 31 March is past its due date for payment. The past due, but not impaired, amount can be analysed by age as follows:

As at 31 March 2016 £000	Customers	As at 31 March 2017 £000
610	Less than three months	505
543	Three to six months	523
188	Six months to one year	246
739	More than one year	744
2,080	**Total**	**2,018**

Liquidity Risk

The Council has external investments with fund managers amounting to £333.8m at 31 March 2017. The Council has ready access to these funds to ensure that cash is available as needed, so there is no significant risk that it will be unable to meet its commitments under financial instruments. Instead, the risk is that the Council will be bound to sell external investments at a time of unfavourable market conditions.

The Council has ready access to borrowings from the money markets and the Public Works Loan Board. At 31 March 2017 the Council had fixed rate borrowings amounting to £31.0m from the Public Works Loan Board.

The maturity analysis of the sums borrowed is as follows:

As at 31 March 2016 (restated) £000		As at 31 March 2017 £000
23,110	10-20 years	23,093
7,000	20-30 years	7,000
1,000	Over 40 years	1,000
31,110	**Total borrowing**	**31,093**

Market Risk

a) Interest Rate Risk

The Council is exposed to risk in terms of its exposure to interest rate movements on its borrowings and investments.
The Council's investment strategy aims to manage interest rate risk within the Council's investments by having various investment portfolios managed by external fund managers.

The investment portfolios are also separated into different asset classes to minimise the overall exposure to interest rate movements. The entire investment portfolio is held in unitised funds which increases diversification. As at 31 March 2017 the composition of these funds was diversified between the following asset classes:

- UK Equities
- Overseas Equities
- Diversified Growth Fund
- Emerging Market Equities
- UK Index Linked Gilts
- UK Corporate Bonds
- Other Bonds
- Cash

A risk has been identified that not all of the General Fund reserves are held in a way that can be quickly converted to cash. There is no short-term risk associated with how the money is held but if the Council has a need to make a significant and unplanned draw on reserves, it may need to borrow to secure the cash required. This issue will be addressed in detail in the financial planning process.

The largest investment exposure is to the Global Equity Fund and a risk assessment of a general shift of +/-1% in the Fund would have resulted in a gain or loss in the region of £1.2m for 2016/17.

The Council at 31 March 2017 had external fixed rate borrowing amounting to £31.1m and no variable rate borrowing. Borrowings are not valued at fair value, so nominal gains and losses on fixed rate borrowings would not impact on the Surplus or Deficit on the Provision of Services or Other Comprehensive Income and Expenditure.

The Treasury Section actively assesses interest rate exposure to determine the impact on the Council's financial reserves strategy and medium to longer-term financial strategy, which in turn informs the annual budget setting process. The Council uses the services of Capita Asset Services to advise on any borrowing requirements, including associated interest rate risks.

b) Price Risk

The Council had £333.8m of investments as at 31 March 2017 in the form of equity, bonds, diversified growth fund, and cash held within unitised products. The Council is consequently exposed to losses arising from movement in the price of these investment categories.
The Council's investment strategy reduces its exposure to price movements by diversifying its investment portfolio through the use of external fund managers, asset classes, investment guidelines and benchmarks.

The Council's external investments are all classified as 'available for sale' meaning that all movements in price will impact on gains and losses recognised in the CIES. A general shift of 5% in the general price of shares (positive or negative) would have resulted in a £11.5m gain or loss being recognised in the CIES for 2016/17.

c) Foreign Exchange Risk

The Council has £184.3m invested in overseas equities held within unitised products which are denominated in foreign currencies. The exposure to risk of loss in adverse movements in exchange rates is greatly reduced through the use of currency hedging strategies to specifically negate any currency movement impact.

Note 17: Debtors

As at 31 March 2016 £000		As at 31 March 2017 £000
1,702	Central Government Bodies	2,766
10,075	Other Local Authorities	23,347
152	NHS Bodies	379
1,198	Public Corporations and Trading Funds	1,227
8,706	Other Entities and Individuals	10,150
21,833	**Total short-term debtors**	**37,869**

29	**Total long-term debtors**	**77**

Long-term Debtors

In 2016/17 £77k of debtors has been classified as long-term debtors (£29k in 2015/16).

Movements in impairment allowance

The Council has made allowance for the risk of incurring bad debts on its General Fund and Housing Revenue Account. The debtor figures in the Balance Sheet are shown net of this allowance and the movement between years is shown in the table below:

2015/16 (restated) £000		2016/17 £000
(223)	**General Fund Balance at 1 April**	**(213)**
91	Miscellaneous Invoices written off	116
32	Council Tax written off	36
(11)	Transfer provision from HRA to cover General Fund rents	(14)
(102)	Change in General Fund Provision	(72)
(213)	**Balance at 31 March**	**(147)**
(49)	**Housing Revenue Account Balance at 1 April**	**(39)**
31	Rents written off	20
11	Transfer provision from HRA to cover General Fund rents	14
(32)	Change in HRA Provision	(48)
(39)	**Balance at 31 March**	**(53)**

Note 18: Assets Held for Sale

2015/16 £000		2016/17 £000
12,577	**Balance at 1 April 2016**	**654**
	Assets newly classified as held for sale:	
624	Property, plant and equipment	1,256
	Assets declassified as held for sale:	
(267)	Property, plant and equipment	0
(12,280)	**Assets sold**	(555)
654	**Balance at 31 March 2017**	**1,355**

Note 19: Cash and Cash Equivalents

The balance of cash and cash equivalents is made up of the following elements:

2015/16 £000		2016/17 £000
34	Cash held by the Council	29
2,486	Bank current accounts	3,880
2,520	**Total**	**3,909**

Note 20: Short-Term Creditors

As at 31 March 2016 £000		As at 31 March 2017 £000
(3,607)	Central Government Bodies	(3,740)
(10,001)	Other Local Authorities	(20,516)
(99)	NHS Bodies	(108)
(679)	Public Corporations and Trading Funds	(872)
(10,072)	Other Entities and Individuals	(14,217)
(24,458)	**Total**	**(39,453)**

Note 21: Inventories

	Ports & Harbours		Infrastructure		ICT Equipment		Total	
	2016/17 £000	2015/16 £000	2016/17 £000	2015/16 £000	2016/17 £000	2015/16 £000	2016/17 £000	2015/16 £000
Balance at 1 April	**2,804**	**3,447**	**1,441**	**1,557**	**319**	**175**	**4,564**	**5,179**
Purchases	594	407	2,251	2,677	255	232	3,100	3,316
Recognised as an expense in the year	(528)	(1,050)	(2,293)	(2,784)	(332)	(88)	(3,153)	(3,922)
Balances written off	0	0	0	(9)	0	0	0	(9)
Balance at 31 March	**2,870**	**2,804**	**1,399**	**1,441**	**242**	**319**	**4,511**	**4,564**

Inventories include consumable stores, maintenance materials, building services (work-in-progress, property acquired or constructed for sale) and items of ICT equipment.

Note 22: Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that will probably require settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation.

A provision for £1.2m is recognised for decommissioning costs that are expected to be incurred between 2017 and 2026. The provision is split between long and short-term provisions to recognise the estimated payment due in 2017/18. The provision is calculated at today's prices based on the estimated remaining useful life of the landfill site and its current usage. Total estimated costs will be adjusted in the year when events indicating a change become known.

A provision of £0.075m was recognised in 2014/15 in relation to a grant payment for works at Symbister Peerie Dock. The grant will only be paid out if certain conditions are met. The deadline for the drawdown of the grant is March 2018.

The Council is required to participate in the Carbon Reduction Commitment Energy Efficiency Scheme where it is required to purchase and surrender allowances, currently retrospectively, on the basis of carbon emissions. As carbon dioxide is emitted (i.e. as energy is used), a liability is recognised and then discharged by surrendering allowances. A provision of £0.1m is recognised, calculated on the basis of the current market price of the allowances required to meet the liability at 31 March 2017.

Shetland Islands Council requires to respond to legal claims raised against it. The potential liabilities that arise from this consist of an estimate of legal fees and an estimate of the settlement of any actions. The provision is based on the information available at 31 March 2017.

A number of financial guarantees transferred to the Council as part of the wind-up of the Shetland Development Trust. The likelihood of these guarantees being called has been assessed and a provision of £0.1m has been recognised as at 31 March 2017.

A provision of £0.3m was recognised in 2015/16 in relation to holiday pay on non-contractual overtime, backdated to 1 January 2015.

This was paid out during 2016/17 and systems are now in place to compensate employees for paid leave at a rate that includes non-contractual overtime.

Long-term Provisions	Balance at 1 April	Amounts used in 2016/17	Unused amounts reversed	Additional provisions made	Transfer to Short-term Provisions	Transfer from Short-term Provisions	Balance at 31 March
Decommissioning	(1,282)	35	26	(67)	280	(222)	**(1,230)**
Total Long-term Provisions	**(1,282)**	**35**	**26**	**(67)**	**280**	**(222)**	**(1,230)**

Short-term Provisions	Balance at 1 April	Amounts used in 2016/17	Unused amounts reversed	Additional provisions made	Transfer to Long-term Provisions	Transfer from Long-term Provisions	Balance at 31 March
Carbon Reduction Commitment	(127)	127	0	(127)	0	0	**(127)**
Symbister Peerie Dock	(75)	0	0	0	0	0	**(75)**
Outstanding Legal Actions	(5,348)	5,021	10	0	0	0	**(317)**
Decommissioning	(188)	246	0	0	222	(280)	**0**
Financial Guarantees	(139)	24	0	0	0	0	**(115)**
Backdated Holiday Pay	(300)	300	0	0	0	0	**0**
Total Short-term Provisions	**(6,177)**	**5,718**	**10**	**(127)**	**222**	**(280)**	**(634)**

Note 23: Leases

The Council as a Lessee

Finance Leases

The Council acquired its office headquarters and a music, cinema and creative industries centre under finance leases. The assets acquired under these leases are carried as property, plant and equipment in the balance sheet at the following net amounts:

As at 31 March 2016 £000		As at 31 March 2017 £000
6,713	Property, plant and equipment	6,507
6,713		6,507

The Council is committed to making minimum payments under these leases comprising settlement of the long-term liability for the interest in the property acquired and finance costs that will be payable by the Council in future years while the liability remains outstanding. The minimum lease payments are made up of the following amounts:

As at 31 March 2016 £000	Finance lease liabilities (net present value of minimum lease payments):	As at 31 March 2017 £000
(75)	Current	(75)
(1,667)	Non-current	(1,592)
(2,825)	Finance costs payable in future years	(2,508)
(4,567)	**Minimum Lease Payments**	**(4,175)**

The minimum lease payments are payable over the following periods:

	Minimum Lease		Finance Lease Liabilities	
	As at 31 March 2017 £000	As at 31 March 2016 £000	As at 31 March 2017 £000	As at 31 March 2016 £000
Not later than one year	(364)	(393)	(75)	(75)
Later than one year and not later than five years	(1,204)	(1,300)	(300)	(300)
Later than five years	(2,607)	(2,874)	(1,292)	(1,367)
	(4,175)	**(4,567)**	**(1,667)**	**(1,742)**

The minimum lease payments do not include rents that are contingent on events taking place after the lease was entered into, such as adjustments following rent reviews. There were contingent rents of £10k payable in 2016/17 (£57k in 2015/16).

Operating Leases

The Council leases a number of buildings and areas of land in Shetland. The largest is at Sullom Voe oil terminal where the Council leases land from Shetland Charitable Trust for £0.9m per year and sub-leases it to BP for the same amount. This lease arrangement is due to run until 2025.

The minimum lease payments due under non-cancellable leases in future years are:

As at 31 March 2016 £000		As at 31 March 2017 £000
1,907	Not later than one year	2,209
6,614	Later than one year and not later than five years	7,482
8,725	Later than five years	6,780
17,246	**Total**	**16,471**

The expenditure charged to the CIES during the year in relation to these leases was:

As at 31 March 2016 £000		As at 31 March 2017 £000
2,426	Minimum lease payments	2,512
(1,039)	Sub-lease payments receivable	(1,011)
1,387	**Total**	**1,501**

The Council as a Lessor

Finance Leases

During 2015/16 and 2016/17 the Council did not have any finance leases as lessor.

Operating Leases

The Council leases out property and equipment under operating leases for the following purposes:

- for the provision of community services, such as culture and arts, sports facilities, tourism services and community centres; and
- for economic development purposes to provide suitable affordable accommodation for local businesses

The minimum sub-lease payments expected to be received in future years are:

As at 31 March 2016 £000		As at 31 March 2017 £000
(972)	Not later than one year	(980)
(3,824)	Later than one year and not later than five years	(4,750)
(4,277)	Later than five years	(2,404)
(9,073)	**Total**	**(8,134)**

The total value of rental income, excluding sub-leases, recognised during the period was £1.7m (£0.8m in 2015/16).

The future minimum lease payments receivable under non-cancellable leases in future years are:

As at 31 March 2016 £000		As at 31 March 2017 £000
(338)	Not later than one year	(1,085)
(1,231)	Later than one year and not later than five years	(4,273)
(4,293)	Later than five years	(12,723)
(5,862)	**Total**	**(18,081)**

The minimum lease payments receivable do not include rents that are contingent on events taking place after the lease was entered into, such as adjustments following rent reviews. In 2015/16 and 2016/17 no contingent rents were receivable by the Council.

Note 24: Defined Benefit Pension Schemes

Participation in Pension Schemes

As part of the terms and conditions of employment of its employees, the Council makes contributions towards the cost of post-employment benefits. Although these benefits will not actually be payable until employees retire, the Council has a commitment to make the payments and that needs to be disclosed at the time that employees earn their future entitlement. The Council participates in two post-employment schemes:

1. The Local Government Pension Scheme, administered locally by Shetland Islands Council, is a funded defined benefit scheme, meaning that the Council and employees pay contributions into a fund, calculated at a level intended to balance the pension liabilities with investment assets. From April 2015 the pensions accrual rate guarantees a pension based on 1/49th of pensionable pay. (Prior to April 2015 the pension accrual rate guaranteed a pension based on 1/60th of final pensionable salary and years of pensionable service. Prior to 2009, the accrual rate guaranteed a pension based on 1/80th and a lump sum based on 3/80th of final pensionable salary and years of pensionable service).

   There is no automatic entitlement to a lump sum in respect of post-2009 service. Members may however opt to give up (commute) pension for lump sum up to the limit set by the Finance Act 2004. The Scheme's Normal Retirement Age is now linked to the members State Pension Age (the minimum age being 65). Pensions are increased annually in line with changes to the Pensions (Increases) Act 1971 and Section 59 of the Social Security Pensions Act 1975.

2. Arrangements for the award of discretionary post-retirement benefits upon early retirement is an unfunded defined benefit arrangement, under which liabilities are recognised when awards are made but there are no investment assets built up to meet these pensions liabilities, and cash has to be generated to meet actual pension payments as they eventually fall due.

Shetland Islands Council Pension Fund is operated under the regulatory framework for the Local Government Pension Scheme and the governance of the Scheme is the responsibility of the Pension Fund Committee and The Pension Board. The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administrating authority for the Shetland Islands Council Pension Fund.

The Pension Fund Committee is made up of the councillors who currently sit on the Policy & Resources Committee.

The Pension Board comprises elected members of Shetland Islands Council along with employee and employer representatives and a pension / deferred member representative.

Policy is determined in accordance with the Pension Fund Regulations. Management of the Fund's investments is carried out by the Council which receives recommendations from the Pension Fund Committee and Pension Board. The Council selects and appoints a number of external investment managers/partners and monitors their investment performance.

Under the Regulations employers fall into three categories: scheme employers (also known as scheduled bodies), community admission bodies and transferee admission bodies. Admission agreements are generally assumed to be open-ended. However, either party can voluntarily terminate the admission agreement by giving an appropriate period of notice to the other parties. Any deficit arising from the cessation valuation will usually be levied on the departing admission body as a capital payment.

The principal risks to the Council of the Scheme are the longevity assumptions, statutory changes to the scheme, structural changes or curtailments to the Scheme (i.e. large-scale withdrawals from the Scheme, including employers ceasing to participate in the Scheme), changes to inflation, bond yields, and the performance of the equity investments held by the Scheme.

These are mitigated to a certain extent by the statutory requirements to charge to the General Fund and Housing Revenue Account the amounts required by statute as described in the accounting policies note.

Transactions Relating to Post-Employment Benefits

The Council recognises the cost of retirement benefits in the reported cost of services when they are earned by employees, rather than when the benefits are eventually paid as pensions. The charge required to be made in the CIES, however, is based on the cash payable in the year, so the real cost of post-employment / retirement benefits is reversed out of the General Fund via the Movement in Reserves Statement.

The following transactions have been made in the CIES and the General Fund Balance via the Movement in Reserves Statement during the year:

2015/16 £000	Local Government Pension Scheme	2016/17 £000
	Comprehensive Income and Expenditure Statement	
	Cost of Services:	
15,678	Current service cost	13,882
223	Past service cost (including curtailments)	220
	Financing and Investment Income and Expenditure:	
5,920	Net interest expense	5,044
21,821	**Total Post-Employment Benefit charged to the Surplus or Deficit on the Provision of Services**	**19,146**
	Other Post-Employment Benefit charged to the Comprehensive Income and Expenditure Statement	
6,054	Return on plan assets (excluding the amount included in the net interest expense)	(55,844)
(49,254)	Actuarial (gains) and losses arising on changes in financial assumptions	133,459
(6,219)	Actuarial (gains) and losses arising from other experience	1,675
(27,598)	**Total Post-Employment Benefit charged to the Comprehensive Income and Expenditure Statement**	**98,436**
	Movement in Reserves Statement	
(21,821)	Reversal of net charges made to the Surplus or Deficit for the Provision of Services for post-employment benefits in accordance with the Code	(19,146)
12,669	Employer's contributions and direct payments to pensioners payable in the year	11,890

The amount included in the Balance Sheet arising from the Council's obligation in respect of the Pension Fund is as follows:

2015/16 £000		2016/17 £000
(479,250)	Present value of the defined benefit obligation	(635,789)
336,121	Fair value of assets in the Local Government Pension Scheme	406,114
(143,129)	**Net liability arising from Defined Benefit Obligation**	**(229,675)**
(113,671)	Local Government Pension Scheme	(196,052)
(13,633)	Unfunded liabilities for Pension Fund	(15,936)
(15,825)	Unfunded liabilities for Teachers	(17,687)
(143,129)	**Total**	**(229,675)**

Assets and Liabilities in relation to Post-Employment Benefits

Reconciliation of fair value of the Scheme assets:

2015/16 £000		2016/17 £000
328,421	**Opening balance at 1 April**	**336,121**
10,560	Interest income	11,797
	Re-measurement gains and (losses):	
(6,054)	Return on assets excluding amounts included in net interest	55,844
12,669	Employer contributions	11,890
3,083	Contributions by scheme participants	3,239
(12,558)	Benefits paid	(12,777)
336,121	**Closing balance at 31 March**	**406,114**

Reconciliation of present value of the Scheme liabilities (defined benefit obligation):

2015/16 £000		2016/17 £000
511,817	**Opening balance at 1 April**	**479,250**
15,678	Current service cost	13,882
16,480	Interest cost	16,841
3,083	Contributions by scheme participants	3,239
	Remeasurement (gains) and losses:	
(49,254)	Actuarial (gains) and losses from changes in financial assumptions	133,459
(6,219)	Actuarial (gains) and losses from other experience	1,675
(12,558)	Benefits paid	(12,777)
223	Past service costs including curtailments	220
479,250	**Closing balance at 31 March**	**635,789**

Analysis of Pension Fund's Assets

Shetland Islands Council's share of the Pension Fund's assets at 31 March 2017 comprised:

2015/16 £000	Quoted Prices not in Active Markets	2016/17 £000
54	**Cash and cash equivalents**	**1,643**
	Property:	
32,578	UK property	42,306
2,208	Overseas property	1,321
34,786	**Sub-total Property**	**43,627**
	Investment Funds and Unit Trusts:	
203,512	Equities	256,211
32,478	Bonds	35,237
65,291	Other	69,396
301,281	**Sub-total Investment Funds and Unit Trusts**	**360,844**
336,121	**Total Assets**	**406,114**

Basis for Estimating Assets and Liabilities

Liabilities have been assessed on an actuarial basis using the projected unit credit method which is an estimate of the pensions that will be payable in future years, dependent on assumptions about mortality rates, salary levels, etc. Hymans Robertson LLP, an independent firm of actuaries, has assessed both the Local Government Pension Scheme and Discretionary Benefits liabilities. Estimates for the Shetland Islands Council's Pension Fund are based on the latest full valuation of the Scheme as at 31 March 2014, projected forward to 31 March 2017.

The principal assumptions used by the actuary have been:

2015/16		2016/17
	Long-term expected rate of return on assets in the Scheme:	
3.2%	Investment Funds and Unit Trusts	3.5%
	Mortality Assumptions:	
	Longevity at 65 for current pensioners (in years):	
22.8	Men	22.8
23.8	Women	23.8
	Longevity at 65 for future pensioners (in years):	
24.9	Men	24.9
26.7	Women	26.7
3.2%	Rate of inflation	3.4%
4.2%	Rate of increase in salaries	4.4%
2.2%	Rate of increase in pensions	2.4%
3.5%	Rate for discounting scheme liabilities	2.6%
70.0%	Take-up of option to convert annual pension into retirement lump sum (Pre-April 2009)	70.0%
85.0%	Take-up of option to convert annual pension into retirement lump sum (Post-April 2009)	85.0%

The estimation of the defined benefit obligations is sensitive to the actuarial assumptions set out in the table above. The sensitivity analyses below have been determined based on reasonably possible changes of the assumptions occurring at the end of the reporting period and assumes for each change that the assumption analysed changes, while all the other assumptions remain constant. The assumptions in longevity, for example, assume that life expectancy increases or decreases for men and women. In practice, this is unlikely to occur, and changes in some of the assumptions may be interrelated. The estimations in the sensitivity analysis have followed the accounting policies for the Scheme, i.e. on an actuarial basis using the projected unit credit method.

