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Date: 27 February 2019

Dear Sir/Madam

You are invited to the following meeting:

**Audit Committee**  
**Council Chamber, Town Hall, Lerwick**  
**Thursday 7 March 2019 at 10am**

Apologies for absence should be notified to Louise Adamson 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.

(d) Confirm the minutes of the meeting held on 13 December 2018 (enclosed0

**Items**

1. Scottish Household Survey  
*CPS-03*
2. Audit Scotland and Other External Audit Reports  
*CPS-06*
3. Annual Audit Plans 2018/19 for Shetland Islands Council and Shetland  
Islands Council Pension Fund  
*F-016*



## MINUTES

## A & B

**Audit Committee**  
**Council Chamber, Town Hall, Lerwick**  
**Thursday 13 December 2018 at 10.00am**

**Present:**

A Duncan	C Hughson
A Manson	R McGregor
I Scott	R Thomson

**Apologies:**

J Fraser	S Leask
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**In attendance (Officers):**

C Ferguson, Director – Corporate Services  
D Bell, Executive Manager – Human Resources  
J Manson, Executive Manager - Finance  
C McIntyre, Executive Manager – Audit, Risk and Improvement  
J Riise, Executive Manager – Governance and Law  
S Goodlad, Team Leader – Building Services  
E Cripps, Internal Auditor  
R McNeillie, Internal Auditor  
A Anderson, Internal Audit Assistant  
L Adamson, Committee Officer

**Also:**

C Healy, Deloitte, LLP [by phone]

**Chairperson**

Mr Duncan, Chair of the Committee, presided.

**Circular**

The circular calling the meeting was held as read.

The Chair welcomed Mr Healy, who was linking to the meeting by phone, and also the staff in attendance from the Internal Audit Team.

**Declarations of Interest**

None

**Minutes**

The Committee confirmed the minutes of the meeting held on 30 August 2018 on the motion of Mr Scott, seconded by Mrs Hughson.

The Committee confirmed the minutes of the meeting held on 19 September 2018 on the motion of Mr Scott, seconded by Ms Manson.

17/18 **Six-Monthly Internal Audit Progress Report 2018/19**

The Committee considered a report by the Executive Manager – Audit, Risk and Improvement (IA-26-18-F) that presented details of progress made to date against the Audit Plan approved for 2017/18.

The Executive Manager – Audit, Risk and Improvement introduced the report.

In referring to the Internal Audit of Flexitime/Annual Leave/TOIL, the Chair sought further information relating to the finding that in some areas there is evidence of non-compliance with policy requirements. In responding, the Executive Manager – HR advised that these are three quite different policies, and with a diverse workforce current recording can be by both electronic and manual systems, which she said can be prone to human error. She advised on the move to make recording of flexitime/TOIL/annual leave more straightforward, and confirmed that a review of the Policies would be undertaken next year to address the matters highlighted during the audit.

In responding to a question on the findings from the audit of i-phones/i-pads, the Director of Corporate Services reported from CMT on the need for more clarity from service areas to determine the standard product to be procured, and when there is an exception, this would have to be justified by a business case. She added that this improved process will also lead to savings for each service area.

During the discussion, reference was made to the internal audit of the “Dundee Council Fraud review” where it was noted that a report was being drafted. The Executive Manager – Finance agreed to provide a briefing to Committee on the control issues identified.

There were no further questions, and the Committee noted the report.

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**Decision:**

The Committee NOTED the contents of the six-monthly report and COMMENTED accordingly.

18/18 **External Audit Annual Report 2017/18**  
**Update on Recommendations**

The Committee considered a report by the Director of Corporate Services (CRP-21-18-F) that provided an update on the progress made to address recommendations highlighted within the External Audit Annual Report 2017/18.

The Director of Corporate Services summarised the main terms of the report. She advised that the Action Plan at Appendix 2 includes the Lead Officer allocated to each Action to better reflect the work to be addressed. In referring to Action “AAP03, Financial sustainability: Savings Target, she advised on the change of Lead Officer from the

Executive Manager – Finance to Director of Corporate Services with the action being primarily about the Business Transformation Programme (BTP) and the Service Redesign Programme (SRP) and how these are to be merged and resourced. The Director of Corporate Services provided updates on a number of the actions, highlighting the recent reporting of the Tertiary Review and the Council's ongoing commitment to that project, and the Graduate Placement Scheme which is due to go live in January 2019.

Reference was made to the audit findings relating to the valuation of property assets, where a request was made for a report back to Committee on the value of all Council assets, including those transferring from SLAP. The Director of Corporate Services reported on the work that has been ongoing in this area, and advised on the proposal to report during the Summer on the valuation of property assets. She confirmed that vacancies had been filled in the Estates and Assets Service.

In response to concern raised on the lack of information to, and involvement of Members, when opening offers for the sale of Council assets, it was agreed that a briefing would be provided to Members of the Committee on the processes in place when considering and accepting offers.

During the discussion, comment was made on the length of certain procedures where bureaucratic processes are currently followed. A request was made for a systematic review of all the Council's policies and procedures to be undertaken as part of the BTP. The Director of Corporate Services confirmed that each work stream of the BTP and SRP will look at processes that can be streamlined rather than a separate work stream. She advised however that legislation can dictate processes so there could be a limitation in certain areas. The Director of Corporate Services confirmed that a report on transformation will come back to Audit Committee through the work in the audit programme for next year and in future reporting.