Shetland Islands Council does not have an asset and liability matching strategy.

Impact of changes in assumptions	2016/17	
	%	£000
0.5% decrease in real discount rate	12%	73,545
0.5% increase in the salary increase rate	4%	25,488
0.5% increase in the pension increase rate	7%	45,813

Impact on the Council's Cash Flows

The objectives of the Scheme are to keep employers' contributions at as constant a rate as possible. The Fund has agreed a strategy with the Scheme's actuary to achieve a funding level of 100% in the longer term. The Scheme is a multi-employer defined benefit plan and employers' contributions have been determined so that employee and employer rates are standard across all participating local authorities. Employers' common contribution rate was set at 19.8% for 2016/17. The three years set out in the latest triennial valuation as at 31 March 2014 are as follows:

Year	Employer contributions
2015/16	18.70%
2016/17	19.80%
2017/18	20.80%

The total contributions expected to be made by the Council to the Pension Fund in the year to 31 March 2018 is £10.855m.

The weighted average duration of the defined benefit obligation for Scheme members is 19.6 years for 2016/17.

Note 25: Pension Schemes Accounted for as Defined Contribution Schemes

Teachers employed by the Council are members of the Teachers' Pension Scheme, administered by the Scottish Public Pensions Agency (SPPA). The Scheme provides teachers with specified benefits upon their retirement and the Council contributes towards the costs by making contributions based on a percentage of members' pensionable salaries.

The Scheme is a multi-employer defined benefit scheme. The Scheme is unfunded and the SPPA uses a notional fund as the basis for calculating the employer's contribution rate paid by local authorities. Valuations of the notional fund are undertaken every four years. The Scheme has in excess of 160 participating employers and consequently, the Council is not able to identify its share of the underlying financial position and performance of the Scheme with sufficient reliability for accounting purposes. For the purposes of these annual accounts it is therefore accounted for on the same basis as a defined contribution scheme. As a proportion of the total contributions into the Teachers' Pension Scheme, the Council's own contributions equated to approximately 0.7% (0.7% for 2015/16).

In 2016/17, the Council paid £2.6m to the SPPA in respect of teachers' pension costs, representing 17.2% of pensionable pay (£2.4m and 14.9% for 2015/16). There were no contributions remaining payable at the year-end.

The Council is responsible for the costs of any additional benefits awarded upon early retirement outside of the terms of the Teachers' Pension Scheme. In 2016/17 these amounted to £0.9m, representing 5.2% of teachers' pensionable pay (£0.9m and 6.0% for 2015/16). These costs are accounted for on a defined benefit basis. The Council is not liable to the Scheme for any other entities' obligations

Note 26: Cash Flow Statement – Operating Activities

Cash flows for operating activities include the following:

2015/16 £000		2016/17 £000
(966)	Interest received	(1,718)
2,687	Interest paid	2,266
0	Dividends received	(605)
1,721	**Total**	**(57)**

The Surplus or Deficit on the Provision of Services has been adjusted for the following non-cash movements:

2015/16 £000		2016/17 £000
(25,427)	Depreciation, impairment and revaluations	(18,614)
(1,128)	Amortisation	(1,067)
22	Decrease in impairment for bad debts	52
(6,330)	Increase in creditors	(14,904)
1,767	Increase in debtors	14,620
(615)	Decrease in inventories	(53)
(9,152)	Movement in pension liability	(7,256)
(13,544)	Carrying amount of non-current assets sold or de-recognised	(2,000)
5,379	Other non-cash items charged to the net surplus or deficit on the provision of services	(6,160)
(49,028)	**Total**	**(35,382)**

The Surplus or Deficit on the Provision of Services has been adjusted for the following items that are investing and financing activities:

2015/16 £000		2016/17 £000
9,166	Proceeds from the sale of property, plant and equipment, investment property and intangible assets	4,134
7,907	Any other items for which the cash effects are investing or financing cash flows	4,825
17,073	**Total**	**8,959**

Note 27: Cash Flow Statement – Investing Activities

2015/16 £000		2016/17 £000
13,837	Purchase of property, plant and equipment, investment property and intangible assets	20,889
13,035	Purchase of short-term and long-term investments	700
(9,159)	Proceeds from the sale of property, plant and equipment, investment property and intangible assets	(4,134)
(1,513)	Proceeds from short-term and long-term investments	(2,142)
(7,996)	Other receipts from investing activities	(4,825)
8,204	**Total**	**10,488**

Note 28: Cash Flow Statement – Financing Activities

2015/16 £000		2016/17 £000
(48)	Cash receipts of short and long-term borrowing	0
89	Cash payments for the reduction of the outstanding liabilities relating to finance leases and on-balance sheet PFI contracts	94
14	Repayments of short and long-term borrowing	18
55	**Total**	**112**

Note 29: Usable Reserves

The movements in the Council's usable and unusable reserves are detailed in the Movement in Reserves Statement.

Note 30: External Audit Costs

The Council has incurred the following costs in respect of external audit services provided in accordance with the Code:

2015/16 £000		2016/17 £000
206	Fees payable to with regard to external audit services carried out by the appointed auditor for the year	218
206	**Total**	**218**

Note 31: Agency Services

The Council is required by legislation to provide a collection service for Scottish Water, involving the collection of around £2.9m of Scottish Water charges in 2016/17. The legislation stipulates a minimum amount that Scottish Water must pay in commission for this service.

Comparative figures for 2015/16 have been restated to remove non-material transactions.

2015/16 £000		2016/17 £000
32	Expenditure incurred in collection service for Scottish Water	35
(70)	Commission payable by Scottish Water	(73)
(38)	**Net surplus arising on the agency arrangements**	**(38)**

Note 32: Related Parties

The Council is required to disclose material transactions with related parties, bodies or individuals that have the potential to control or influence the Council or to be controlled or influenced by the Council. Disclosure of these transactions allows readers to assess the extent to which the Council might have been constrained in its ability to operate independently, or might have secured the ability to limit another party's ability to bargain freely with the Council.

Central Government and Other Public Bodies

Central Government has effective control over the general operations of the Council; it is responsible for providing the statutory framework within which the Council operates, provides the majority of its funding in the form of grants, and prescribes the terms of many of the transactions that the Council has with other parties (e.g. Council Tax bills, housing benefits). Details of all grants received from Central Government and other public bodies can be found on page 46.

Members

Members of the Council have direct control over the Council's financial and operating policies. The Council holds a Register of Members' Interests, which is open to public inspection at the Office Headquarters, Montfield, 28 Burgh Road, Lerwick during office hours. This is also available to view on the Council's website. The Register details the bodies where members are represented or for which they have declared an interest. The Council made payments totalling £6.1m in 2016/17 (£4.8m in 2015/16) to these bodies.

Officers

At the end of the financial year all senior managers were required to disclose any involvement with related parties of the Council. No significant items were reported.

Local Government Pension Scheme

The Local Government Pension Scheme is administered locally by Shetland Islands Council for the benefit of employees. The Council has made payments to the Local Government Pension Scheme as detailed in Note 24: Defined Benefit Pension Schemes.

Integrated Joint Board

The Integration Joint Board (IJB) was formally constituted on 27 June 2015 and is responsible for the strategic planning of the functions delegated to it by the Council and the Shetland Health Board. The IJB represents a Joint Venture between the two bodies.

In 2016/17, the Council contributed £19.6m towards the IJB and has received £20.4m in commissioning income.

The Council also provided support to the IJB in terms of back office functions. No charge was made for these services

Note 33: Capital Expenditure and Capital Financing

The total amount of capital expenditure incurred in the year is shown in the table below, together with the resources that have been used to finance it. Where capital expenditure is to be financed in future years by charges to revenue as assets are used by the Council, the expenditure results in an increase in the Capital Financing Requirement (CFR), a measure of the capital expenditure incurred historically by the Council that has yet to be financed.

2015/16 (restated) £000		2016/17 £000
35,135	**Opening Capital**	**26,474**
	Capital investment:	
14,390	Property, plant and equipment	20,594
0	Intangible assets	295
55	Revenue Expenditure Funded from Capital	2,026
	Sources of finance:	
(1,556)	Capital receipts	(4,134)
(8,685)	Government grants and other contributions	(6,807)
(34)	Funding from reserves	(1,765)
	Sums set aside from revenue:	
0	Direct revenue contributions	(1,557)
(89)	Lease principal	(94)
(12,742)	Loans fund principal	(1,330)
26,474	**Closing Capital Financing**	**33,702**

Note 34: Contingent Liabilities

The Council operates in a legal environment that is extremely complex and as such risks action being raised against it. Any claims are contested and consequently, any financial liability cannot be quantified as at 31 March 2017.

Shetland Islands Council has one outstanding claim under the Equal Pay Act 1970 for past pay inequalities with male colleagues. The financial impact can only be determined when sufficient detail is available. It is therefore not possible to provide any financial quantification at this stage, however, no material loss is anticipated.

There is a developing line of case law around the pay and grading structures that organisations currently have in place. The most significant issues for the Council are the pay grade changes required in response to the implementation of the Living Wage. The Council is unable to fully quantify the financial liability until the position has been fully reviewed.

There are a number of admitted bodies within Shetland Islands Council Pension Fund. If any of these bodies default on their obligations, the shortfall would likely have to be met by the Council over time and through an adjustment to employer contribution rates. The financial risk cannot be quantified until such circumstances arise.

Note 35: Trust Funds administered by the Council

The Council administers, as sole trustee, five trust funds related to specific services. These are varied in nature and relate principally to legacies left by individuals over a great many years. Funds are, in the main, held in deposit accounts with local banks. The funds do not represent assets of the Council and are not included in the Balance Sheet.

2015/16 £000		2016/17 £000
(268)	Bare Trust (SDT)	(30)
(666)	Zetland Educational Trust	(667)
(3)	Others (3 Trusts)	(3)
(937)	**Total**	**(700)**

The Bare Trust was set up following the cessation of the Shetland Development Trust on 28 February 2015. It holds a number of loans and equity investments which were not considered to be cost effective to transfer to the council on the winding up of the Development Trust. All assets and income arising from the Trust Fund will be paid or delivered to SIC. The Council, as Trustee, has full management powers as if they were absolute owners and not trustees.

The Zetland Educational Trust, with an income of £4k and expenditure of £2k, pays bursaries to university students, aids apprentices and supports educational trips.

The other trusts are essentially dormant due to their low annual income.

Note 36: Events after the Balance Sheet Date

The annual accounts were authorised for issue on 20 September 2017. Events taking place after this date are not reflected in the financial statements or notes. Where events taking place before this date provided information about conditions existing at 31 March 2017, the figures in the financial statements and notes have been adjusted in all material respects to reflect the impact of this information.

Note 37: Group Interests

Introduction

The Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 requires the Council to prepare group accounts where the Council has interests in subsidiaries, associates and/or jointly controlled entities, subject to the consideration of materiality. The Council has assessed that it has no material group entities, therefore no Group Accounts have been prepared. This assessment is based on the following considerations.

Group Boundary

Shetland Islands Council has considered all entities in which it has an interest for consolidation into the group accounts. To determine whether an entity should be included in the Council's group accounts, the factors of control, significant influence and materiality are considered.

Subsidiaries

The Code defines a subsidiary as an entity that is controlled by another entity. The Council does not have any subsidiaries that meet this definition.

Joint Ventures

The Code defines joint venture as a joint arrangement whereby the parties that have joint control of the arrangements have rights to the net assets of the arrangements. The Shetland Health and Social Care Partnership (IJB) meets the definition of a joint venture.

Associates

The Code defines an associate as an entity for which the Council is an investor that has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the entity. The Council has identified two entities that meet the definition of an associate. These are:

- Orkney and Shetland Valuation Joint Board
- Zetland Transport Partnership (ZetTrans)

Materiality

Where the financial impact of omitting an entity from the group accounts would not cause a user of the accounts to form a different view on the accounts, the Council has opted not to include these entities within the group boundary.

Orkney and Shetland Valuation Joint Board (O&SVJB)

The O&SVJB provides the valuation service for Orkney and Shetland and is funded by both Councils. The Council provides five members of the Board out of ten and contributed 49% of the Board's operating costs (48.7% in 2015/16).

The Council's share of the year-end net liability is £0.9m as at 31 March 2017 (£0.7m in 2015/16), which is considered not material for consolidation in group accounts.

Zetland Transport Partnership (ZetTrans)

ZetTrans was formed in 2006/07 by the Regional Transport Partnerships (Establishment, Constitution and Membership) (Scotland) Order 2005, made under the Transport (Scotland) Act 2005.

The Council contributed 93.5% of the Partnership's operating costs in 2016/17 (93.9% in 2015/16) and holds four out of six seats on the Partnership.

The Council's share of the net liability is nil at 31 March 2017 (nil in 2015/16) and is therefore considered not material for consolidation in group accounts.

The table below details Shetland Islands Council's share of ZetTrans' financial results for the year:

2015/16 £000	Zetland Transport Partnership	2016/17 £000
(2,022)	Gross Income	(2,031)
2,022	Gross Expenditure	2,031
0	**Net (Surplus) / Deficit**	**0**
2,022	Current Assets	2,031
(2,022)	Current Liabilities	(2,031)
0	**Net Assets**	**0**

Integration Joint Board (IJB)

The Integration Joint Board (IJB) was formally constituted on 27 June 2015 and is responsible for the strategic planning of the functions delegated to it by the Council and the Shetland Health Board. It represents a Joint Venture between these two bodies.

The Council contributed 42.8% of the Board's operating costs in 2016/17 (47.5% in 2015/16). It has three out of six voting members on the board.

The Council's share of the net assets and surplus of the Integration Joint Board was £0.06m as at 31 March 2017 (£0 in 2015/16), which is considered not material for consolidation in group accounts.

2015/16 £000	Integration Joint Board	2016/17 £000
(7,756)	Gross Income	(45,418)
7,756	Gross Expenditure	45,293
0	**Net (Surplus) / Deficit**	**(125)**
7,756	Current Assets	45,418
(7,756)	Current Liabilities	(45,293)
0	**Net Assets**	**125**

Entities previously consolidated

Shetland Charitable Trust (SCT)

The SCT is both a charity and a trust. The governing trust deed requires that the trustees act in the best interest of the inhabitants of Shetland. SCT carries out some charitable activities itself, but mostly achieves its objects by funding other charities in Shetland.

Shetland Islands Council does not contribute any funding to SCT and, as a result of an ongoing restructure of govenance arrangements, no longer has a significant influence (see third item in Note 38: Critical Judgements in Applying Accounting Policies below). As a result, SCT does not meet the accounting definition of a group entity.

Note 38: Critical Judgements in Applying Accounting Policies

In applying the accounting policies set out in Note 38, the Council has had to make certain judgments about complex transactions or those involving uncertainty about future events. The critical judgments made in the annual accounts are:

- There are a number of legal claims currently outstanding against the Council. Where a reliable estimate can be made, these have been included as provisions within the Council's Balance Sheet. Where it has not been possible to establish a reliable estimate, the claims have been accounted for as contingent liabilities.
- There is a high degree of uncertainty about future levels of funding for local government. The Council has determined, however, that this uncertainty is not yet sufficient to provide an indication that its assets may be impaired as a result of (for example) reduced maintenance.
- The Council had seven members out of 15 on the board of the Shetland Charitable Trust in 2016/17. In June 2016, the Council agreed that

its elected members would no longer be put forward to serve as trustees of the Shetland Charitable Trust. The Council is not an investor in the Shetland Charitable Trust, therefore it is not consolidated in the Group Accounts.

- The Council has made an accrual for holiday pay owed to employees at 31 March 2017. The estimate is based on a sample of 6% of non-schools staff and 100% of school-based staff.

Note 39: Accounting Policies

General principles

The Code specifies the applicable accounting policies for:

- selecting measurement bases for recognising assets, liabilities, gains and losses in the annual accounts;
- making changes to reserves; and
- the minimum disclosure requirements.

A valid estimation technique can be used to derive the monetary amount (i.e. the one that best reflects the economic reality of a transaction or event) to be recognised in the accounts in the circumstances when the basis of measurement for the monetary amount cannot be applied with certainty (and the range of options is considered to be material).

Changes in accounting policies and estimates, errors and prior period adjustments

Changes in accounting policies are made only when required by proper accounting practices, or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Council's financial position or financial performance. A change in accounting policy requires a prior period adjustment.

Changes in accounting estimates are accounted for prospectively, i.e. in the current and future years affected by the change and do not give rise to a prior period adjustment.

Prior period adjustments arise as a result of a change in accounting policies or to correct a material error. Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period. Where a change in accounting policy is made, it is applied retrospectively (unless stated otherwise) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Accounting conventions and concepts

The accounting convention adopted in the accounts is historical cost modified by the revaluation of certain categories of non-current assets, pension liability and financial instruments.

The concept of the Council operating as a going concern is based on the premise that sufficient funding is available so that its functions and services will continue in existence for the foreseeable future.

The concept of materiality derives from the premise that financial statements need not be precisely accurate in order to represent a true and fair view. It is a matter of professional judgement as to whether users of the accounts could come to different conclusions about the Council's standards of stewardship or make different economic decisions as a result of deviations from the provisions set out in the Code.

The accounting policies which have a significant effect on the amounts recognised in the financial statements of Shetland Islands Council are summarised below.

A Accruals of Income and Expenditure

Recognition of income and expenditure in the CIES

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- revenue from the sale of goods is recognised when the Council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the Council;
- revenue from the provision of services is recognised when the Council can measure reliably the percentage of completion of the transaction, and it is probable that economic benefits or service potential associated with the transaction will flow to the Council;

- supplies are recorded as expenditure when they are consumed, but where there is a gap between the date supplies are received and their consumption they are carried as inventories on the Balance Sheet;
- expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather than when payments are made; and
- interest receivable on investments and payable on internal borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract.

Recognition of debtors and creditors on the Balance Sheet

Where income and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to the CIES for the income that might not be collected.

B Cash and Cash Equivalents

In the Cash Flow Statement, cash (represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours) and cash equivalents (investments that mature in no more than three months or less from the Balance Sheet date and that are readily convertible to known amounts of cash with insignificant risk of change in value) are shown net of bank overdrafts that are repayable on demand.

C Charges to Revenue for Non-current Assets

Services are debited with the following amounts to record the cost of holding non-current assets during the year:

- depreciation attributable to the assets used by the relevant service;
- revaluation and impairment losses on assets used by the service where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off; and
- amortisation of intangible non-current assets attributable to the service.

The Council is not required to raise Council Tax to fund depreciation, amortisation, revaluation or impairment losses. However, it is required to make an annual contribution from revenue equal to loans fund principal charges.

The General Fund is balanced by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

D Contingent Assets

Where an event has taken place that gives the Council a possible asset whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council. A contingent asset is disclosed in a note to the accounts where it is probable that there will be an inflow of economic benefits or service potential not recognised in the Balance Sheet.

E Contingent Liabilities

Contingent liabilities are disclosed in the accounts but not recognised in the Balance Sheet, in circumstances where:

- an event has taken place that gives the Council a possible obligation whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council; or
- a provision would otherwise be made but either it is not probable that an outflow of resources will be required or the amount of the obligation cannot be measured reliably.

F Employee Benefits

Accumulated absences

The Employee Statutory Adjustment Account absorbs the differences that would otherwise arise on the General Fund Balance from accruing for compensated absences (holidays) earned but not taken in the year, e.g. annual leave entitlement carried forward at 31 March. Statutory arrangements require that the impact on the General Fund Balance is neutralised by transfers to or from the Account.

Benefits payable during employment

Short-term employee benefits (i.e. those due to be settled within 12 months of the year-end) such as wages, salaries, paid annual leave, paid sick leave, bonuses and non-monetary benefits (e.g.

cars) for current employees are recognised as an expense for services in the year in which employees render service to the Council.

An accrual is made for the cost of holiday entitlements earned by employees but not taken before the year-end, which employees can carry forward into the next financial year. The accrual is made at the wage and salary rates applicable in the following accounting year, being the period in which the employee takes the benefit.

The accrual is charged to Surplus or Deficit on the Provision of Services, but then reversed out through the Movement in Reserves Statement so that holiday benefits are charged to revenue in the financial year in which the holiday entitlement arises.

Termination benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an employee's employment before the normal retirement date, or an employee's decision to accept voluntary redundancy in exchange for those benefits; and are charged on an accruals basis to the appropriate service or, where applicable, to the Non Distributed Costs line in the CIES, at the earlier of when the Council can no longer withdraw the offer of those benefits or when the Council recognises costs for a restructuring.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement appropriations are required to and from the Pensions Reserve to remove the notional debits and credits for pension enhancement termination benefits, and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

Post-employment benefits

Employees of the Council may be members of one of two separate pension schemes:

- The Teachers' Pension Scheme, administered by the Scottish Government; or
- The Local Government Pension Scheme, administered by Shetland Islands Council.

Both Schemes provide defined benefits to members (retirement lump sums and pensions) which are earned as employees work for the Council.

The arrangements for the teachers' Scheme, however, mean that liabilities for these benefits cannot ordinarily be identified specifically to the Council. The Scheme is therefore accounted for as if it was a defined contribution scheme and no liability for future payments of benefits is recognised in the Balance Sheet. The Children's Services line in the CIES is charged with the employer's contributions payable in respect of teachers' pensions in the year.

The Local Government Pension Scheme

The Local Government Pension Scheme is accounted for as a defined benefits scheme.

The liabilities of Shetland Islands Council's pension fund attributable to the Council are included in the Balance Sheet on an actuarial basis using the projected unit method, i.e. an assessment of the future payments that will be made in relation to retirement benefits earned to date by employees, based on assumptions about mortality rates, employee turnover rates, projections of earnings for current employees, etc.

Liabilities are discounted to their value at current prices using a discount rate derived from a corporate bond yield curve constructed from yields on high quality bonds and recognising the weighted average duration of the benefit obligation determined at the most recent actuarial valuation.

The pension fund assets attributable to the Council are included in the Balance Sheet at their fair value:

- quoted securities – current bid price;
- unquoted securities – professional estimate; and
- unitised securities – current bid price.

The change in the net pension liability is analysed into seven components:

- **current service cost** – the increase in liabilities as a result of years of service earned this year which is allocated in the CIES to the services for which the employees worked;
- **past service cost** – the increase in liabilities arising from current year decisions whose effect relates to years of service earned in earlier

years, which is debited to the Surplus or Deficit on the Provision of Services in the CIES as part of Non Distributed Costs;

- **net interest cost on the defined benefit liability** – the change during the period in the net defined benefit liability that arises from the passage of time charged to the Financing and Investment Income and Expenditure line of the CIES. This is calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the period to the net defined benefit liability at the beginning of the period, taking into account any changes in the net defined benefit liability during the period as a result of contribution and benefit payments;
- **remeasurements comprising:**
  - **return on scheme assets** – excluding amounts included in net interest on the net defined benefit liability which are charged to the Pensions Reserve as Other Comprehensive Income and Expenditure;
  - **actuarial gains and losses** – changes in the net pension liability that arise because events have not coincided with assumptions made at the last actuarial valuation, or because the actuaries have updated their assumptions, which is charged to the Pensions Reserve. Actuarial gains and losses are shown within Other Comprehensive Income and Expenditure within the CIES; and
  - **contributions paid to the pension fund** – cash paid as employer's contributions to the pension fund in settlement of liabilities which are not accounted for as an expense.
- **In relation to retirement benefits**, statutory provisions require the General Fund Balance to be charged with the amount payable by the Council to the pension fund or directly to pensioners in the year, not the amount calculated according to the relevant accounting standards in the CIES.

In the Movement in Reserves Statement this means that there are transfers to and from the Pensions Reserve to remove the notional debits and credits for retirement benefits, and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end. The negative balance that arises on the Pensions Reserve thereby measures the beneficial impact to the General Fund of being required to account for retirement benefits on the basis of cash flows, rather than as benefits are earned by employees.

Discretionary benefits

The Council also has restricted powers to make discretionary awards of retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff (including teachers) are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme.

G Events after the Balance Sheet date

Events after the Balance Sheet date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the annual accounts is authorised for issue.

Two types of events can be identified:

- those that provide evidence of conditions that existed at the end of the reporting period whereby the annual accounts are adjusted to reflect such events; and
- those that are indicative of conditions that arose after the reporting period whereby the annual accounts are not adjusted to reflect such events, but where a category of events would have a material effect and disclosure is made in the notes of the nature of the events and their estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the annual accounts.

H Financial Instruments

Financial liabilities

Financial liabilities are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument, and are initially measured at fair value and are carried at their amortised cost. Annual charges to the Financing and Investment Income and Expenditure line in the CIES for interest payable are based on the carrying amount of the liability, multiplied by the effective rate of interest for the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments over the life of the instrument to the amount at which it was originally recognised.

This means that the amount presented in the Balance Sheet is the outstanding principal repayable (plus accrued interest), and interest charged to the CIES is the amount payable for the year according to the loan agreement.
Financial guarantees are measured at fair value and are estimated by considering the probability of the guarantee being called.

Financial assets

Financial assets are classified into two types:

- loans and receivables – assets that have fixed or determinable payments but are not quoted in an active market; and
- available-for-sale assets – assets that have a quoted market price and/or do not have fixed or determinable payments.

a) Loans and receivables

Loans and receivables are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument, and are initially measured at fair value. They are subsequently measured at their amortised cost. Annual credits to the Cost of Services in the CIES for interest receivable are based on the carrying amount of the asset, multiplied by the effective rate of interest for the instrument. For this Council it means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the CIES is the amount receivable for the year in the loan agreement.

On an annual basis loans and receivables are assessed for impairment. Events that provide objective evidence of impairment include significant financial difficulties of the counterparty, or a breach of contract. Impairment losses and gains or losses on derecognition are taken to the Cost of Services.

However, the Council has made a loan to a local organisation at less than market rates (soft loans). When soft loans are made, a loss is recorded in the CIES (debited to the appropriate service) for the present value of the interest that will be foregone over the life of the instrument, resulting in a lower amortised cost than the outstanding principal.

Interest is credited to the Financing and Investment Income and Expenditure line in the CIES at a marginally higher effective rate of interest than the rate receivable from the borrowing organisations, with the difference serving to increase the amortised cost of the loan in the Balance Sheet.

Statutory provisions require that the impact of soft loans on the General Fund Balance is the interest receivable for the financial year, the reconciliation of amounts debited and credited to the CIES to the net gain required against the General Fund Balance is managed by a transfer to or from the Financial Instruments Adjustment Account in the Movement in Reserves Statement.

b) Available-for-sale assets

Available-for-sale assets are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument, which initially is measured and carried at fair value.

Available-for-sale financial assets are shown in the Balance Sheet at fair value, which is based on the unit price provided by the Council's external fund providers.

The fund providers use the following principles when determining the unit price:

- instruments with quoted market prices – the market price; and
- investments with no quoted market prices – probable realisation value based on recent market transactions, reference to transactions that are substantially the same, and discounted cash flows.

Changes in fair value are balanced by an entry in the Available-for-Sale Financial Instrument Reserve and the gain/loss is recognised in the Surplus or Deficit on Revaluation of Available-for-Sale Financial Assets in the Other Comprehensive Income and Expenditure section of the CIES.

On derecognition, any balance on the Available-for-Sale Financial Instruments Reserve in relation to the assets sold are recycled through the Surplus or Deficit on the Provision of Services.

To ensure there is no mismatch between Other Comprehensive Income and Expenditure and the Movement in Reserves Statement, recycled amounts are also deducted as an additional item from the Other Comprehensive Income and Expenditure to avoid overstating gains for the year.

Where assets are identified as impaired because there is a significant or prolonged decline in the fair value below cost, the asset is written down and a charge made to the Financing and Investment Income and Expenditure line in the CIES. The impairment loss is measured as any shortfall of fair value against the acquisition cost of the instrument (net of any principal repayment and amortisation).

The Council invests through three Fund Managers, Baillie Gifford, Blackrock and Insight. These Fund Managers all invest on behalf of the Council into unitised products. They record income and account for transactions relating to these units as follows:

- Both Insight and Baillie Gifford receive and record income during the year. The income is re-invested into their units.
- No income is generated by Blackrock outwith their units.

The Council pays all Fund Manager fees on receipt of their invoices.

I Loans Fund

The Council operates a loans fund which covers the following areas:

- interest – includes all interest paid on external loans;
- expenses – includes all expenses incurred in the running of the Loans Fund, including a central support charge for staff costs and use of Council systems;
- principal – includes all capital advances to services; and
- borrowing – loans raised from external bodies, currently the Public Works Loan Board.

Each year the loans fund will identify the amount of capital interest it has to distribute and calculate the loans pool rate. This is then used to calculate the annual loan charges to Council services. The capital interest rate charged by the Council's loans fund in 2016/17 was 4.41%.

J Financing Costs

Financing costs comprise principal and interest. Repayment of debt to the loans fund is based on an equal instalment basis. Interest is allocated on the basis of the debt outstanding at the start of the financial year, with a proportionate adjustment in respect of borrowings or repayments during the financial year.

Interest is debited to the Financing and Investment Income and Expenditure section of the CIES, while the principal is debited to the General Fund through the Movement in Reserves Statement.

K Foreign Currency Translation

Where the Council has entered into a transaction denominated in a foreign currency the transaction is converted into sterling at the exchange rate applicable on the date the transaction was effective. Where amounts in foreign currency are outstanding at the year-end, they are reconverted at the spot exchange rate at the Balance Sheet date. Resulting gains or losses are recognised in the Financing and Investment Income and Expenditure line in the CIES.

L Government Grants and Contributions

Government grants, third party contributions and donations are recognised as due to the Council and credited to the CIES when there is reasonable assurance that the Council will comply with any conditions attached to payment of the grants and that the grants and contributions will be received.

Monies advanced as grants and contributions for which conditions have not been satisfied are carried in the Balance Sheet as creditors. When conditions are satisfied, the grant or contribution is credited to the relevant service line (attributable revenue grants and contributions) or Taxation and Non-Specific Grant Income (non-ring fenced revenue grants and all capital grants) in the CIES.

Where capital grants are credited to the CIES they are reversed out of the General Fund Balance in the Movement in Reserves Statement. Where the grant has yet to be used to finance capital expenditure, it is posted to the Capital Grants Unapplied Reserve. Where it has been applied, it is posted to the Capital Adjustment Account. Amounts in the Capital Grants Unapplied Reserve are transferred to the Capital Adjustment Account once they have been applied to fund capital expenditure.

M Intangible Assets

Expenditure on non-monetary assets that do not have physical substance, but are controlled by the Council as a result of past events (e.g. software licences), is capitalised when it is expected that future economic benefits or service potential will flow from the intangible asset to the Council. Internally generated assets are capitalised where it is demonstrable that the project is technically feasible and is intended to be completed (with adequate resources being available), and the Council will be able to generate future economic benefits or deliver service potential by being able to sell or use the asset.

Expenditure is capitalised where it can be measured reliably as attributable to the asset and is restricted to that incurred during the development phase. Research expenditure cannot be capitalised, nor expenditure on the development of websites if the website is solely or primarily intended to promote or advertise the Council's goods or services.

Intangible assets are measured initially at cost. Amounts are revalued annually where the fair value of the assets held by the Council can be determined by reference to an active market. Fishing quota and fishing licenses meets this criterion. The depreciable amount of an intangible asset is amortised over its useful life on a straight-line basis to the relevant service lines in the CIES. The useful life and amortisation rate used in the calculation of amortisation is 3 to 20 years.

An asset is tested for impairment whenever there is an indication that the asset might be impaired; any losses recognised are posted to the relevant service lines in the CIES. Any gain or loss arising on the disposal or abandonment of an intangible asset is posted to the Other Operating Expenditure line in the CIES.

Where expenditure on intangible assets qualifies as capital expenditure for statutory purposes, amortisation, impairment losses and disposal gains and losses are not permitted to have an impact on the General Fund Balance. The gains and losses are therefore reversed out of the General Fund Balance in the Movement in Reserves Statement and posted to the Capital Adjustment Account and the Capital Receipts Reserve.

N Inventories and Long Term Contracts

Inventories are included in the Balance Sheet at the lower of cost (based on average prices) and net realisable value. The cost of inventories is assigned using the weighted average costing formula, except for fuel which is calculated on a first in first out (FIFO) basis.

Long-term contracts are accounted for on the basis of charging the Surplus or Deficit on the Provision of Services with the value of works and services received under the contract during the financial year.

O Landfill Allowances Schemes

Landfill allowances, whether allocated by DEFRA or purchased from another Waste Disposal Authority (WDA), are recognised as current assets and are initially measured at fair value. The Scheme has been placed under review in Scotland since 2008/09 as a result of the absence of an active market for the allowances and hence assets and liabilities have been measured at nil since 2010/11. Due to the inactive market, penalties have been suspended but not cancelled.

P Leases

a) Operating leases

The Council as lessee

Rentals paid under operating leases are charged to the CIES as an expense to the services benefitting from use of the leased property, plant or equipment.

The Council as lessor

Where the Council grants an operating lease over a property or an item of plant or equipment, the asset is retained in the Balance Sheet. Rental income is credited to the CIES. Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the relevant asset and charged as an expense over the lease term on the same basis as rental income.

b) Finance leases

The Council recognises a finance lease when the risks and rewards of the asset substantially lie with the Council. The accounting treatment of finance leases is to recognise the asset on the Council's Balance Sheet as well as a liability to represent future principal repayments. A depreciation charge is recognised in the CIES as well as an interest charge.

The Council as lessee

Property, plant and equipment held under finance leases is recognised on the Balance Sheet at the commencement of the lease at its fair value measured at the lease's inception (or the present value of the minimum lease payments, if lower). The asset recognised is matched by a liability for the obligation to pay the lessor. Initial direct costs of the Council are added to the carrying amount of the asset. Premiums paid on entry into a lease are applied to writing down the lease liability.

Contingent rents are charged as an expense in the periods in which they are incurred.

Lease payments are apportioned between:

- a charge for the acquisition of the interest in the property, plant or equipment which is applied to write down the lease liability; and
- a finance charge (debited to the Financing and Investment Income and Expenditure line in the CIES).

Property, plant and equipment recognised under finance leases is accounted for using the policies applied generally to such assets, subject to depreciation being charged over the lease term if this is shorter than the asset's estimated useful life (where ownership of the asset does not transfer to the Council at the end of the lease period).

The Council is not required to raise Council Tax to cover depreciation or revaluation and impairment losses arising on leased assets. Instead, a prudent annual contribution is made from revenue funds towards the deemed capital investment in accordance with statutory requirements. Depreciation and revaluation and impairment losses are therefore substituted by a revenue contribution in the General Fund Balance, by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

The Council as lessor

Where the Council grants a finance lease over a property or an item of plant or equipment, the relevant asset is written out of the Balance Sheet as a disposal. At the commencement of the lease the carrying amount of the asset in the Balance Sheet (whether property, plant and equipment or assets held for sale) is written off to the Other Operating Expenditure line in the CIES as part of the gain or loss on disposal. A gain, representing the Council's net investment in the lease, is credited to the same line in the CIES also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal), matched by a lease (long-term debtor) asset in the Balance Sheet.

Lease rentals receivable are apportioned between:

- a charge for the acquisition of the interest in the property which is applied to write down the lease debtor (together with any premiums received); and
- finance income (credited to the Financing and Investment Income and Expenditure line in the CIES).

The gain credited to the CIES on disposal is not permitted by statute to increase the General Fund Balance and is required to be treated as a capital receipt. Where a premium has been received, this is posted out of the General Fund Balance to the Capital Receipts Reserve in the Movement in Reserves Statement. Where the amount due in relation to the lease asset is to be settled by the payment of rentals in future financial years, this is posted out of the General Fund Balance to the Capital Receipts Reserve in the Movement in Reserves Statement.

The written-off value of disposals is not a charge against Council Tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing.

Amounts are therefore appropriated to the Capital Adjustment Account from the General Fund Balance in the Movement in Reserves Statement.

Q Overheads and Support Services

The CIES no longer needs to be presented in line with the CIPFA Service Reporting Code of Practice 2016/17 (SeRCOP). This means that for services within the General Fund, the total cost principle, whereby all 'back office' functions are allocated to front-line services, no longer applies.

Where such services are provided to the Housing Revenue Account or Ports and Harbours, a charge has been made in the year, reported as income in the providing service and expenditure in the receiving services in the CIES.

R Property, Plant and Equipment

Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and that are expected to be used during more than one financial year are classified as property, plant and equipment.

Recognition

Expenditure on the acquisition, creation or enhancement of property, plant and equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Council and the cost of the item can be measured reliably.

Expenditure that maintains, but does not add to, an asset's potential to deliver future economic benefits or service potential (i.e. repairs and maintenance) is charged as an expense when it is incurred.

Measurement

Assets are initially measured at cost, comprising:

- the purchase price;
- any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and
- the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

Assets are carried in the Balance Sheet using the following measurement bases:

- infrastructure assets are held at depreciated historical cost;
- community assets and assets under construction are held at historical cost;
- council dwellings are held at current value, determined using the basis of existing use value for social housing; and
- all other assets are held at current value, determined as the amount that would be paid for the asset in its existing use value.

Where there is no market-based evidence of current value because of the specialist nature of an asset, depreciated replacement cost is used as an estimate of current value.

Where non-property assets have short useful lives or low values (or both), depreciated historical cost basis is used as a proxy for current value.

Assets included in the Balance Sheet at current value are revalued every five years. Increases in valuations are matched by credits to the Revaluation Reserve to recognise unrealised gains.

Where decreases in value are identified, they are accounted for as follows:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains); and
- where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service lines in the CIES.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007, the date of its formal implementation. Gains arising before this date have been consolidated into the Capital Adjustment Account.

Impairment

Assets are assessed at each year-end as to whether there is any indication that they may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for as follows:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service lines in the CIES; and
- where an impairment loss is reversed subsequently, the reversal is credited to the relevant service lines in the CIES, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

Depreciation

Depreciation is provided for all property, plant and equipment assets by the systematic allocation of their depreciable amounts over their useful lives. An exception is made for assets without a determinable finite useful life (i.e. freehold land and certain community and heritage assets) and assets that are not yet available for use (i.e. assets under construction).

The following useful lives and depreciation rates have been used in the calculation of depreciation (straight-line method):

- council dwellings: 30 years
- other land and buildings: 1 - 120 years
- vehicles, plant, furniture and equipment: 1 - 50 years
- infrastructure: 5 - 60 years

Depreciation is applied in the year from 1 April based on asset valuations as at 31 March of the previous financial year, supported by exceptional calculations based on weighted averages for major acquisitions or disposals taking place towards the start or end of the year.
Surplus assets are depreciated on a straight-line basis over their useful economic life. The relevant economic life for surplus assets is in line with those stated above for each category of asset.
Where an item of property, plant and equipment has major components whose costs are significant in relation to the total cost of the item, the components are depreciated separately.

Revaluation gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the Revaluation Reserve to the Capital Adjustment Account.

Disposals and non-current assets held for sale

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an asset held for sale. The asset is revalued immediately before reclassification and then carried at the lower of this amount and fair value less costs to sell. Where there is a subsequent decrease to fair value less costs to sell, the loss is posted to the Other Operating Expenditure line in the CIES. Gains in fair value are recognised only up to the amount of any previous losses recognised in the Surplus or Deficit on Provision of Services. Depreciation is not charged on assets held for sale.

If an asset no longer meets the criteria to be classified as an asset held for sale, it is reclassified back to a non-current asset. It is valued at the lower of its carrying amount before the asset was classified as held for sale, adjusted for depreciation, amortisations or revaluations that would have taken place if the asset had not been put into assets held for sale, and its recoverable amount at the date of the decision not to sell.

When an asset is disposed of or decommissioned, the carrying amount of the asset in the Balance Sheet (whether property, plant and equipment or assets held for sale) is written off to the Other Operating Expenditure line in the CIES as part of the gain or loss on disposal. Receipts from disposals (if any) are credited to the same line in the CIES, also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal). Any revaluation gains accumulated for the asset in the Revaluation Reserve are transferred to the Capital Adjustment Account.

Amounts received for a disposal are categorised as capital receipts. The balance of receipts is required to be credited to the Capital Receipts Reserve, and can then only be used for new capital investment. Receipts are appropriated to the Reserve from the General Fund Balance in the Movement in Reserves Statement. The written-off value of disposals is not a charge against Council Tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing. Amounts are appropriated to the Capital Adjustment Account from the General Fund Balance in the Movement in Reserves Statement.

S Surplus Assets

Surplus assets are measured at fair value over a five-year rolling programme. Fair value is the price that would be received to sell an asset between market participants at the measurement date. The fair value measurement assumes that the transition to sell the asset takes place either in the principal market for the asset or in the absence of a principal market, in the most advantageous market for the asset.

The Council measures the fair value of the asset using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their economic best interest.

When measuring fair value, the Council takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Council uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available. Inputs to the valuation techniques in respect of assets and liabilities for which fair value is measured or disclosed in the council's financial statements are categorised within the fair value hierarchy, as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets that the authority can assess at the measurement date;
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly; and
- Level 3 – unobservable inputs for the asset.

T Heritage Assets

Heritage assets are those assets that are intended to be preserved in trust for future generations because of their cultural, environmental or historical associations. Heritage assets include historical buildings and the museum collection.

As a general policy, heritage assets are recognised on the Balance Sheet where the Council has information on the cost or value of the asset. Where information on cost or value is not available, and the cost of obtaining the information outweighs the benefits to the users of the financial statements, the asset is not recognised on the Balance Sheet.

The carrying amounts of heritage assets are reviewed where there is evidence of impairment, e.g. where an item has suffered physical deterioration or breakage or where doubts arise as to authenticity. Any impairment is recognised and measured in accordance with the Council's general policies on impairment.
It is likely that disposals of heritage assets will be made only very occasionally. Where this does occur, the proceeds of such items will be accounted for in accordance with Council's general provisions relating to the disposal of property, plant and equipment.

Historical buildings

These are held on the Balance Sheet at fair value, determined as the amount that would be paid for the asset in its existing use value but, where there is no market-based evidence of fair value because of the specialist nature of an asset, depreciated replacement cost is used as an estimate of fair value. They are depreciated on a straight-line basis over their remaining useful life.

Museum collection

The Council's museum collection is reported in the Balance Sheet at valuations based on specialist judgement. Assets are valued in the year of acquisition and reviewed periodically.

U Carbon Reduction Commitment

The Council is required to participate in the Carbon Reduction Commitment Energy Efficiency Scheme. This Scheme is currently in its second phase, which ends on 31 March 2019. The Council is required to purchase allowances, either prospectively or retrospectively, and surrender them on the basis of emissions, i.e. carbon dioxide produced as energy is used. As carbon dioxide is emitted (i.e. as energy is used) a liability and an expense are recognised. The liability will be discharged by surrendering allowances. The liability is measured at the best estimate of the expenditure required to meet the obligation, normally at the current market price of the number of allowances required to meet the liability at the reporting date. The cost to the Council is recognised and reported in the costs of the Council's services and is apportioned to services on the basis of energy consumption.

V Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation.

Provisions are charged as an expense to the appropriate service lines in the CIES in the year that the Council becomes aware of the obligation, and are measured at the best estimate at the Balance Sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried in the Balance Sheet. Estimated settlements are reviewed at the end of each financial year. Where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service.

Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received if the Council settles the obligation.

W Reserves

Reserves are created by appropriating amounts out of the General Fund Balance in the Movement in Reserves Statement, with the exception of the Reserve Fund. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year against the Surplus or Deficit on the Provision of Services in the CIES. The reserve is then appropriated back into the General Fund Balance in the Movement in Reserves Statement so that there is no net charge against Council Tax for the expenditure.

In addition, Shetland Islands Council operates a Reserve Fund, as permitted under statute by the Zetland County Council Act 1974. Only surpluses from the Harbour Account can be credited to this reserve. This reserve is to fund Ports and Harbours' expenditure and may be applied to any expenditure that benefits the inhabitants of Shetland.

Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments, retirement and employee benefits and do not represent usable resources for the Council; these reserves are explained in the relevant policies.

X Revenue Expenditure funded from Capital under Statute

Expenditure incurred during the year that may be capitalised under statutory provisions, but does not result in the creation of a non-current asset, has been charged as expenditure to the relevant service in the CIES in the year. Where the Council has determined to meet the cost of this expenditure from existing capital resources or by borrowing, a transfer in the Movement in Reserves Statement from the General Fund Balance to the Capital Adjustment Account reverses out the amounts charged so that there is no impact on the level of Council Tax.

Y Value Added Tax

VAT payable is included as an expense only to the extent that it is not recoverable from Her Majesty's Revenue and Customs. VAT receivable is excluded from income.

ZETLAND EDUCATIONAL TRUST SCHEMES

1961 TO 1965

Shetland
Islands Council

TRUSTEES' ANNUAL REPORT AND

FINANCIAL STATEMENTS

FOR THE YEAR ENDED

31 MARCH 2017

Contents

1. INTRODUCTION

The Trustees present their annual report together with the financial statements and the auditor's report for the year ended 31 March 2017.

ADMINISTRATION INFORMATION

Charity Name	Zetland Educational Trust Schemes 1961 to 1965, known as Zetland Educational Trust (ZET)
Charity Number	SC001146
Contact Address	Shetland Islands Council Office Headquarters 8 North Ness Business Park Lerwick Shetland ZE1 0LZ
Current Trustees	Shetland Islands Council
Auditor	Deloitte LLP 1 City Square Leeds LS1 2AL

2. STRUCTURE, GOVERNANCE AND MANAGEMENT

CONSTITUTION

The Zetland Educational Trust (ZET), as currently constituted, was formed in 1961 (amended in 1965) through the amalgamation of a number of bequests. It is registered with the Office of the Scottish Charity regulator (OSCR) and its governing document is a trust deed.

The Zetland Educational Trust comprises a number of endowments as specified in the ZET schemes 1961 and 1965, which are vested in Shetland Islands Council as the governing body and statutory successors to the County Council for the County of Zetland.

TRUSTEES

The trustees of ZET are the elected members of Shetland Islands Council and are appointed through their election to the Council.

The Executive Manager – Finance is the designated officer within Shetland Islands Council with responsibility for the proper administration of the trust's financial affairs and for keeping adequate and up to date accounting records.

The Executive Manager – Finance is responsible for ensuring that the financial statements of ZET are produced in accordance with the Charities Accounts (Scotland) Regulations 2006 (as amended), for making judgements and estimates that are both reasonable and prudent, and for taking steps to prevent and detect fraud and other irregularities.

TRUSTEES (cont.)

The Executive Manager – Finance has considered and taken steps to address any risks to which the charity may be exposed, in particular those related to its operation and finances. The trustees are satisfied that adequate systems are in place to mitigate exposure to such risks.

MANAGEMENT

The elected members, as trustees, are responsible for all major decisions relating to the trust.

Authority to award grants has been delegated by the trustees to Shetland Islands Council Children's Services. The nominated officer is the Executive Manager – Quality Improvement.

The Executive Manager – Quality Improvement has the power to authorise expenditure within the limits of the Trust's annual income. Designated staff within Children's Services are responsible for the day-to-day administration of the funds.

3. OBJECTIVES & ACTIVITIES

CHARITABLE PURPOSES

The purpose of the trust is the advancement of education of people belonging to Shetland.

The Zetland Educational Trust generally provides grants amounting to 75% of total project costs, with the remainder of project costs to be met by fundraising activities or in-kind support. The Trust does not give funds retrospectively. Applications are invited on an annual basis from individuals, schools and other educational organisations operating in Shetland.

The amount of funds available for disbursement will vary each year depending on interest received by the trust.

The trust will fund projects that fall under the following headings:

- **Educational excursions**

  The trust may provide assistance to meet the costs of organised educational excursions for the benefit of pupils attending school centres in Shetland. The pupils should derive some educational benefit from attending the excursion.

- **Special equipment**

  The trust may fund the enhancement of education by assisting the provision of special equipment additional to that which the local authority may reasonably be expected to supply.

- **Promotion of ability and skill in swimming**

  The trust may fund the promotion and encouragement of swimming among pupils in Shetland through organised instruction by paying fees, travelling expenses and personal expenses of teams, instructors and any other appropriate costs.

- **Promotion of knowledge of Shetland**

  The trust may fund the promotion of knowledge of Shetland: its character, its skills and its arts, among persons being educated in Shetland by, for example, assisting to meet the costs of museum provision, making films designed to develop the knowledge of Shetland and any other appropriate costs.

- **Educational experiments and research**

  The Trust may fund bodies, or other persons it approves, to undertake educational experiments and research, including archaeological research that, in its opinion, will be for the educational benefit of persons in Shetland.

4. PERFORMANCE

The Trust's only regular source of income is bank interest.

In the year to 31 March 2017 there were 12 bursaries (2015/16: 10) awarded to university students in support of their studies, totalling £2,400 (2015/16: £2,000). These bursaries are issued in the name of the original donors: E&M Gair (nine awards) and Arthur Anderson (three awards). These awards will continue to be awarded as the students progress through their degree programmes.

The Trust also provides grants for projects of a general educational nature in line with the objectives set out above. There were no such disbursements in the year to 31 March 2017 (2015/16: nil).

5. FINANCIAL REVIEW

OVERVIEW

In the year to 31 March 2017, the Trust made a surplus of £1,579 (2015/16: £3,193).

At 31 March 2017 the trust held cash and bank balances amounting to £667,320 (2015/16: £665,741).

RESERVES POLICY

On 7 March 2017, the trustees approved the transfer of the Trust's reserves of £660,000, currently invested in a fixed term deposit account, to be invested in a Corporate Bond Fund. The existing fixed term deposit is due to end on 28 April 2017.

6. DECLARATION

This report was signed on behalf of the trustees on 20 September 2017 by:

....
Jonathan Belford, CPFA
Executive Manager – Finance
20 September 2017

Independent auditor's report to the trustees of Zetland Educational trust scheme 1965 and the accounts commission

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice approved by the Accounts Commission, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the statement of accounts of Zetland Educational Trust Scheme 1965 for the year ended 31 March 2017 under Part VII of the Local Government (Scotland) Act 1973 and section 44(1)(c) of the Charities and Trustee Investment (Scotland) Act 2005. The financial statements comprise the Statement of Receipts and Payments, Statement of Balances and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and a receipts and payments basis.
In our opinion the accompanying financial statements:

- properly present the receipts and payments of the charities for the year ended 31 March 2017 and their statement of balances at that date; and
- have been prepared in accordance with the requirements of the Charities and Trustee Investment (Scotland) Act 2005, and regulations 9(1),(2) and (3) of The Charities Accounts (Scotland) Regulations 2006.

Basis of opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the charities in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standards for Auditors, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the trustees for the financial statements

The trustees are responsible for the preparation of financial statements which properly present the receipts and payments of the charities, and for such internal control as the trustees determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the audit of the financial statements

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require us to comply with the Financial Reporting Council's Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the charities and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the trustees; and the overall presentation of the financial statements.

Our objectives are to achieve reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK&I) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Other information in the statement of accounts

The trustees are responsible for the other information in the statement of accounts. The other information comprises the information other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission or required by applicable law to the extent explicitly stated later in this report.

In connection with our audit of the financial statements in accordance with ISAs (UK&I), our responsibility is to read all the financial and non-financial information in the statement of accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Report on other requirements

Opinion on other prescribed matter

We are required by the Accounts Commission to express an opinion on the following matter. In our opinion, based on the work undertaken in the course of the audit the information given in the Trustees' Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Charities Accounts (Scotland) Regulations 2006.

Matters on which we are required to report by exception

We are required by The Charity Accounts (Scotland) Regulations 2006 to report to you if, in our opinion:

- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

…………………………………….

Sarah Anderson, FCCA (for and on behalf of Deloitte LLP)
1 City Square
Leeds
LS1 2AL
United Kingdom

20 September 2017

Deloitte LLP is eligible to act as an auditor in terms of section 1212 of the Companies Act 2006.

The Statement of Receipts and Payments, as required by the Charities Accounts (Scotland) Regulations 2006, provides an analysis of the incoming and outgoing cash and bank transactions for the year.

	Note	Restricted Funds £	2016/17 £	2015/16 £
Receipts				
Income from bank investments		3,979	3,979	5,193
Total receipts		**3,979**	**3,979**	**5,193**
Payments				
Grants and donations	3	2,400	2,400	2,000
Total payments		**2,400**	**2,400**	**2,000**
Net receipts		**1,579**	**1,579**	**3,193**
Surplus for the year		**1,579**	**1,579**	**3,193**

The Statement of Balances, as required by the Charities Accounts (Scotland) Regulations 2006, reconciles the cash and bank balances at the start and end of the financial year, with any surpluses shown in the Statement of Receipts and Payments.

Note	Restricted Funds £	2016/17 £	2015/16 £
Cash and bank			
Opening balance	10,741	10,741	7,548
Less transfer to Investments	(5,000)	(5,000)	-
Surplus for the year	1,579	1,579	3,193
Closing balance	**7,320**	**7,320**	**10,741**
Market valuation of investments			
Bank of Scotland - Fixed Term Deposit	660,000	660,000	-
Bank of Scotland - Current Account	-	-	655,000
Total Investments	**660,000**	**660,000**	**655,000**
Trust balances at 1 April 2016	**665,741**	**665,741**	**662,548**
Add surplus for the year	1,579	1,579	3,193
Trust Balance at 31 March 2017	**667,320**	**667,320**	**665,741**

Signed on behalf of the trustees on 20 September 2017 by:

....
Jonathan Belford, CPFA
Executive Manager – Finance
20 September 2017

1. Basis of Accounting

The financial statements have been prepared on a receipts and payments basis in accordance with the Charities & Trustee Investment (Scotland) Act 2005 and the Charities Accounts (Scotland) Regulations 2006.

2. Trustee Remuneration, Expenses and Related Party Transactions

a) No remuneration or expenses were paid during the period to any trustee or persons connected to a trustee during 2016/17;

b) There were no related party transactions during the year; and

c) Shetland Islands Council has not charged the Trust any fees for legal, financial or administrative services provided during the year.

3. Bursaries and Grants

Type of activity or project supported	2016/17		2015/16	
	Number	£	Number	£
Disbursements				
Arthur Anderson Bursaries	3	600	4	800
E & M Gair Bursaries	9	1,800	6	1,200
Total	**12**	**2,400**	**10**	**2,000**

4. Cash and Investments

There are two bank accounts held by the trust: a fixed term deposit account that earns interest and a cheque account, from which payments are made.

5. Audit Fees

Shetland Islands Council has an agreement with ZET whereby the cost of independent audit is borne by the Council unless the Trust earns a minimum income of £10,000 in the year. For 2016/17 and 2015/16 the Council paid audit fees on behalf of the Trust.

6. Taxation

The Zetland Educational Trust is not liable to income or capital gains tax on its activities. Irrecoverable VAT is included in any expense to which it relates.

Agenda Item **2**		

Shetland Islands Council

Meeting(s):	Audit Committee Pension Fund Board Pension Fund Committee	20 September 2017
Report Title:	Annual Audit Report on the 2016/17 Audit – Shetland Islands Council Pension Fund	
Reference Number:	F-080-F	
Author / Job Title:	Executive Manager – Finance	

1.0 Decisions / Action required:

1.1 That the Audit Committee:

a) NOTES the findings of the 2016/17 audit as contained in the external auditor's Annual Report at Appendix 1;

b) CONSIDERS a verbal report by the external auditor;

c) CONSIDERS the audited Annual Accounts for 2016/17 (Appendix 2) for Shetland Islands Council Pension Fund;

1.2 That Pension Fund Committee:

a) NOTES the findings of the 2016/17 audit as contained in the external auditor's Annual Report at Appendix 1;

b) APPROVES the agreed Action Plan as outlined in the Annual Report;

c) APPROVES the audited Annual Accounts for 2016/17 (Appendix 2) for Shetland Islands Council Pension Fund for signature.

2.0 High Level Summary:

2.1 The Local Authority Accounts (Scotland) Regulations 2014 ("the Regulations") require the Pension Fund to prepare and publish annual accounts that are subject to external audit. The appointed external auditor is Deloitte LLP.

2.2 Section 10 of the Regulations requires the Committee / Board to consider any report made by the appointed auditor before deciding whether to sign the audited accounts.

2.3 International Standard on Auditing 260 (ISA 260) requires the external auditors to communicate significant findings from the audit, including:

- the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures;
- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- written representations requested by the auditor; and
- other matters which in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

2.4 Deloitte LLP's ISA 260 findings are included in the Annual Audit Report at Appendix 1 and confirms their unmodified opinion, which means that the annual accounts are free from material misstatement and present a true and fair view of the Pension Fund's financial position at 31 March 2017.

2.5 The unaudited accounts for the year to 31 March 2017 were approved by the Pension Fund Committee on 19 June 2017 and there are no changes to the accounting deficit or net assets in the audited annual accounts.

2.6 There is an additional note (Note 11) in the audited accounts relating to the fair value of investments.

3.0 Corporate Priorities and Joint Working:

3.1 The preparation and presentation of the Audited Annual Accounts is a key element of the Pension Fund's overall governance and reporting arrangements.

4.0 Key Issues:

4.1 The Pension Fund's accounts for the year to 31 March 2017 were submitted to Deloitte LLP by the statutory deadline of 30 June 2017. The external auditor was required to complete the audit by 30 September 2017 and to report on certain matters arising to those charged with governance.

4.2 The Annual Audit Report (Appendix 1) highlights three significant risk areas that auditors reviewed, as follows:

a) Accuracy of contributions payable to the Fund;

b) Valuation of investments; and

c) Compliance of the financial statement with the amendments made by the 2016/17 Code of Audit Practice.

4.3 Pages 6 to 10 of the report at Appendix 1 presents how, in each of these areas, the result of the audit control testing was satisfactory, with one exception being the absence of a note to the accounts disclosing a Fait Value Hierarchy in relation to investments.

4.4 As well as reviewing the annual accounts, the scope of the audit includes wider issues, such as governance, transparency and financial sustainability. Some of the key audit findings (detailed in Appendix 1) in these areas are:

- **Financial Sustainability:** The Fund has sufficient plans in place to continue to be financially sustainable in the medium and long term.
- **Financial Management:** Appropriate financial reports are provided to the Pension Fund Committee to challenge variances and under-performance.
- **Governance and Transparency:** The policies and procedures around governance, Codes of Conduct, etc are clear and transparent and available for all members to read on the Shetland Islands Council website.
- **Value for money:** There is sufficient scrutiny over expenditure of the Fund, in particular investment management fees.

5.0 Exempt and/or confidential information:

5.1 None.

6.0 Implications :	
6.1 Service Users, Patients and Communities:	None
6.2 Human Resources and Organisational Development:	None
6.3 Equality, Diversity and Human Rights:	None
6.4 Legal:	The Local Authority Accounts (Scotland) Regulations 2014 require the Pension Fund to meet to consider and aim to approve the audited Annual Accounts for signature no later than 30 September each year, having regard to any report made on those accounts and any advice given by the proper officer or the auditor.
6.5 Finance:	None
6.6 Assets and Property:	None
6.7 ICT and new technologies:	None
6.8 Environmental:	None
6.9 Risk Management:	The Annual Audit Report includes the identification of key risks and internal control arrangements in place to manage those risks, together with any improvement actions required.
6.10 Policy and Delegated Authority:	The remit of the Audit Committee includes consideration of audit matters as well as overseeing and reviewing any action taken in relation to audit activity. The preparation and presentation of the Annual Accounts, is a key element of the Pension Fund's overall governance and reporting arrangements.
6.11 Previously considered by:	N/A

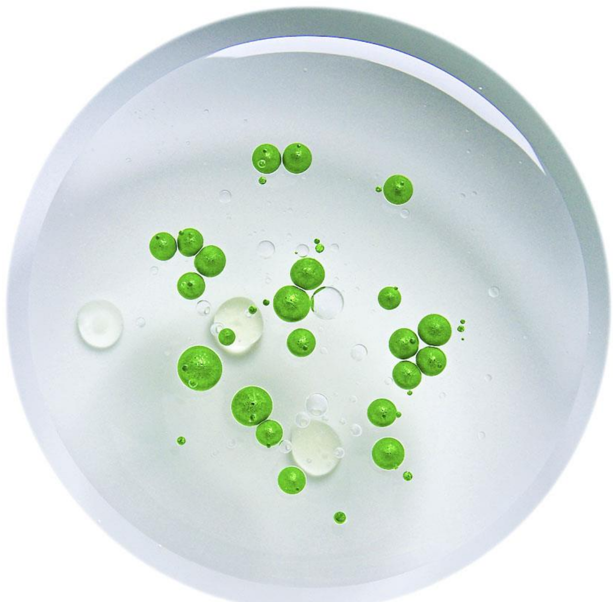
Contact Details:
Jonathan Belford, Executive Manager – Finance,
email: Jonathan.belford@shetland.gov.uk

12 September 2017

Background Documents: *The Local Authority Accounts (Scotland) Regulations 2014*

Deloitte.

Shetland Islands Council



2016/17 Annual Audit Report to the Members and Controller of the audit

13 September 2017

Contents

01 Our final report

02 Appendices

Director introduction
The key messages in this report

I have pleasure in presenting our Annual Audit Report to the Members and Audit Controller for the 2016/17 audit of the Shetland Islands Council Pension Fund ("the Fund"). I would like to draw your attention to the following key messages:

Audit quality is our number one priority. We plan our audit to focus on audit quality with the following objectives:

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

Audit scope

As communicated in our planning report dated 9 February 2017, our main reporting responsibilities are to:

- Provide the Independent Auditor's Report on the annual accounts;
- Provide the annual report on the audit addressed to the Members and Audit Controller; and
- To provide reports to management, as appropriate, in respect of the auditor's responsibilities in the 2016/17 Code of Audit Practice ("2016/17 Code").

We have also read the content of the draft annual report and the governance statement to confirm their consistency with the financial statements and our understanding of the business.

Significant audit risks and areas of audit focus

As communicated in our planning report we identified management override of controls as our significant audit risk. This is in line with Auditing Standards which require us to assume that management override of controls is an audit risk for all of our audits.

In addition we identified the following areas of audit focus:

1. Accuracy of contributions payable to the Fund;
2. Valuation of investments; and
3. Compliance of the financial statements with the amendments made by the 2016/17 Code.

We have not amended the significant audit risk and areas of audit focus during our testing and further details of our work performed and findings can be found on pages 6 to 10.

Wider Scope Requirements

The 2016/17 Code sets out four audit dimensions which set a common framework for all public sector audits in Scotland. These dimensions are:

1. Financial Sustainability;
2. Financial Management;
3. Governance and Transparency; and
4. Value for Money.

Our conclusions on the audit dimensions can be found on pages 11 and 12 of this report.

Director introduction (continued)

The key messages in this report (continued)

Insights	We have included in this report details of any uncorrected misstatements above our reporting threshold and material disclosure deficiencies on page 15. In addition we have included any insights found as a result of our audit testing. These can be found on page 16.
Status of the audit	We are currently progressing the audit towards completion. The following procedures have still to be received/performed and our opinion is subject to their satisfactory completion: • Independent confirmation of the bank account balance at 31 March 2016; • Final technical review of the financial statements and audit file; • Receipt of a signed management representation letter; and • Satisfactory completion of our post-year end events review.
Our conclusion	Based on our work performed to date, and subject to the satisfactory completion of the outstanding items listed above, we anticipate issuing an unmodified audit opinion on the financial statements.

Pat Kenny
Audit Director

Our audit explained

Area dimensions

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

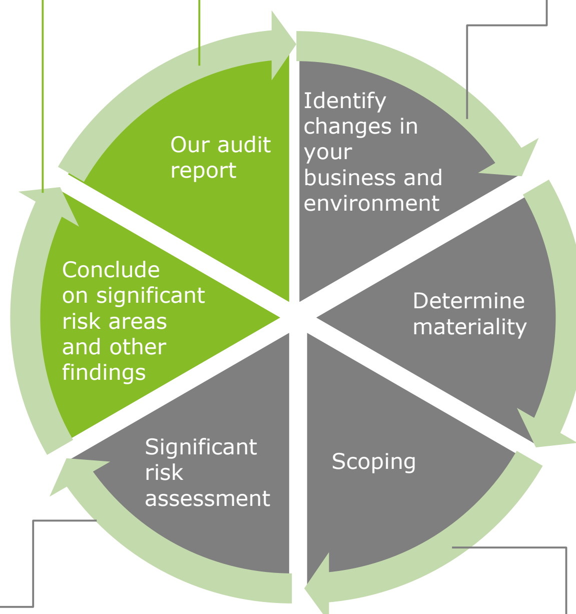
- Financial sustainability
- Financial management
- Governance and transparency
- Value for money

Final audit report

In this report we have concluded on the significant audit risk and areas of audit focus identified in our planning report and any other key findings from the audit.

Key developments in your Fund

As noted in our planning report, there have been no significant changes to the Fund itself during the year. The 2016/17 Code was amended for pension funds from financial year 2016/17 and requires additional disclosures to be included in the financial statements.



Materiality

We have determined materiality based on 1% of the Fund's net assets at 31 March 2017 to be £4,490,000. We have determined performance materiality as £4,041,000 based on total anticipated uncorrected misstatements amounting to 10% of materiality. Our reporting threshold of misstatements in the financial statements is £224,500 based on 5% of materiality.

Significant audit risks and areas of audit focus

Our risk assessment process is a continuous cycle throughout the year. Page 6 provides a summary of our risk assessment of your significant audit risk and areas of audit focus.

Scope of the audit

We have audited the financial statements for the year ended 31 March 2017 of the Shetland Islands Council Pension Fund. The scope of our audit remains consistent with that in our planning report. We have embedded specialists into our audit team where appropriate, including a financial instruments specialist to review our work performed on the Fund's investment assets.

Quality and Independence

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

Timeline 2017

November 2016 – February 2017
Meetings with management and other staff to understand the processes and controls.

March 2017
Year end

July – August 2017
Review of draft accounts, testing of significant risk and performance of substantive testing of results.

20 September 2017
Audit committee meeting

20 September 2017
Accounts sign off

Significant audit risks and areas of audit focus

Dashboard

Significant audit risk	Risk Level	Fraud Risk	Approach to Controls Testing	Level of Judgement
Management override of key controls	Significant Audit Risk	Fraud Risk	D&I	Medium
Areas of audit focus				
Accuracy of contributions payable to the Fund	Area of Audit Focus	Not a Fraud Risk	D&I	Low
Valuation of investments	Area of Audit Focus	Not a Fraud Risk	D&I	Low
Compliance of the financial statements with the amendments made by the 2016/17 Code	Area of Audit Focus	Not a Fraud Risk	D&I	Low

Low levels of judgement/management involvement

Medium levels of judgement/management involvement

High degree of judgement/management involvement

Not a Fraud Risk

Fraud Risk

D & I Design and Implementation

Significant Audit Risk

Area of Audit Focus

Significant audit risk
Management override of controls

Description

International Standards on Auditing requires auditors to identify a presumed risk of management override of controls. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports.

Deloitte Response

In order to address this significant audit risk, we performed the following audit procedures:

- Made enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- Performed testing on the design and implementation of controls surrounding the financial reporting process and the controls over journal entries and other adjustments posted in the preparation of the financial statements;
- Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. As part of our work in this area, we performed an analysis of journal entries which enabled us to focus on journals meeting specific pre-determined parameters determined during our audit planning;
- Reviewed the financial statements for any accounting estimates which could contain management bias, and assessed the judgements taken against supporting evidence;
- Confirmed that there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year; and
- Made enquiries of management in relation to the identification of related party transactions.

Deloitte view
We have no issues to report to the Members and the Controller of the Audit from the testing we have performed.

Areas of audit focus
Accuracy of contributions payable to the Fund

Description

The correct deduction of contributions depends on systems-based processing of membership data and salary details, together with a robust internal control framework. Errors in processing contributions can lead to issues such as non-compliance with the Funding Strategy Statement and deducting incorrect amounts from active members' payroll which can be costly to rectify and cause reputational damage.

Deloitte Response

In order to address this area of audit focus we performed the following audit procedures:

- Reviewed the design and implementation of key controls over the contribution process;
- Performed an analytical review of the employer normal contributions received in the year, basing our expectation on the prior year audited balance, adjusted for the movement in active member numbers, contribution rate changes and any average pay rise awarded in the year;
- For a sample of active members, we recalculated individual contribution deductions to ensure that these are being calculated in accordance with the rates stipulated in the Local Government Pension Scheme (Scotland) Regulations 2014 ("LGPS Regulations") for employee contributions and in the Funding Strategy Statement for employer contributions; and
- Tested that the correct definition of pensionable salary is being used per the LGPS Regulations to calculate contribution deductions.

Deloitte view
We have no issues to report to the Members and the Controller of the Audit from the testing we have performed.

Areas of audit focus
Valuation of investments

Description

There is a risk that investments are not valued accurately in the Pension Fund's financial statements due to the levels of judgement involved in pricing such investments.

Deloitte Response

In order to address this area of audit focus, we performed the following audit procedures:

- Reviewed the design and implementation of key controls over the valuation of these investments by obtaining investment manager and custodian internal control reports and evaluating the implications for our audit of any exceptions noted;
- Agreed year end valuations, sales proceeds and purchases in the financial statements to the reports received directly from the investment managers and the Fund's custodian;
- Agreed the valuations as at 31 March 2016 to the reports received directly from the investment managers and the Fund's custodian;
- Performed valuation testing on the valuation of the investments at 31 March 2016 and 2017 by using a range of techniques depending on the type of investment. Where the investment was not directly quoted on an exchange we confirmed if it is a registered fund and obtained an independent price. Where this was not the case we confirmed if the fund was structured as a unitised insurance policy or used sales transactions close to year end as an estimate of the price. Where none of these options are available we obtained audited financial statements and rolled forward the audited value to the year end using an appropriate benchmark and Pension Fund transactions where the audited accounts are not coterminous with the Pension Fund's year end; and
- Engaged our financial instrument specialists to review the audit work performed in relation to these assets.

Deloitte view

We have no issues to report to the Members and the Controller of the Audit from the testing we have performed.

Areas of audit focus

Compliance of the financial statements with the amendments made by the 2016/17 Code

Description

There is a risk that the Pension Fund's financial statements are not in compliance with the amendments made by the 2016/17 Code of Practice on Local Authority Accounting in the UK. These changes include:

- Amendments to the format of the accounts to be consistent with the new Financial Reports of Pension Schemes – A Statement of Recommended Practice 2015;
- Additional disclosure requirements for investments measured at fair value e.g. fair value hierarchy;
- Disclosure requirements in respect of investment management expenses; and
- An annex that provides an overview of how the other sections of the Code apply to pension funds.

Deloitte Response

In order to address this area of audit focus, we performed the following audit procedures:

- Assessed the design and implementation of key controls over the financial reporting process and, in particular, in relation to the implementation of the provisions of the revised Code;
- Agreed the classification of the investment assets within the fair value hierarchy to independently received investment manager and custodian reports and the reconciliation of those reports as prepared by the finance team;
- Confirmed that the recommended disclosures in respect of investment management expenses comply with the requirements of the Code;
- Obtained a copy of the annex to confirm that the other sections of the Code have been considered where they apply to the Pension Fund; and
- Benchmarked the financial statements to the CIPFA checklist to confirm all appropriate disclosures were included.

Deloitte view

From our testing we noted that the first version of the accounts did not contain a Fair Value Hierarchy disclosure of the investment assets as required by the 2016/17 code and IFRS 13. This has since been updated in the final version of the financial statements.

Wider Scope Requirements

Audit Dimensions

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. We have considered how the Pension Fund addresses these areas as part of our audit work as follows:

Audit dimension	Audit work completed	Audit Conclusion
Financial sustainability considers the going concern assumption used in the financial statements to consider whether the Pension Fund is planning effectively to continue to deliver its benefit services over the medium to long term.	We reviewed the arrangements and financial planning systems in place by the Pension Fund to ensure that its services can continue to be delivered. This included: • a review of the latest actuarial valuation of the Pension Fund and the plans in place to reduce the deficit over the shorter and medium term; and • A review of the funding policy as set out in the Shetland Islands Council Pension Fund Investment Strategy 2014-2027 ("Investment Strategy"), which aims to ensure the long-term solvency of the Pension Fund, so that there are sufficient funds available to meet all benefits as they fall due.	From our work completed we are satisfied the Fund has sufficient plans in place to continue to be financially sustainable in the medium and long term. We did not identify any issues regarding non-payment of contributions due from the Scheduled and Admitted Bodies which would have an impact on the financial sustainability of the Fund. In addition from our review of the Investment Strategy, the Fund has taken investment advice on how best to use it's resources appropriately to ensure future benefits can be settled when the liability arises and the Fund will be 100% funded by 2027.
Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.	• We reviewed the budget and monitoring reporting by the Pension Fund during the year to assess whether financial management and budget setting is effective; and • We ensured that there is a proper officer and fund manager who have sufficient status to be able to deliver good financial management, that monitoring reports contain information linked to performance as well as financial data, and that members have the opportunity to provide a sufficient level of challenge around variances and under-performance.	From our testing completed we can confirm that an Executive Manager – Finance has been appointed who has the appropriate status to act in that role and complies with the five principles outlined in the CIPFA guidance. From our review of the budget process we are satisfied that appropriate financial reports are provided to the Pension Fund Committee to challenge variances and underperformance and that this is performed.

Wider Scope Requirements (continued)

Audit Dimensions (continued)

Audit dimension	Audit work completed	Audit Conclusion
Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	• We reviewed the Pension Committee meeting minutes to assess the effectiveness and scrutiny of governance arrangements. • We reviewed other aspects of governance around the Pension Fund including Codes of Conduct for officers and members, fraud and corruption arrangements, and arrangements for reporting regulatory breaches to the Pensions Regulator. • In addition we reviewed the Annual Governance Statement and Governance Compliance Statement to confirm the governance arrangements observe the guidance issued by Scottish Ministers.	From our testing performed we have no issues to note. The Annual Governance Statement and Governance Compliance Statement contains the required information. The procedures and policies around governance, Codes of Conduct, etc. are clear and transparent and available for all Members to read on the Shetland Island Council website.
Value for money is concerned with using resources effectively and continually improving services.	• We gained an understanding of how the Pension Fund demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered. • We reviewed the scrutiny that is in place to challenge the Pension Fund's investment managers on fees and performance.	From our review of the budget process we are satisfied that there is sufficient scrutiny over expenditure of the Fund, in particular investment management fees. We noted, that despite an increase of £48k in investment management fees during the year, by in large the remainder of administration expenses for the Fund were in line with the prior year. In addition the Investment Strategy document outlines how the Fund will achieve value for money in where the assets are invested, ultimately aiming for 100% funding by 2027.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

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

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

What we don't report

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

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

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

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

The scope of our work

Our observations are developed in the context of our audit of the financial statements.

We described the scope of our work in our audit plan and the supplementary "Briefing on audit matters" circulated to you in February 2017.

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

Deloitte LLP

Statutory Auditor

Glasgow

13 September 2017

Appendices

Audit adjustments
Corrected and uncorrected misstatements

We are required to report any corrected and uncorrected misstatements which are more than 5% of our materiality threshold to the Members and Controller of the Audit.

For the avoidance of doubt we have no corrected or uncorrected misstatements to report to the Members and the Controller of the Audit.

In addition we are required to report any material disclosure deficiencies in the financial statements. From our testing we noted that the first version of the accounts did not contain a Fair Value Hierarchy disclosure of the investment assets as required by the 2016/17 code and IFRS 13. This has since been updated in the final version of the financial statements and we have no further disclosure misstatements to report.

Insights
Recommendations for improvement

Area	Observation	Recommendation
Reporting to the Actuary	During our testing over the information that the Fund provides to the Actuary we noted that reviews are performed before any documentation is sent to the Actuary, however these reviews are not evidenced by way of signature.	We recommend that the reviews of the reports and information sent to the Actuary are signed by way of dated signature so that evidence of the control can be obtained.

Fraud responsibilities and representations

Responsibilities explained

Your Responsibilities

The primary responsibility for the prevention and detection of fraud rests with management and the Audit Committee, and includes establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Our Responsibilities

We are required to obtain representations from the Committee regarding internal controls, assessment of risk and any known or suspected fraud or misstatement. As the Pension Fund's auditor, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error. As set out in the significant risk section of this document, we have identified management override of controls as a significant audit risk for your Fund.

Fraud Characteristics

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant to us as auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter signed on behalf of the Committee:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal controls to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the Pension Fund and involves:

(i) management;

(ii) employees who have significant roles in internal control; or

(iii) others where the fraud could have a material effect on the financial statements.

- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the Pension Fund's financial statements communicated by employees, former employees, analysts, regulators or others.

Independence and fees

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

Independence confirmation	We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.
Fees	The audit fee for 2016/17 is £30,238 net of VAT and out of pocket expenses, as detailed in our Audit Plan. No non-audit services fees have been charged by Deloitte in the period.
Non-audit services	In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the company's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence. We are not aware of any relationships which are required to be disclosed.

Shetland Islands Council

Securing the Best for Shetland

Pension Fund Annual Report and Accounts 2016/17

Photo by Kevin Jones

Contents

Management Commentary

The purpose of the Management Commentary is to inform all users of the accounts and help them understand the most significant aspects of the Pension Fund's financial performance during 2016/17 and year-end financial position as at 31 March 2017.

Background

The Shetland Islands Council Pension Fund is a contributory defined benefit pension scheme administered by Shetland Islands Council. The Pension Fund is governed by the Superannuation Act 1972, and is administered in accordance with The Local Government Pension Scheme (Scotland) Regulations 2014, The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 and The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015.

It provides pensions and other benefits for pensionable employees of scheduled bodies and admitted bodies within Shetland, as shown below. Teachers are not included as they have a separate national pension scheme.

Employers with active members at 31 March 2017

Scheduled Bodies:

- Shetland Islands Council
- Orkney & Shetland Valuation Joint Board

Admitted Bodies:

- Lerwick Port Authority
- Shetland Recreational Trust
- Shetland Fisheries Training Centre Trust
- Shetland Islands Tourism
- Shetland Amenity Trust
- Shetland Seafood Quality Control
- Shetland Charitable Trust
- Shetland Arts Development Agency
- Shetland Care Attendant Scheme (previously Crossroads)

Employers with no active members at 31 March 2017

Admitted Bodies:

- Shetland Enterprise Co Ltd
- ABA Services Ltd

Employers who have ceased to participate in the Scheme

Admitted Bodies:

- Shetland Youth Information Services
- Advocacy Shetland
- Atlantic Ferries
- Community Alcohol & Drugs Services Shetland (CADSS)

In general, employers pay regular monthly contributions to the Pension Fund based on the salary costs of those staff who are Pension Fund members (active members). Where an Employer continues to participate in the Scheme but has no active members, a lump sum is calculated by the actuary to cover the cost of ongoing and future pension payments.

Until 31 March 2015 the defined benefits were calculated based upon a member's final salary, however this changed with the implementation of The Local Government Pension Scheme (Scotland) Regulations 2014.

From 1 April 2015, the Pension Scheme moved away from a final salary pension scheme to a career average revalued earnings scheme (CARE). The changes were introduced to ensure the Pension Scheme is sustainable and affordable for the future.

Administering Authority Arrangements

The Council's Executive Manager - Finance is the officer with responsibility to ensure proper administration of the Council's financial affairs in terms of Section 95 of the Local Government (Scotland) Act 1973.

The Council's Executive Manager – Finance has responsibility for:

- the financial accounting of the Pension Fund;
- the preparation of the Pension Fund Annual Report; and
- being the principal adviser on investment management to the Council in its capacity as Trustee to the Pension Fund and as the Pension Fund's Administering Authority.

The day-to-day management of the investment activities of the Pension Fund is undertaken by the Treasury Section within the Finance Service.

The day-to-day benefits administration for the Pension Fund is managed by the Expenditure Section within the Finance Service.

The Expenditure Section ensures that members of the Scheme are kept up-to-date with Scheme changes by means of regular mail-shots which includes relevant information, for example, revised tiered employee contribution rates, revised Pension Scheme booklets/factsheets, Pension Fund Accounts, etc.

Pension seminars, in conjunction with the Council's Additional Voluntary Contributions (AVC) provider, take place at least once a year. New employees are made aware of the benefits of the Local Government Pension Scheme (LGPS) with a leaflet included along with their contract. A Scheme Guide is also issued to new members of the scheme.

Investment Managers – Appointed

Blackrock - Nov 2008
Schroders - Mar 2007
M & G Investments - Nov 2014
KBI Global Investors Limited - Nov 2014
Newton - Nov 2014

Investment Advisor

KPMG

AVC Providers

Prudential
Equitable Life (closed to new members)

Banker

Bank of Scotland

Custodian

Northern Trust

Fund Actuary

Hymans Robertson LLP

The overview of the financial performance of the Pension Fund rests with the Pension Fund Committee. The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administrating authority for the Shetland Islands Council Pension Fund.

This includes overseeing the administration of the Pension Scheme, managing the Pension Fund's investments and preparing and maintaining the Funding Strategy Statement, Statement of Investment Principles, Governance Compliance Statement and Pension Administration Strategy. The Pension Fund Committee is made up of the Councillors who currently sit on the Council's Policy & Resources Committee.

The Pension Board is the body responsible for assisting the Scheme Manager (the Council) in relation to compliance with scheme regulations and the requirements of the Pensions Regulator. The Pension Board is made up of three Councillors, one Admitted Body employer and four union representatives.

At an operational level, the Global Custodian is responsible for the safekeeping of the Pension Fund's assets while the external fund managers are responsible for the management of those assets. The investment risk is managed, as set out in the Statement of Investment Principles below, through various fund managers investing in a diversified range of asset classes, over a long-term investment horizon.

During the year State Street ceased the provision of performance management services. The Pension Fund is in the process of looking for a new company to undertake independent performance management of fund managers.

Valuation and Membership

At 31 March 2017, the value of the Pension Fund stood at £450m, an increase of £74m on the previous year. The increase in the value of the Pension Fund is due to investment gains and an excess of employer and employee contributions over benefits payable.

The Pension Fund membership increased during the financial year by 476 to 7,043 members, this includes active members (197), deferred members (170) and pensioners (109). The increase in active members was primarily due to an increase in part-time employees in the Council.

The table below shows the breakdown of the 109 new pensioners following retirement during the year:

Retirement Type	Number
Normal	48
Early	17
Redundancy	6
Flexible	9
Ill health	7
Late	20
Efficiency	2
Total	**109**

Risk

The Pension Fund risk register was updated on 7 March 2017. There are a total of 35 risks, broken down into 6 High, 14 Medium and 15 Low. The key risks are summarised below:

- Staff unable to access workplace leading to staff downtime and loss of service delivery;
- Fund's investments fail to deliver returns in line with anticipated returns required to meet the valuation of the long term liabilities;
- Fall in bond yields, leading to risk in value placed on liabilities;
- Employers leaving scheme/closing to new members due to cost/going into liquidation;
- Failure in world stock markets;
- Under performance by active fund managers.

Not all risk can be eliminated; however, every effort is made to mitigate the impact that risks present the Pension Fund, whether it be by active administration, diversification of investment mandates, engagement with employers, or implementation of policies and procedures.

Funding Strategy

The Net Assets Statement shows an increase in net assets of the Pension Fund to £450m. The Pension Fund investment strategy aims to achieve a fully funded Pension Scheme by 2027. Other objectives of the Pension Fund are:

- to secure and maintain sufficient assets to meet liabilities which fall due by the Pension Fund;
- to minimise the risk of assets failing to meet these liabilities, through an investment strategy, specifically tailored to the Pension Fund's requirements; and
- to maximise investment returns within an acceptable level of risk and providing stability in the level of employers' contribution rates.

Funding Strategy Statement

The Regulations on the management of the Pension Fund require the administering authority to prepare, maintain and publish a written Funding Strategy Statement. Details of the Funding Strategy Statement are found in Note 14: Funding Arrangements on page 29.

The purpose of the Funding Strategy Statement is to:

- establish a clear and transparent Fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- support the regulatory requirement to maintain as near constant employer contribution rates as possible; and
- take a prudent longer-term view of funding those liabilities.

The most recent actuarial valuation carried out was at 31 March 2014. It showed that the Pension Fund is valued at £330m and 92% funded, with a deficit of £30m. The triennial valuation sets the employer contribution rates for the next three years. The total employer contribution rate, which is an average across the whole fund, has increased from 18.8% to 20.7%. The increased liability, recognising the value of future pension benefits, is the primary driver for this increase. The next triennial valuation will be as at 31 March 2017, and will be reflected in the 2017/18 accounts.

The Statement of Investment Principles

The Pension Fund Committee and the Pension Board meetings on 26 October 2015 approved the Shetland Islands Council Pension Fund Statement of Investment Principles. This Statement includes an introduction, administration details, objective of the Pension Fund, types of investments, balance between different types of investment, risk, expected return on investments, realisation of investments, responsible investment, securities lending and compliance.

The Pension Fund also complied with the six Myners Principles, which were contained in a schedule to the Statement of Investment Principles.

The Statement of Investment Principles is available for viewing at the Finance Service, Montfield, Burgh Road, during normal working hours. It can also be found here: [http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=18529 – Appendix A.](http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=18529)

Performance Management

The annual accounts summarise the Pension Fund's transactions for the year and satisfies the requirement of the Local Government Pension Scheme (Scotland) Regulation 55 (1) of The Local Government Pension Scheme (Scotland) Regulations 2014) to prepare a Pension Fund Annual Report for the financial year from 1 April 2016 to 31 March 2017.

Primary Financial Statements

The annual accounts summarise the Pension Fund's transactions for the year and its year-end position at 31 March 2017. The Annual Accounts are prepared in accordance with the International Accounting Standards Board (IASB) Framework for the Preparation and Presentation of Financial Statements (the IASB Framework) as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom.

The two primary statements: the Pension Fund Account and Net Assets Statement as at 31 March 2017 include a description of their purpose. These statements are accompanied by Notes to the Accounts, which set out the Accounting Policies adopted by the Pension Fund and provide more detailed analysis of the figures disclosed on the face of the primary financial statements.

The Primary Financial Statements and Notes to the Accounts, including the accounting policies, form the relevant Annual Accounts for the purpose of the auditor's certificate and opinion.

Financial Performance in 2016/17

The Pension Fund Account presents the full economic cost of providing Pension Fund services in 2016/17. This shows a net income of £74.192m. This differs from the draft outturn position, shown below, which was reported to the Pension Fund Committee and Pension Board on 19 June 2017, and which is on Shetland Islands Council's website.

The reason for the difference is that the Pension Fund Account includes growth in the value of the fund and income automatically reinvested into the fund, which is not included in the table below.

The table below shows the variance of actual against budget as shown in the draft outturn report:

Description	2016/17 Annual Budget £000	2016/17 Draft Outturn £000	2016/17 Variance £000
Total Expenditure	12,350	15,009	(2,659)
Total Income	(19,166)	(20,467)	1,301
Net Income	**(6,816)**	**(5,458)**	**(1,358)**

Expenditure was higher than budgeted due to a number of high value lump sum payments, including death benefits. More people than anticipated have retired during 2016/17 resulting in an increase in benefits payable. Income was higher than budgeted due to a number of high value transfers in from other pension funds.

Budgets were set for death benefits, lump sums and transfers in, along with all other expenditure and income. However, it is difficult to estimate these items, due to the variable nature of them. Lump sums and transfers in are based on a person's length of service and salary, which is variable for each individual, and death benefits are directly related to a person's salary.

Administration Strategy

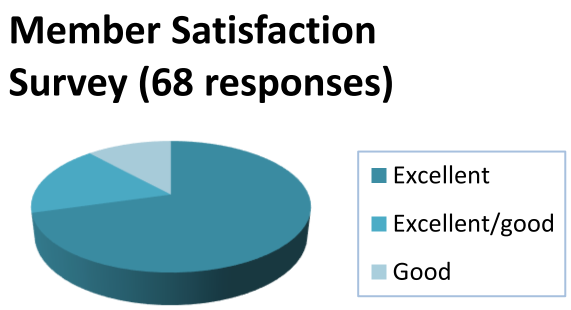
The Pension Fund's Pension Administration Strategy highlights the duties of, and sets performance standards for, both the Fund and all the participating employers.

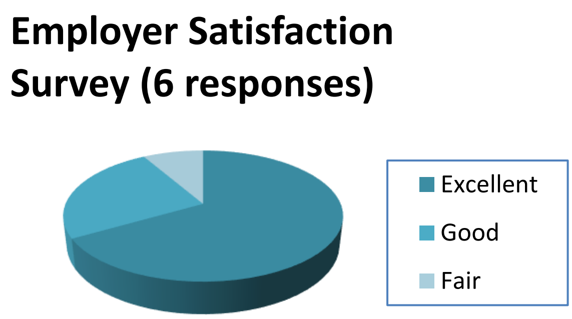
It is vital that employers provide prompt information to the Pension Fund so that timely and accurate information can be provided to the Scheme members. Performance is monitored on a regular basis. The information that the Pension Fund received during the year was delivered in a timely manner by all employers. This included information on new starts, leavers, normal retirements, early retirements and deaths in service. With the exception of a couple of occasions, all employer contributions were received by the 19th of the month following deduction.

Administration Performance

Shetland Islands Council, as a pension administering authority, is also committed to providing a high quality pension service to both members and employers and to ensure members receive their correct pension benefit entitlement.

To ensure excellent customer care is provided, retiring members and employers are requested to complete a customer satisfaction survey. Details of this survey are summarised below:





The customer feedback is very positive for the year and specific comments received will form a basis for identifying and implementing improvement.

Monitoring Arrangements

The Pension Fund Committee and Pension Board receive regular updates on performance and the Committee papers and minutes are available via the Council committee management system website http://www.shetland.gov.uk/coins/.

Reports are prepared on a quarterly basis for the Pension Fund Committee and Pension Board that give an overview of the position of the Pension Fund's external investments and present a summary of each fund manager's performance for the quarter and over a three-year period.

In line with the Pension Fund's governance arrangements to monitor and review fund managers, the Pension Fund Committee and Pension Board invite fund managers to attend the quarterly meetings to give presentations on their mandates and investment performance. At the meeting on 24 May 2016, KBI Global Investors Limited (previously Kleinwort Benson) and M & G gave presentations. At the meeting on 30 August 2016, Schroders gave a presentation, and at the meeting on 7 March 2017, Hymans Robertson, the Pension Fund's actuary, gave a presentation.

Annual visits are made to each fund manager to review the six monthly investment position. For 2016/17, these meetings took place in December 2016. The Pension Fund also receives quarterly audited performance review reports and monthly valuation reports from each fund manager.
This Annual Report and Accounts is available via the Council's website http://www.shetland.gov.uk/about_finances. A full version of this report is provided to the scheduled and active admitted bodies of the Scheme and a summary of the review is provided to all Pension Fund members, via a newsletter.

Remuneration Report

There is no requirement for a remuneration report for the Pension Fund, as the Pension Fund does not directly employ any staff.

All staff are employed by Shetland Islands Council, and their costs are reimbursed by the Pension Fund. The Councillors who are members of the Pension Fund Committee and the Pension Fund Board are also remunerated by Shetland Islands Council.

Details of Councillor and Senior Employee remuneration can be found in the accounts of Shetland Islands Council on the Council's website http://www.shetland.gov.uk/.

Pension Fund Outlook

Administrative

Following "Brexit", a question of how this will affect the Local Government Pension Scheme has been raised. Most of EU legislation that impacts on the LGPS is already written into UK legislation. The scheme will need to continue to comply with such legislation until such time as Britain leaves the EU. Future UK Governments could seek to repeal some or all of this legislation, subject to the terms of any new trade arrangements made with the EU.

With regard to UK government policy and legislative plans for the LGPS, the situation is 'no change'. Regulatory changes, policy objectives and the timescales for implementing them remain as they were before the vote.

Investment

The recent investment strategy review in 2014 was undertaken on the basis of managing risk while investing to achieve the Funding Strategy of having a fully funded Pension Scheme by 2027. During 2016/17, there were some major events such as the US Presidential election and the European Referendum. These events caused volatility within the investment markets but over the financial year, the main markets were higher and the Pension Fund investments benefitted as a result.

The Pension Fund remains cash positive, with income from contributions and investment return exceeding pensions and administrative costs. While this remains the case, the Pension Fund seeks to take advantage of this and grow the assets, while taking an appropriate view on the risks. As the Fund matures and expenditure begins to exceed income then work will have to be undertaken to address the requirement for cash to be achieved from the assets so that the cost of pensions can be met for the long term. It is estimated that the Pension Fund will remain cash positive until 2027, which is the basis for the Investment Strategy.

....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
20 September 2017

....
Jonathan Belford, CPFA
Executive Manager – Finance
20 September 2017

....
Mark Boden
Chief Executive
20 September 2017

Investment Policy and Performance Report

Investment Policy

The investment policy, along with the Pension Fund's approach to the management of risk for the Pension Fund as a whole and in respect of the investment managers, is outlined in the Statement of Investment Principles.

The Council, as the administering authority, has a fiduciary duty to obtain the best possible financial return on the Pension Fund investments against a suitable degree of risk. The Fund Managers, acting in the best financial interests of the Pension Fund, have delegated powers for the acquisition and realisation of investments, but as part of their investment process they are expected to consider all factors, including the social, environmental and ethical policies of companies in which they may invest to the extent that these may materially affect the long term prospects of such companies.

The Fund Managers have all signed up to the United Nations Principles on Responsible Investment Management. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and must be given appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty.

The focus of the Pension Fund's investment strategy is on achieving a 100% funding level before the Pension Fund's contributions equal benefits payable, which is expected to be 2027. Beyond this point, it is expected that payments will exceed contributions made into the Pension Fund. The strategy proposes a less volatile approach with a more diversified asset base. It is estimated that the strategy will improve the level of return, and be protected against the full negative impact of volatile and falling markets due to its increased diversity.

The Pension Fund asset allocation is diversified between equities, bonds, property and cash and is measured against a customised benchmark (which changed in 2015 when the new Investment Policy was approved) as follows:

Asset Class	Allocation from 1 January 2015 %	Allocation to 31 December 2014 %
UK Equities	18	40
Global Equities	40	40
UK Gilts	0	5
UK Corporate Bonds	0	5
Property	12	10
Alternative Bonds	10	0
Diversified Growth Fund	20	0
Total	**100**	**100**

The Pension Fund has five Fund Managers as follows:

Manager	Mandate	% of Pension Fund at March 2017
Blackrock	Passive UK Global Equities	42
Schroders	Active Property	11
Newton	Diversified Growth Fund	17
M & G	Alternative Bonds	22
Kleinwort Benson	Active Global Equities	8
Total		**100**

Investment Performance

Investment performance is monitored against this benchmark return on a quarterly and annual basis; however, the longer-term performance of the Fund Managers is the ultimate measure of achievement.

For the year to 31 March 2017, the Pension Fund had a return of 19.0% compared to the benchmark return of 19.1%.

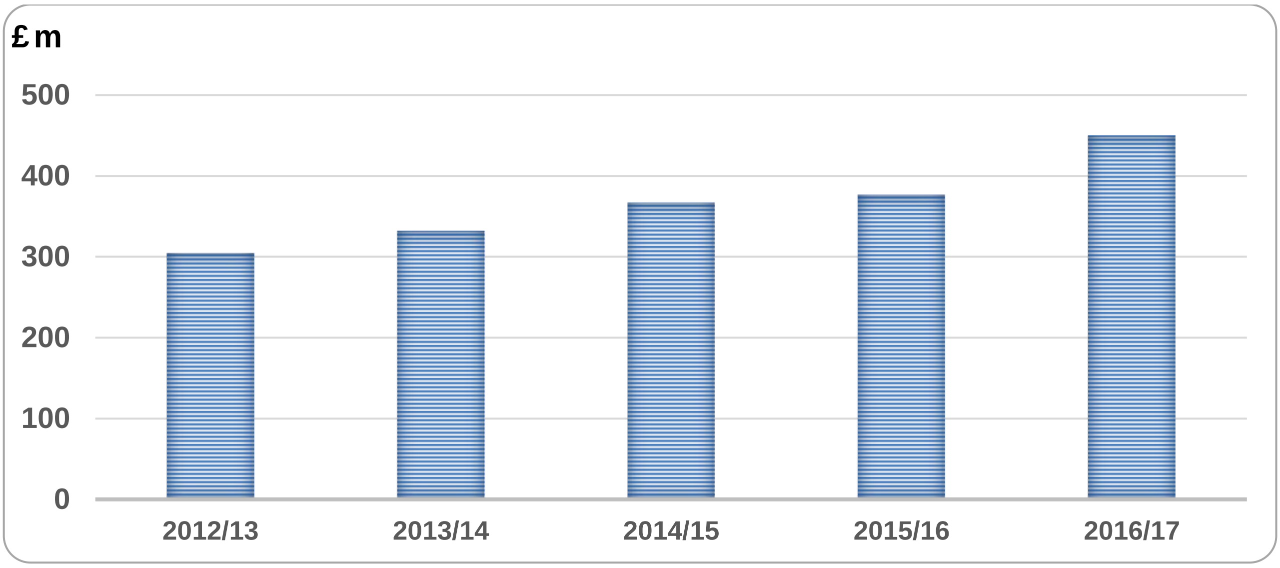
The table below shows the Pension Fund performance over the last five years, and the annualised return over three and five years:

	2012/13	2013/14	2014/15	2015/16	2016/17	Annualised	
						3 Year	5 Year
	%	%	%	%	%	%	%
Fund Return	15.0	6.5	8.8	1.0	19.0	9.4	9.9
Benchmark	14.6	6.7	9.5	2.0	19.1	9.9	10.2
Performance	**0.4**	**-0.2**	**-0.7**	**-1.0**	**-0.1**	**-0.5**	**-0.3**

Over the longer term, the Pension Fund assets have grown in value at over 9% annually. The table above reveals a volatile period of five years, with very strong returns in 2016/17 and in 2012/13.

At the end of 2014/15, the revised Investment Strategy was put in place and this may have been a factor in failing to meet the benchmark in that and the subsequent year.

The graph below shows the market value of the Pension Fund over the last five years:



Annual Governance Statement

Introduction

This Statement documents the governance arrangements for the pension scheme administered by Shetland Islands Council.

Administering Authority

Shetland Islands Council (the Council) is the Administering Authority for the Local Government Pension Scheme (LGPS) set up for the Shetland Islands geographic area.

Regulatory Framework

The Scottish Public Pensions Agency (SPPA) is responsible for regulating the LGPS in Scotland and the Council administers the pension scheme in accordance with these regulations.

The Council manages the Pension Fund in terms of The Local Government Pension Scheme (Scotland) Regulations 2014. The objectives are discharged through the Pension Fund Committee. The Administering Authority is assisted in its duties by the Pension Board.

The financial transactions are conducted in compliance with the Council's Financial Regulations.

The Pension Fund is invested in compliance with the Council's Statement of Investment Principles.

Scope of Responsibility

The Council is responsible for ensuring that the Pension Fund:

- business is conducted in accordance with the law and appropriate standards;
- is safeguarded and properly accounted for; and
- is invested economically, efficiently and effectively.

In discharging these responsibilities, Council members and staff are responsible for implementing effective arrangements for governing the affairs of the Pension Fund. Considerable work has been undertaken in relation to improving the financial governance framework and ensuring that the Council's arrangements comply with the regulations of CIPFA Statement on the Role of the Chief Financial Officer in Local Government (2010).

The management of the Pension Fund is a service in its own right, governed by a suite of appropriate management arrangements, such as:

- appropriate strategic investment policies (such as the Funding Strategy Statement and Statement of Investment Principles);
- service planning arrangements;
- staff time allocations, appropriate to the scale of the Pension Fund;
- performance management arrangements, especially for Pension Fund investments and customer responsiveness;
- systems of internal control to safeguard assets and ensure best value;
- engagement with stakeholders and clear policy on representative roles and responsibilities;
- Governance Statement;
- risk register and business continuity plans;
- support for cash and treasury management;
- training plan; and
- independent and objective scrutiny.

To this end, the Pension Fund is managed within the overall governance arrangements of Shetland Islands Council. The Council has recently refreshed its decision-making arrangements and the governance of the Pension Fund is included within those arrangements. The Shetland Islands Council meeting of 8 March 2017 refreshed the Code of Corporate Governance to ensure compliance with best practice.

Governance Framework

The governance framework consists of the systems, processes, cultures and values by which the Pension Fund is directed and controlled. It describes the way in which staff and representatives inform all the stakeholders and ask for their views on any key issues. It is important to monitor the achievements of the Pension Fund, particularly with regard to the long-term investment strategy. From a service point of view, as with other service areas, there is a need to ensure that the service is delivered efficiently and effectively and in line with all the characteristics of a best value service.

Critical to the success of a well-managed Pension Fund is appropriate internal control arrangements.

The systems of internal financial control are intended to ensure that:

- assets are safeguarded;
- transactions are authorised and properly recorded; and
- material errors or irregularities are either prevented or detected within a reasonable timescale.

The system is based on a framework of skilled staff who are aware of their responsibilities, good management information, financial regulations and effective systems and procedures.

Within Shetland Islands Council, there is a need to focus on the controls required to ensure clear separation of duties, due to the small number of staff directly employed to work on the Pension Fund. The Pension Fund relies on the same systems of internal control as those that are in place for Shetland Islands Council (which are internally and externally audited and assessed on an annual basis).

The effective arrangements include:

- an appropriate level of knowledge for Pension Fund Committee and Pension Board members to ensure that they have adequate knowledge to oversee the governance of the Pension Fund business;
- clear objectives, good decision making at committee level, clear delegations to committee and staff, with appropriate, independent scrutiny of decision making and performance;
- a clear set of objectives for the Pension Fund, as described in the Funding Strategy Statement and Investment Principles;
- good performance monitoring arrangements, with committee members being able to directly question those responsible for all aspects of the business on a regular basis;
- a clear statement of risk (risk register), combined with effective risk management arrangements;
- an annual review of compliance against regulation, guidance and best practice arrangements;
- the Monitoring Officer ensuring compliance with regulation and guidance;
- clear monitoring arrangements;
- compliance with LGPS Investment Regulations;
- compliance with the CIPFA / Myners investment principles;
- appropriate custodian arrangements for investments;
- codes of conduct to support good relationships between committee members and staff who support the work of the Pension Fund;
- a demonstrable best value service, including good use of benchmarking data on the cost and quality of service provided; and
- effective internal control arrangements.

The governance framework cannot eliminate all risks of failure to meet policy objectives. An effective framework can, however, provide a reasonable (but not absolute) assurance of effectiveness.

Review of Effectiveness

The Pension Fund has a responsibility for ensuring the continuing effectiveness of its governance framework and systems of internal control.

The Pension Fund approaches this with reference to the Council and its approach. This considers different layers of assurance, namely management assurance both internally through the Council and externally through the group entities; the assurance and recommendations provided by internal audit; external audit and other external scrutiny reports; and self-evaluation compliance.

Management Assurance

As the administration of the Pension Fund is directly within the remit of the Director of Corporate Services, assurance has been sought from her in relation to the effectiveness of internal financial controls. This assurance provides the opportunity to highlight any weaknesses or areas of concern that should be considered. For 2016/17, no areas of weakness or concern were raised.

In relation to the effectiveness of the Council's arrangements to its statutory officers, both the Executive Manager – Finance (Chief Financial Officer) and Executive Manager – Governance & Law (Monitoring Officer) are full members of the Corporate Management Team and are in attendance at the Council, Audit Committee and Policy and Resources Committee to advise as appropriate.

The Council Committee structure supports the organisational and management structure of the Council, incorporating a culture of accountability that has been developed throughout. The Pension Fund Committee oversees the business of the Pension Fund, the Administering Authority being supported by the Pension Board. The Audit Committee remains responsible for ensuring the effectiveness of the internal audit function and also considering all reports prepared by the external auditor.

The Audit Committee's remit ensures that the work of the Council, from both a control and performance perspective, is checked and scrutinised. As well as an annual plan, the Committee can call for one-off reviews to investigate a particular issue. The Council's Executive Manager - Audit, Risk & Performance reports directly to the Audit Committee.

Assurance from Internal Audit

The Council provides internal audit arrangements to the Pension Fund both as a tool of management and with direct reporting to the Council's Audit Committee. The Internal Audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS). The service works to an approved Annual Plan, based on the approved Audit Strategy, based on the Audit Universe and an annual assessment of the known and potential risks.

During the year there were no specific internal audits carried out for the Pension Fund, and the controls work undertaken across the Council systems by internal audit were found to be generally adequate.

External Audit and Other External Scrutiny

Each year, the external auditors undertake an assessment of the internal controls in operation in the Council, to determine whether they can place reliance on them in the preparation of the final accounts. Recent reports by Audit Scotland identified a limited number of minor recommendations in the area of internal control and these are being addressed by management in order to ensure weaknesses are strengthened.

The Local Government Pension Scheme (LGPS) regulations require LGPS administering authorities to measure their governance arrangements against the standards set out in the guidance. Where compliance does not meet the published standard, there is a requirement for administering authorities to set out any reasons for non-compliance in their governance compliance statement.

Self-Evaluation of Compliance

The Governance Compliance Statement set out below describes the extent to which the governance arrangements comply with best practice and any actions required to implement improvements.

Principle	Compliance and Comments
Structure	
The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council.	Yes, the Pension Fund Commitee has been delegated responsiblity for overseeing the management and administration of the LGPS and managing the investments of the Pension Fund.
That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes, the Pension Board, which meets concurrently with the Pension Fund Committee, includes representatives from employers (Councillors), admitted bodies (a Board Member) and scheme members (Trade Unions).
That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes, the Pension Fund Committee and Pension Board meet concurrently to aid easy and open communication.
That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	The Pension Board is not a secondary committee, both the Pension Fund Committee and Pension Board meet concurrently and have access to the same agenda papers. There is no need for a Pension Board member to be on the Committee.
Committee Membership and Representation	
All key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: i) employing authorities (including non-scheme employers, e.g., admitted bodies); ii) scheme members (including deferred and pensioner scheme members); iii) where appropriate, independent professional observers; and expert advisors (on an ad-hoc basis).	i) Yes - Pension Fund Committee and Pension Board ii) Yes, Pension Board iii) Yes, e.g. engaging with the appointed actuary or investment manager when professional advice is required.
Where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes, Pension Board members have the same access to information, papers and training
Selection and role of lay members	
That committee or board members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.	Yes, training provided during 2015/16
That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes, 'Declarations of Interest' is a standing item on all agendas.

Principle	Compliance and Comments
Voting	
The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes, these are contained in the Terms of Reference for both Pension Fund Committee and Pension Board.
Training/Facility time/Expenses	
That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Yes A Member Development Programme is in place. The Constitution clearly sets out the scope of approved duties. There is supplementary guidance to ensure Members' expenses are reimbursed in line with regulatory requirements.
That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	No The policies for employer representatives and staff representatives are necessarily different and cannot be equally applied.
That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	Yes A Member Development Programme was implemented. All member development is being monitored and logged centrally. Personal development plans are in place for 18 out of 22 Members.
Meetings (frequency/quorum)	
That an administering authority's main committee or committees meet at least quarterly.	Yes, the Pension Fund Committee and Pension Board meets at least four times per annum and is wholly focused on Pension Fund business.
That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Yes, the Pension Board sits concurrently with the Pension Fund Committee.
That an administering authority that does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Lay members are included in formal governance arrangements.
Access	
That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes, committee papers are sent out to all Pension Fund Commitee and Pension Board members, and all agenda items and subsequent minutes are available on the Shetland Islands Council Committee Information Pages (COINS).

Principle	Compliance and Comments
Scope	
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes, full scope of the Pension Fund Committee and Pension Board are found in their Terms of Reference
Publicity	
That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes The Annual Newsletter is available to all Members. The Annual Report and Accounts will be made available on-line.

Significant Governance Issues

The system of governance can provide only reasonable (and not absolute) assurance that assets are safeguarded, transactions are authorised and properly recorded, material errors or irregularities are either prevented or would be detected within a timely period and all the significant risks impacting on the achievement of our objectives have been mitigated.

Following a review of the effectiveness of the code of governance there are no significant governance issues that require to be reported.

Certification

It is our opinion that the governance and internal control environment provides reasonable and objective assurance that any significant risks impacting on the achievement of the principal objectives of the Pension Fund will be identified and actions taken to avoid or mitigate their impact.

....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
20 September 2017

....
Mark Boden
Chief Executive
Shetland Islands Council
20 September 2017

Statement of Responsibilities for the Statement of Accounts

The administering authority's responsibilities

The Authority is required to:

- make arrangements for the proper administration of its Pension Fund and to ensure that the proper officer has the responsibility for the administration of those affairs (section 95 of the Local Government (Scotland) Act 1973). In this authority, that officer is the Executive Manager – Finance;
- manage its affairs to secure economic, efficient and effective use of resources and to safeguard its assets;
- ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003); and
- approve the Annual Accounts for signature.

I can confirm that these Annual Accounts were approved for signature by the Council on 20 September 2017.

Signed on behalf of Shetland Islands Council

....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
20 September 2017

The Executive Manager – Finance's responsibilities

The Executive Manager - Finance is responsible for the preparation of the Pension Fund Statement of Accounts in accordance with proper practices as required by legislation and as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code).

In preparing the Annual Accounts, the Executive Manager - Finance has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- complied with legislation; and
- complied with the local authority Accounting Code (in so far as it is compatible with legislation).

The Executive Manager - Finance has also:

- kept proper accounting records which were up to date; and
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

I certify that the Annual Accounts give a true and fair view of the financial position of the Pension Fund at the reporting date and the transactions of the Pension Fund for the year ended 31 March 2017.

....
Jonathan Belford, CPFA
Executive Manager – Finance
Shetland Islands Council
20 September 2017

Pension Fund Account 2016/17

The Pension Fund Account sets out all income and expenditure of the Pension Fund.

2015/16 £000		Notes	2016/17 £000	2016/17 £000
	Dealings with members, employers and others directly involved in the scheme			
(16,627)	Contributions	4	(16,026)	
(529)	Transfers in from other pension funds	5	(1,258)	
(886)	Other income		(28)	
(18,042)	**Total Additions**			**(17,312)**
11,890	Benefits payable	6	12,785	
133	Payments to and on account of leavers	7	363	
946	Other payments		4	
12,969	**Total Withdrawals**			**13,152**
(5,073)	**Net (additions)/withdrawals from dealings with members**			**(4,160)**
1,736	Management expenses	8		1,856
(3,337)	**Net additions including Fund Management Expenses**			**(2,304)**
	Return on investments			
(2,887)	Investment income	9	(3,154)	
(1,645)	(Profits) and losses on disposal of investments and changes in market value of investments	12b	(68,734)	
(4,532)	**Net return on investments**			**(71,888)**
(7,869)	**Net increase in the net assets available for benefits during the year**			**(74,192)**
(367,838)	**Opening net assets of the scheme**			**(375,707)**
(375,707)	**Closing net assets of the scheme**			**(449,899)**

Net Assets Statement as at 31 March 2017

The Net Assets Statement sets out the value, as at the Statement date, of all assets and current liabilities of the Pension Fund. The net assets of the Pension Fund (assets less current liabilities) represent the funds available to provide for pension benefits at the statement date.

The financial statements summarise the transactions of the Pension Fund during the year and its net assets at the year-end. It should be noted, however, that they do not take account of the obligations to pay pensions and benefits that fall due after the end of the year. The actuarial position of the Pension Fund, which does take account of such obligations, is discussed in the Actuarial Statement. These financial statements should be read in conjunction with that information. In addition, as required by IAS26, the Actuarial Present Value of Promised Retirement Benefits is disclosed in the notes to these financial statements.

2015/16 £000		Notes	2016/17 £000	2016/17 £000
	Investment Assets			
375,149	Investment Assets	10	448,957	
375,149	**Total Investment Assets**			**448,957**
	Current Assets			
1,102	Debtors	16	1,345	
1,178	Bank current accounts		1,011	
2,280	**Total Current Assets**			**2,356**
	Current Liabilities			
(1,497)	Sundry creditors	18	(366)	
(225)	Benefits payable		(1,048)	
(1,722)	**Total Current Liabilities**			**(1,414)**
375,707	**Net assets of the scheme available to fund benefits at the reporting period end**			**449,899**

The audited accounts were authorised for issue on 20 September 2017.

....
Jonathan Belford, CPFA
Executive Manager – Finance
20 September 2017

Notes to the Accounts

Note 1: Description of Pension Fund

The Shetland Islands Council Pension Fund is part of the Local Government Pension Scheme and is administered by Shetland Islands Council. The Council is the reporting entity for this Pension Fund.

The following description of the Pension Fund is a summary.

General

The Pension Fund is governed by the Superannuation Act 1972 and by the Public Service Pensions Act 2013. The Pension Fund is administered in accordance with the following secondary legislation:

- The Local Government Pension Scheme (Scotland) Regulations 2014;
- The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014;
- The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015; and
- the LGPS (Management and Investment of Funds) Regulations 2010.

It is a contributory defined benefit pension scheme administered by Shetland Islands Council to provide pensions and other benefits for pensionable employees of scheduled bodies, Shetland Islands Council, Orkney and Shetland Valuation Joint Board and admitted bodies within Shetland. Teachers are not included as they have a separate national pension scheme.

The Pension Fund is overseen by the Pension Board and Pension Fund Committee.

Membership

Membership of the LGPS is automatic, but employees are free to choose to opt out of the Scheme and make their own personal pension arrangements outside the Scheme.

Organisations participating in the Shetland Islands Council Pension Fund include:

- Scheduled bodies, which are local authorities and similar statutory bodies whose staff are automatically entitled to be members of the Pension Fund; and
- Admitted bodies, which are other organisations that participate in the Pension Fund under an admission agreement between the Pension Fund and the relevant organisation. Admitted bodies include voluntary, charitable and similar bodies or private contractors undertaking a local authority function following outsourcing to the private sector.

There are 11 employer organisations with active members within Shetland Islands Council Pension Fund including the Council itself, a summary of membership is shown below:

31 March 2016	Shetland Islands Council Pension Fund	31 March 2017
12	**Number of employers with active members**	**11**
	Number of employees in scheme:	
2,763	Shetland Islands Council	2,957
382	Other employers	385
3,145	**Total**	**3,342**
	Number of pensioners/dependants	
1,493	Shetland Islands Council	1,583
126	Other employers	145
1,619	**Total**	**1,728**
	Deferred pensioners	
1,538	Shetland Islands Council	1,611
265	Other employers	362
1,803	**Total**	**1,973**
6,567	**Scheme Total**	**7,043**

Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Pension Fund in accordance with the Local Government Pension Scheme (Scotland) Regulations 2014 and range from 5.5% to 12% of pensionable pay for the financial year ending 31 March 2017. Employee contributions are matched by employers' contributions, which are set, based on triennial actuarial funding valuations. The actuarial valuation as at 31 March 2014 set these employers' contribution rates, which range from 17.2% to 33.8% of pensionable pay.

Benefits

Pension benefits under the LGPS are calculated as per the table below:

Service pre 1 April 2009	Service post 31 March 2009	Service Post 31 March 2015
Each year worked is worth 1/80 x final FTE pensionable salary	Each year worked is worth 1/60 x final FTE pensionable salary	Each year worked is worth 1/49 x actual pensionable salary
Automatic lump sum of 3 x salary.	No automatic lump sum.	No automatic lump sum
In addition, part of annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.	Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.	Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.

There are a range of other benefits provided under the scheme including early retirement, ill health retirement and death benefits. For more details, please refer to http:\\www.scotlgps2015.org/ or contact Shetland Islands Council Pension Section on 01595 744644.

Benefits in payment are index-linked in line with the consumer price index.

Note 2: Basis of Preparation

The Statement of Accounts summarises the Pension Fund's transactions for the 2016/17 financial year and its position at year-end as at 31 March 2017. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17, which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.
The accounts summarise the transactions of the Pension Fund and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits that fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, is disclosed at Note 15 on page 31 of these accounts.

Accounting Standards Issued, not Adopted

Accounting standards issued but not adopted by the code in 2016/17 are:

- Amendments to IAS 19 Employee Benefits (Defined Benefit Plans: Employee Contributions);
- Annual Improvements to IFRSs 2010-2012 Cycle;
- Annual Improvements to IFRSs 2012-2014 Cycle;
- Amendment to IAS 1 Presentation of Financial Statements (Disclosure Initiative);
- The changes to the format of the Comprehensive Income and Expenditure Statement, the Movement in Reserves Statement and the introduction of the new Expenditure and Funding Analysis;
- The changes to the format of the Pension Fund Account and the Net Assets Statement.

The Code requires implementation from 1 April 2017 and there is therefore no impact on the 2016/17 financial statements.

Note 3: Assumptions Made about the Future and Other Major Sources of Estimation Uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Council about the future, or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors.

However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the net assets statement at 31 March 2017 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. An actuary to the Fund is appointed to provide the fund with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, 0.5% decrease in the real discount rate assumption would result in an increase in the pension liability of £83m. A 0.5% increase in salary increase rate assumption would increase the value of liabilities by approximately £30m, and a 0.5% increase in pension increase rate assumption would increase the liability by approximately £50m.

Note 4: Contributions Receivable

By category:

31 March 2016 £000		31 March 2017 £000
(12,781)	Employers - normal	(12,190)
(186)	Employers - augmentation	(18)
(3,660)	Members - normal	(3,818)
(16,627)	**Total**	**(16,026)**

By authority:

31 March 2016 £000		31 March 2017 £000
(14,160)	Administering authority	(13,589)
(129)	Scheduled bodies	(135)
(2,338)	Admitted bodies	(2,302)
(16,627)	**Total**	**(16,026)**

Note 5: Transfers in from Other Pension Funds

The total transfers received during the year are as follows:

31 March 2016 £000		31 March 2017 £000
(529)	Individual transfers in	(1,258)
(529)	**Total**	**(1,258)**

The Pension Fund received 41 transfers in during 2016/17 with an average value of £30,683 compared to 35 transfers in during 2015/16 with an average value of £15,100.

Note 6: Benefits Payable

By category:

31 March 2016 £000		31 March 2017 £000
8,920	Pensions	9,312
2,690	Commutation and lump sum retirement benefits	2,671
280	Lump sum death benefits	802
11,890	**Total**	**12,785**

By authority:

31 March 2016 £000		31 March 2017 £000
10,353	Administering authority	11,410
191	Scheduled bodies	111
1,346	Admitted bodies	1,264
11,890	**Total**	**12,785**

Note 7: Payments to and on Account of Leavers

31 March 2016 £000		31 March 2017 £000
20	Refunds to members leaving service	17
31	Payments for members joining state scheme	14
82	Individual transfers	332
133	**Total**	**363**

Note 8: Management Expenses

31 March 2016 £000		31 March 2017 £000
256	Administration Expenses	318
38	Oversight and Governance Expenses	51
	Investment Management Expenses	
1,346	Management Fees	1,420
64	Performance Fees	35
32	Custody Fees	32
1,736	**Total**	**1,856**

Note 9: Investment income

31 March 2016 £000		31 March 2017 £000
(2,729)	Pooled investment vehicles	(2,988)
(6)	Interest on cash deposits	(4)
(152)	Other	(162)
(2,887)	**Total**	**(3,154)**

Note 10: Investments

Market Value As at 31 March 2016 £000		Market Value As at 31 March 2017 £000
294,476	Pooled funds	361,371
33,926	Fixed income unit trusts	38,019
46,668	Pooled property unit trusts	48,112
44	Cash deposits	1,218
35	Property income due	237
375,149	**Total investment**	**448,957**

Note 10a - Reconciliation of movements in investments

	Market Value at 1 April 2016 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2017 £000
Investment Assets:					
Pooled funds - managed funds	146,051	0	(38)	25,363	171,376
- unit linked insurance policies	153,247	0	(35)	41,855	195,067
Fixed income unit trusts	33,926	2,571	0	1,522	38,019
Pooled property unit trusts	41,576	3,402	(2,119)	(6)	42,853
Total Pooled Investment Vehicles	**374,800**	**5,973**	**(2,192)**	**68,734**	**447,315**
Investment Income Due:					
Fixed income income due	270				187
Property income due	35				237
Total Investment Income Due	**375,105**				**447,739**
Other investment balances:					
Cash deposits	44				1,218
Net investment assets	**375,149**	**5,973**	**(2,192)**	**68,734**	**448,957**

	Market Value at 1 April 2015 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2016 £000
Investment Assets:					
Pooled funds - managed funds	142,922	2,000	(1,000)	2,129	146,051
- unit linked insurance policies	154,858	0	0	(1,611)	153,247
Fixed income unit trusts	34,059	825	0	(958)	33,926
Pooled property unit trusts	33,663	7,263	(1,435)	2,085	41,576
Total Pooled Investment Vehicles	**365,502**	**10,088**	**(2,435)**	**1,645**	**374,800**
Investment Income Due:					
Fixed income due	170				270
Property income due	5				35
Total Investment Income Due	**365,677**				**375,105**
Other investment balances:					
Cash deposits	511				44
Net investment assets	**366,188**	**10,088**	**(2,435)**	**1,645**	**375,149**

Indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. The amount of indirect costs is not separately provided to the Scheme.

Note 10b - Analysis of Pooled Investment Vehicles

31 March 2016 £000		31 March 2017 £000
	Additional analysis	
67,159	Pooled funds (UK)	81,933
153,482	Pooled funds (Overseas)	203,697
73,565	Diversified Growth	75,554
33,926	Alternative Credit	38,019
45,021	Pooled property unit trust (UK)	46,731
1,647	Pooled property unit trust (Overseas)	1,381
374,800	**Total Pooled Investment Vehicles**	**447,315**

Note 10c - Analysis by Fund Manager

Market Value 31 March 2016			Market Value 31 March 2017	
£000	%		£000	%
147,159	39	BlackRock	188,816	42
46,774	12	Schroders	49,560	11
73,566	20	Newton Asset Management	75,554	17
73,454	20	Kleinwort Benson	96,821	22
34,196	9	M & G Investments	38,206	8
375,149	**100**	**Total investment assets**	**448,957**	**100**

The following investments represent more than 5% of the net assets of the scheme:

Market Value 31 March 2016			Market Value 31 March 2017	
£000	%		£000	%
67,128	18	Aquila Life UK equity index	81,933	18
33,926	9	M & G Alpha Opp Fd AGBP	38,019	8
73,454	20	KBI 1 Dividend Plus	96,821	22
73,566	20	Newton Real Rtrn X ACC NAV	75,554	17
80,028	21	Aquila Life World EX UK Fund Series 1	106,875	24

Note 11: Fair Value Hierarchy

Asset and liability valuations have been classified into three levels according to the quality and reliability of information used to determine their fair values. Transfers between levels are recognised in the accounts in the year in which they occur.

Level 1

Assets and liabilities at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as Level 1 comprise quoted equities, quoted fixed securities, quoted index linked securities and unit trusts.

Level 2

Assets and liabilities at Level 2 are those where quoted market prices are not available, for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value.

Level 3

Assets and liabilities at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data.

The following table provides an analysis of the financial assets of the pension fund, grouped into Levels 1 and 2, based on the level at which the fair value is observable. The Pension Fund has no Level 3 investments.

As at 31 March 2016 £000	Fair value through profit and loss	As at 31 March 2017 £000
349	Level 1	470
374,800	Level 2	448,487
375,149	**Net Investment assets**	**448,957**

Basis of Valuation

The basis of valuation for each class of investment asset is set out below. There has been no change in the valuation techniques used during the year. All assets have been valued using fair value techniques that represent the highest and best price available at the reporting date.

Description of Asset	Valuation hierarchy	Basis of valuation	Observable and unobservable inputs	Key sensitivities affecting the valuations provided
Market quoted investments	Level 1	Published bid market price ruling on the final day of the accounting period	Not required	Not required
Exchange traded pooled investments	Level 1	Closing bid value on published exchanges	Not required	Not required
Pooled investments - overseas unit trusts and property funds	Level 2	Closing bid price where bid and offer prices are published Closing single price where single price published	NAV-based pricing set on a forward pricing basis	Not required

Note 12: Financial Instruments

Note 12a - Classification of financial instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including gains and losses, are recognised.

The following table analyses the carrying amounts of financial assets and liabilities (excluding cash) by category and net assets statement heading. No financial assets were reclassified during the accounting period.

31 March 2016				31 March 2017		
Fair value through profit and loss £000	Receivables £000	Financial liabilities £000		Fair value through profit and loss £000	Receivables £000	Financial liabilities £000
			Financial assets			
			Pooled funds			
142,264	0		- managed funds	167,339	0	
152,212	0		- unit linked insurance policies	194,032	0	
33,927	0		Fixed income unit trusts	38,019	0	
46,667	0		Pooled property unit trusts	48,112	0	
0	1,222		Cash	0	2,229	
35	0		Property income due	237	0	
0	1,102		Debtors	0	1,345	
375,105	**2,324**		**Total Financial assets**	**447,739**	**3,574**	
			Financial liabilities			
		(1,722)	Creditors			(1,414)
		(1,722)	**Total Financial liabilities**			**(1,414)**
375,105	**2,324**	**(1,722)**	**Total Financial Instrume**	**447,739**	**3,574**	**(1,414)**

Note 12b - Net gains and losses on financial instruments

31 March 2016 £000		31 March 2017 £000
	Financial assets	
(1,645)	Fair value through profit and loss	(68,734)
(1,645)	**Total**	**(68,734)**

Note 12c - Value of financial instruments

31 March 2016			31 March 2017	
Book value £000	Market value £000		Book value £000	Market value £000
		Financial assets		
323,479	375,105	Fair value through profit and loss	327,613	447,739
323,479	**375,105**	**Total**	**327,613**	**447,739**

Note 13: Nature and Extent of Risks Arising from Financial Instruments

Risk and risk management

The Pension Fund's primary long-term risk is that its assets will fall short of its liabilities (i.e. promised benefits payable to members).

Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Pension Fund and to maximise the opportunity for gains across the whole Pension Fund portfolio. The Pension Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Pension Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Pension Fund's forecast cash flows. The Pension Fund manages these investment risks as part of its overall Pension Fund risk management programme.

Responsibility for the Pension Fund's risk management strategy rests with the Council. Risk management policies are established to identify and analyse the risks faced by the Council's pension operations. Policies are reviewed regularly to reflect changes in activity and market conditions.

Market risk

Market risk is the risk of loss from fluctuations in equity, bond and property prices, interest and foreign exchange rates and credit spreads. The Pension Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market condition, expectations of future price and yield movements and the asset mix.

The objective of the Pension Fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industrial sectors and individual securities. To mitigate market risk, the Pension Fund and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

Other price risk

Other price risk represents the risk that the value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual instrument, or its issuer, or factors affecting all such instruments in the market.

The Pension Fund's investment managers mitigate this price risk through diversification and the selection of investments, which is monitored by the Council, as the administering authority, and the Fund Managers to ensure it is within limits specified in the Pension Fund investment strategy.

Other Pension Fund price risk - sensitivity analysis

In agreement with the Pension Fund's performance analyst and following analysis of historical data and expected investment return during the financial year, the Pension Fund has determined that the following movements in market price risk are deemed reasonably possible for the financial year 2016/17 reporting period:

Asset Type	Potential market movements (+/-)
UK Equities	15.8%
Overseas Equities	18.4%
Property	14.2%
Cash	0.0%
Diversified Growth	12.5%
Alternative Credit	6.1%

The potential price changes disclosed above are determined based on the observed historical volatility of asset class returns. ‘Riskier’ assets such as equities will display greater potential volatility than bonds as an example, so the overall outcome will depend largely on Pension Funds’ asset allocations. The potential volatilities are consistent with a one standard deviation movement in the change in value of the assets over the latest three years. This can then be applied to the period end asset mix.

Had the market price of the Pension Fund investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price would have been as shown in the following table (the prior year comparator is shown below):

Asset Type	Value as at 31 March 2017 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
Cash and cash equivalents	1,218	0.00%	1,218	1,218
Investment portfolio assets:				
UK Equities	81,933	15.8%	94,878	68,988
Global Equities (ex UK)	279,250	18.4%	330,632	227,868
Property	38,206	14.2%	43,631	32,781
Diversified Growth	46,749	12.5%	52,593	40,905
Alternative Credit	1,601	6.1%	1,699	1,503
Total assets	**448,957**		**524,651**	**373,263**

Asset Type	Value as at 31 March 2016 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
Cash and cash equivalents	44	0.01%	44	44
Investment portfolio assets:				
UK Equities	67,159	10.61%	74,285	60,033
Overseas Equities	227,047	9.43%	248,458	205,636
Total Bonds & Index Linked	34,196	4.77%	35,827	32,565
UK Property	45,048	1.98%	45,940	44,156
Overseas Property	1,655	20.37%	1,992	1,318
Total assets	**375,149**		**406,546**	**343,752**

Interest rate risk

The Pension Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Pension Fund's direct exposure to interest rate movements as at 31 March 2016 and 31 March 2017 are set out below:

31 March 2016 £000		31 March 2017 £000
	Asset type	
44	Cash and cash equivalents	1,218
1,178	Cash balances	1,011
1,222	**Total**	**2,229**

Interest rate risk sensitivity analysis

The Pension Fund recognises that interest rates can vary and can affect both income to the Pension Fund and the value of the net assets available to pay benefits. A 110 basis point (BPS) movement in interest rates is viewed as a reasonable level of risk sensitivity for the Pension Fund under current interest rate circumstances. The Pension Fund's performance analyst has also agreed that the long-term average rates are expected to move less than 110 basis points (hence 100 basis points used in the examples below) from one year to the next and experience suggests that such movements are possible.

The analysis that follows assumes the total Fund volatility takes into account the expected interactions between the different asset classes shown, based on the underlying volatilities and correlations of the assets, in line with mean variance portfolio theory.

Asset Type	Carrying amount as at 31 March 2017 £000	Change in year in the net assets available to pay benefits +100 BPS £000	-100 BPS £000
Cash and cash equivalents	1,218	12	(12)
Cash balances	1,011	10	(10)
Total change in assets available	**2,229**	**22**	**(22)**

Asset Type	Carrying amount as at 31 March 2016 £000	Change in year in the net assets available to pay benefits +100 BPS £000	-100 BPS £000
Cash and cash equivalents	44	0	0
Cash balances	1,178	12	(12)
Total change in assets available	**1,222**	**12**	**(12)**

Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Pension Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the Pension Fund (£ sterling). The Pension Fund holds both monetary and non-monetary assets denominated in currencies other than £ sterling.

The following table summarises the Pension Fund's currency exposure as at 31 March 2017 and as at the previous period end:

31 March 2016 £000		31 March 2017 £000
	Asset type	
227,047	Pooled Funds - overseas equities	279,250
1,655	Pooled Property Unit Trusts - overseas	1,601
228,702	**Total**	**280,851**

Currency risk - sensitivity analysis

Following analysis of data provided by the Pension Fund's performance analysts, the Pension Fund considers the likely volatility associated with foreign exchange rate movements to be 10%.

This analysis assumes that all other variables, in particular interest rates, remain constant. A 10% strengthening/weakening of the pound against the various currencies in which the Pension Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Asset Type	Carrying amount as at 31 March 2017 £000	Change to net assets available to pay benefits +10.0% £000	-10.0% £000
Pooled Funds - overseas equities	279,250	307,175	251,325
Pooled Property Unit Trusts - overseas	1,601	1,761	1,441
Total change in assets available	**280,851**	**308,936**	**252,766**

Asset Type	Carrying amount as at 31 March 2016 £000	Change to net assets available to pay benefits +6.15% £000	-6.15% £000
Pooled Funds - overseas equities	227,047	241,010	213,084
Pooled Property Unit Trusts - overseas	1,655	1,757	1,553
Total change in assets available	**228,702**	**242,767**	**214,637**

Credit risk

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Pension Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Pension Fund's financial assets and liabilities.

In essence, the Pension Fund's entire investment portfolio is exposed to some form of credit risk. However, the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

Deposits are not made with banks and financial institutions unless they meet the Council's credit criteria. The Council has also set limits on the value of these deposits, which can be placed with any bank or financial institution, apart from the bank the Council uses for its daily operations.

The Council believes it has managed its exposure to credit risk, and has had no experience of default or uncollectible deposits over the past five financial years.

The Pension Fund's cash holding under its treasury management arrangements at 31 March 2017 was £2.229m (31 March 2016: £1.222m). This was held with the following institutions:

31 March 2016 £000		31 March 2017 £000
	Fund manager deposits	
42	Schroders cash	1,211
2	BlackRock cash	7
	Bank current accounts	
1,178	Bank of Scotland Plc	1,011
1,222	**Total**	**2,229**

Liquidity risk

Liquidity risk represents the risk that the Pension Fund will not be able to meet its financial obligations as they fall due. The Pension Fund takes steps to ensure that it has adequate cash resources to meet its commitments.

The Pension Fund has immediate access to all its cash holdings. The Pension Fund also has an overdraft facility to cover any unexpected short-term cash needs. The overdraft facility has not been used over the past five years and therefore the Pension Fund's exposure to liquidity risk is considered negligible.

The Pension Fund defines liquid assets as assets that can be converted to cash within three months. Illiquid assets are those assets that will take longer than three months to convert into cash. As at 31 March 2017, the value of illiquid assets was £38.2m, which represented 8.5% of the Pension Fund assets (31 March 2016: £46.7m, which represented 12.4% of the Pension Fund assets).

Refinancing risk

The key risk is that the Pension Fund will be bound to replenish a significant proportion of its financial instruments at a time of unfavourable interest rates. The Pension Fund does not have any financial instruments that have a refinancing risk as part of its treasury management and investment strategies.

Note 14: Funding Arrangements

In line with the Local Government Pension Scheme (Scotland) Regulations 2014, the Pension Fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period. The valuation for the current accounting period took place as at 31 March 2014.

The funding policy is set out in the Pension Fund's Funding Strategy Statement (FSS), dated February 2015.

The key elements of the funding policy are:

- to ensure the long-term solvency of the Pension Fund using a prudent long-term view. This will ensure that sufficient funds are available to meet all members'/dependents' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return. This will also minimise the costs to be borne by Council Tax payers;
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

Employee benefits are guaranteed, and employee contributions are fixed, so employers need to pay the balance of the cost of delivering the benefits to members and dependants. The Funding Strategy Statement sets out how the Administering Authority has balanced the conflicting aims of affordability and stability of employer contributions and prudence in the funding basis, with regard to employer liabilities.

Funding position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was at 31 March 2014. This valuation revealed that the Pension Fund's assets, which at 31 March 2014 were valued at £333 million, were sufficient to meet 92% (91% at 31 March 2011 valuation) of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £30 million (2011 valuation: £25 million).

The common rate of contribution payable by each employing authority under regulation 32(4)(a) of the Administration Regulations for the period 1 April 2015 to 31 March 2018 is 20.7% of pensionable pay, (i.e. the rate which all employers in the Pension Fund pay).

Individual employers' rates are adjusted under regulation 32(4) (b) from the common contribution rate. The contribution rates payable for the period 1 April 2015 to 31 March 2018 were set in accordance with the Pension Fund's funding policy as set out in its Funding Strategy Statement.

The payment due by the Shetland Islands Council during this period includes an employer's rate of 18.7%, 19.8% and 20.8% per annum for each of the three years.
Copies of the 2014 Valuation Report and Funding Strategy Statement are available on request from Shetland Islands Council, the Administering Authority to the Pension Fund.

Principal actuarial assumptions and method used to value the liabilities

Full details of the method used are described in a valuation report from the actuaries, Hymans Robertson LLP, available on request from Shetland Islands Council, the Administering Authority to the Pension Fund.

Method

The liabilities were assessed using an accrued benefits method, which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

Assumptions

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Pension Fund assets at their market value.

The key financial assumptions adopted for the 2014 valuation were as follows:

Financial assumptions	31 March 2014 % p.a. Nominal	% p.a. Real
Discount rate	5.2%	2.5%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	0.0%

Mortality assumptions

The key demographic assumption was the allowance made for longevity. The baseline longevity assumptions adopted at this valuation were based on the Fund's VitaCurves, and assumed that improvements have reached a peak of 1.25%. Based on these assumptions, the average future life expectancies at age 65 are as follows:

Mortality assumption at age 65	Males	Females
Current Pensioners	22.8 yrs	23.8 yrs
Future Pensioners	24.9 yrs	26.7 yrs

Historic mortality assumptions

Life expectancies for the prior year-end are based on the PFA92 and PMA92 tables. The allowances for future life expectancies for the year ended 31 March 2016 are:

- **Prospective Pensioners:** Vita base curves with improvements in line with CMI 2012, assuming current rate of improvements have peaked with minimum underpin of 1.25% p.a.

- **Pensioners:** Vita base curves with improvements in line with CMI 2012, assuming current rate of improvements have peaked with minimum underpin of 1.25% p.a.

Commutation assumption

An allowance is included for future retirements to elect to take 70% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 85% of the maximum tax-free cash post-April 2009 service.

Note 15: Actuarial Present Value of Promised Retirement Benefits

In addition to the triennial funding valuation, the Pension Fund's actuary also undertakes a valuation of the Pension Fund liabilities, on an IAS 19 basis, every year using the same base data as the funding valuation rolled forward to the current financial year, taking account of changes in membership numbers and updating assumptions to the current year.

In order to assess the value of the benefits on this basis, the actuary has updated the actuarial assumptions (set out below) from those used for funding purposes (see Note 14). The actuary has also used ill health and death benefits in line with IAS 19.

The actuarial present value of promised retirement benefits at 31 March 2017 was £693 million (31 March 2016: £517 million). The Pension Fund accounts do not take account of liabilities to pay pensions and other benefits in the future.

The liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2014.

Assumptions

The assumptions used are those adopted for the Administering Authority's IAS 19 report as required by the Code of Practice. These are given below:

31 March 2016 % p.a.	Year ended	31 March 2017 % p.a.
2.2	Inflation/pension increase rate	2.4
4.2	Salary increase rate	4.4
3.5	Discount rate	2.6

Note 16: Current Assets

31 March 2016 £000		31 March 2017 £000
	Debtors:	
25	Contributions due - employees	322
1,038	Contributions due - employers	1,020
27	Transfer values receivable	0
2	Sundry debtors	2
0	Prepayments	1
10	Accrued Income	0
1,178	Bank current accounts	1,011
2,280	**Total**	**2,356**

Analysis of debtors

31 March 2016 £000		31 March 2017 £000
0	Central government bodies	1
38	Other local authorities	1,162
1	Public corporations & trading funds	0
1,063	Other entities and individuals	182
1,102	**Total**	**1,345**

Note 17: Unfunded Pension

31 March 2016 £000		31 March 2017 £000
702	Added years pension	694

Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 [Section 31] allows local authorities and admitted bodies to pay additional pension on a voluntary basis. Additional pension in respect of added years' enhancement is awarded from the body or service where the employee retired and costs are paid directly.

Note 18: Current Liabilities

31 March 2016 £000		31 March 2017 £000
(1,497)	Sundry creditors	(366)
(225)	Benefits payable	(1,048)
(1,722)	**Total**	**(1,414)**

Analysis of creditors

31 March 2016 £000		31 March 2017 £000
(1)	Central government bodies	(1)
(484)	Other local authorities	(286)
(36)	Public corporations and trading funds	(25)
(1,201)	Other entities and individuals	(1,102)
(1,722)	**Total**	**(1,414)**

Note 19: Additional Voluntary Contributions

31 March 2016 £000		31 March 2017 £000
4,704	Prudential	5,164
91	Equitable Life	89
4,795	**Total**	**5,253**

AVC contributions of £0.672m were paid directly to Prudential during the year (2015/16 £0.582m).

Note 20: Related Party Transactions

Shetland Islands Council

The Shetland Islands Council Pension Fund is administered by Shetland Islands Council. Consequently there is a strong relationship between the Council and the Pension Fund.

The Council incurred costs of £0.338m (2015/16 £0.261m) in relation to the administration of the Pension Fund and was subsequently reimbursed by the Pension Fund for these expenses.

The investments of the Pension Fund are overseen by the Council's Treasury Section; their costs are levied by staff time allocations. Costs incurred were £0.032m (2015/16 £0.051m) in relation to investment of the Pension Fund and the Council was subsequently reimbursed by the Pension Fund for these expenses.

The Council processed pensioner payments of £9.312m (2015/16 £8.920m). Such payments are reimbursed in full by the Pension Fund.

In addition the Council is the single largest employer of Pension Fund members, and contributed £10.350m to the Pension Fund (2015/16 £11.077m).

All monies owed to the Pension Fund from the Council and due from the Pension Fund to the Council, were paid in the year.

Governance

There are two members of the Pension Fund Committee who are in receipt of pension benefits from the Shetland Islands Council Pension Fund. In addition, there are other committee members who are active members of the Pension Fund.

Each member of the Pension Fund Committee and Pension Board is required to declare their interests at each meeting.

Key management personnel

Key Management personnel for the Pension Fund include the Shetland Islands Council Councillors, who sit on the Pension Fund Committee and Pension Board. These members are listed below. Another key person is the Section 95 Officer for Shetland Islands Council, Jonathan Belford. All these key personnel are remunerated by Shetland Islands Council.

Pension Fund Committee Membership
Alistair Cooper
Stephen Coutts
Gary Robinson
Cecil Smith
George Smith
Theo Smith
Michael Stout
Vaila Wishart
Pension Board Membership
Malcolm Bell
Robert Henderson
Drew Ratter

Note 21: Changes in Actuarial Present Value of Promised Retirement Benefits

Actuarial Present Value of Promised Retirement Benefits	Vested Benefits £000	Unvested Benefits £000	Total £000
Balance As at 31 March 2017	693	-	693
Increase/(Decrease) in Value during 2016/17	176	-	176
Balance As at 31 March 2016	**517**	**-**	**517**
Increase/(Decrease) in Value during 2015/16	(34)	-	(34)
Balance As at 31 March 2015	**551**	**-**	**551**

Note 22: Critical Judgements in Applying Accounting Policies

Pension Fund liability

The Pension Fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 15. This estimate is subject to significant variances based on changes to the underlying assumptions.

Note 23: Events after the Balance Sheet Date

There have been no events since 31 March 2017, and up to the date when these accounts were authorised that require any adjustments to these accounts.

Note 24: Accounting Policies

Pension Fund account - revenue recognition

A Contribution income

Normal contributions, both from the members and from the employers, are accounted for on an accrual basis at the percentage rate recommended by the Pension Fund actuary in the payroll period to which they relate.

Employers' augmentation contributions and pension strain costs are accounted for in the period in which the liability arises. Any amounts due in the year but unpaid will be classed as current financial assets. Amounts not due until future years are classed as long-term financial assets.

B Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the Pension Fund during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations (see notes 5 and 7).

Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged.

C Investment income

- **Interest income**
  Interest income is recognised in the Pension Fund account as it accrues.
- **Distributions from pooled funds**
  Distributions from pooled funds are recognised on the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.
- **Movement in the net market value of investments**
  Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

Pension Fund account - expense items

D Benefits payable

Pensions and lump-sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the net assets statement as current liabilities.

E Taxation

The Pension Fund is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of the investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a Pension Fund expense as it arises.

F Management expenses

All administrative expenses are accounted for on an accruals basis. All costs relating to staff of the pensions administration team are charged direct to the Pension Fund. Management, accommodation and other overheads are apportioned to the Pension Fund in accordance with Council policy.

All investment management expenses are accounted for on an accruals basis.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change.

One of the investment managers invests using a fund of funds approach and within these unit trusts managers levy charges.

Any fees due but unpaid are disclosed in the net assets statement as current liabilities.

The cost of obtaining investment advice from external consultants is included in investment management charges.

A proportion of the Council's costs, representing management time spent by officers on investment management, are charged to the Pension Fund in accordance with Council policy.

Net assets statement

G Financial assets

Financial assets are included in the net assets statement on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the Pension Fund becomes party to the contractual acquisition of the asset. From this date, any gains or losses arising from changes in the value of the asset are recognised by the Pension Fund.

The values of investments shown in the net assets statement are determined as follows:

H Pooled investment vehicles

These are valued at closing bid price if both bid and offer prices are published; or if single priced, at closing single price. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income, which is reinvested in the Pension Fund, net of applicable withholding tax.

I Foreign currency transactions

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the market rates at the date of transaction. End-of-year market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchase and sales outstanding at the end of the reporting period.

J Cash and cash equivalents

Cash comprises cash in hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

K Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits is assessed on an annual basis by the Fund actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS 26, the Pension Fund has opted to disclose the actuarial present value of the promised retirement benefits by way of a note to the net assets statement (Note 15).

L Additional voluntary contributions

Shetland Islands Council Pension Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the Pension Fund. The Pension Fund has appointed Prudential and Equitable Life (closed to new members) as its AVC providers. AVCs are paid to the AVC provider by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

AVCs are not included in the accounts in accordance with section 4(1) (b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 but are disclosed as a note only (Note 19).

Actuarial Statement for 2016/17

This statement has been prepared in accordance with Regulation 55(1) (d) of the Local Government Pension Scheme (Scotland) Regulations 2014. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated March 2015. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund, using a prudent long-term view. This will ensure that sufficient funds are available to meet all members'/dependents' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return;
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £333 million, were sufficient to meet 92% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £30 million.

Individual employers' contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 31 March 2015.

Method

The liabilities were assessed using an accrued benefits method, which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

Assumptions

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2014 valuation were as follows:

Financial Assumptions	31 March 2014	
	% p.a. Nominal	% p.a. Real
Discount rate	5.2%	2.5%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	-

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI 2012 model, assuming the current rate of improvements has reached a peak and will converge to long-term rate of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.8 years	23.8 years
Future pensioners*	24.9 years	26.7 years

*Future pensioners are assumed to be currently aged 45 as at 31 March 2014.

Copies of the 2014 valuation report and Funding Strategy Statement are available on request from Shetland Islands Council, the Administering Authority to the Fund.

Experience over the period since April 2014

The Fund's experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements). Real bond yields have fallen sharply, which places a significantly higher value on liabilities. The effect of this will have been partially offset by strong asset returns. The overall impact on the funding position at 31 March 2017 is that funding levels have likely worsened and deficits increased since the last formal valuation. This excludes the impact of possible changes to funding assumptions for the 2017 formal valuation, and membership experience, which will be measured as part of that valuation: these items may improve or worsen the funding position.

The next actuarial valuation will be carried out as at 31 March 2017. The Funding Strategy Statement will also be reviewed at that time.

Douglas Green

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

3 May 2017

Hymans Robertson LLP
20 Waterloo Street, Glasgow G2 6DB

Independent auditor's report to the members of Shetland Islands Council Pension Fund and the Accounts Commission

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice approved by the Accounts Commission, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the annual accounts of Shetland Islands Council Pension Fund for the year ended 31 March 2017 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account and Net Assets Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the 2016/17 Code).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2016/17 Code of the state of affairs of the Fund as at 31 March 2017 and of its surplus on the provision of services for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2016/17 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Basis of opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standards for Auditors, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Executive Manager – Finance for the financial statements

As explained more fully in the Statement of Responsibilities, the Executive Manager – Finance is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Executive Manager – Finance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the audit of the financial statements

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require us to comply with the Financial Reporting Council's Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the Fund and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Executive Manager – Finance and the overall presentation of the financial statements.

Our objectives are to achieve reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK&I) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Other information in the annual accounts

The Executive Manager – Finance is responsible for the other information in the annual accounts. The other information comprises the information other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission to the extent explicitly stated later in this report.

In connection with our audit of the financial statements in accordance with ISAs (UK&I), our responsibility is to read all the financial and non-financial information in the annual accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Report on other requirements

Opinions on other prescribed matters

We are required by the Accounts Commission to express an opinion on the following matters.
In our opinion, the auditable part of the Remuneration Report has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014.

In our opinion, based on the work undertaken in the course of the audit

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003; and
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016).

Matters on which we are required to report by exception

We are required by the Accounts Commission to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the auditable part of the Remuneration Report are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- there has been a failure to achieve a prescribed financial objective.

We have nothing to report in respect of these matters.

……………………………………………………………
Pat Kenny, CPFA (for and on behalf of Deloitte LLP)

110 Queen Street
Glasgow
G1 3BX
United Kingdom

20 September 2017