In terms of processes and timescales for recruitment and selection, the Executive Manager – HR advised from a recent review of procedures and on the intention to arrange a briefing for Members. She referred to the legal requirements for pre-employment checks for recruiting to posts in Social Work, Social Care and for teachers. She advised that Workforce Policy Workshops will be arranged for Managers early next year, where the priority focus will be working with services on recruitment and retention, attracting people to Shetland, and on improved support for staff joining the Council.

In responding to questions on proposals for participatory budgeting, the Executive Manager – Finance advised on the joint working with officers in Community Planning and Development, which includes considering a range of options with a view to develop plans to move forward in this area. In response to a question, the Executive Manager – Finance said that when the plans have been developed these would be provided to Members of the Committee by way of a briefing.

During the discussion on the participatory budget process, reference was made to the importance of involving Community Councils in the process. Concern was however raised at the high level of vacancies in community councils across Shetland following the recent elections. There was also a call to involve more community groups, and to widen community engagement. The Director of Corporate Services advised on the ongoing work to promote further engagement in the process, to encourage participation, engage with communities and to tap into activities within the local areas, which support the Participation strand of Shetland's Partnership Plan.

In responding to questions relating to the Graduate Placement Scheme to launch in January 2019, the Committee was advised on the intention for graduates to take forward project work in the BTP and SRP. In that regard, reference was made to the Council's target to attract and retain young people in Shetland, which is the aim of the Graduate Placement Scheme.

In responding to a comment made, that certain staff are not being given access to training requested, the Executive Manager – HR advised on her disappointment in that regard. In referring to the budget for training and the work undertaken in Workforce Development, she advised on the priorities to train staff when there is a need to achieve certain qualifications and in the ongoing development of staff. She advised also that in certain circumstances where there is no budget for training, a Manager can put forward a case to justify spend. In that regard, she would encourage staff to discuss all training requirements with their Manager and/or the Human Resources Services.

Mr C Healy, Deloitte LLP, commented positively on the progress being made on the recommendations going forward.

During further discussion, Members commented on the participatory budget process, the link to Community Councils, on the need to empower local communities and to encourage participation on Community Councils. Reference was made to feedback from a Community Council on their concern in terms of the lack of response from communications to the Council. The Director of Corporate Services referred to recent commitment from the Chief Executive to ensure there is a quick response and solution to any queries from Community Councils. Reference was also made to the Chief Executive's attendance at recent meetings of the Association of Community Councils, where Community Councils had confirmed the improved situation with Council responses.

Concern was expressed on the move to multi ward areas for both Community Council and Council elections, which could be a reason for the low number of individuals standing for both elections. In responding, the Executive Manager – Governance and Law advised on the provision in the Islands Act to break from the multi-member wards, and also on the ongoing Boundary Commission Review. In that regard, he advised that

a review of Community Councils will commence when the Local Government Boundaries have been agreed. The Chair commented that the outcome of these reviews would be awaited.

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**Decision:**

The Committee

- CONSIDERED the information presented in the report and appendices;
- ADVISED the Director of Corporate Services of any additional information required in order for the Committee to be able to provide assurance to the Council regarding the issues covered in this report; and
- ADVISED Policy and Resources Committee and the Council of the Committee's views in this regard

*(The Committee adjourned at 11.20am, and reconvened at 11.30am).*

19/18

**Audit Scotland and Other External Audit Reports**

The Committee considered a report by the Executive Manager – Audit, Risk and Improvement (IA-28-18-F) which provided an opportunity for the Committee to consider and monitor progress on any recommended actions resulting from Audit Scotland and External Audit body reports that have been or will be presented to the functional Committees.

The Executive Manager – Audit, Risk and Improvement introduced the report

In referring to the progress statement relating to “EA183 Education Scotland – Cunningburgh Primary School”, the Chair sought further information on the comment that the “Leadership of change” had been ranked as ‘weak’. The Executive Manager – Audit, Risk and Improvement indicated that he would seek further information from the relevant officer, and an update would be provided to Members by email.

In response to a question, the Executive Manager – Audit, Risk and Improvement undertook to inform Members of the Committee on the frequency of meetings of the Joint Governance Group.

In response to a question, the Executive Manager – Audit, Risk and Improvement reminded Members to relay any specific questions or issues prior to Committee, as the relevant officer could attend the meeting to provide further information on any of the reports presented.

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**Decision:**

The Committee NOTED the contents of the report.

20/18

### **Audit Committee Self-Assessment**

A report by the Executive Manager – Audit, Risk and Improvement (IA-27-18-F) provided the Committee with the findings of the Self-Assessment of Audit Committee.

The Executive Manager – Audit, Risk and Improvement summarised the main terms of the report. He advised that the findings from the self-assessment would indicate that the Committee substantially follows the CIPFA guidelines on Audit Committees.

During the discussion, the Director of Corporate Services advised that while the response rate had not been high, all aspects will be taken on board and followed up with Committee in more detail. In that regard, it was agreed that an informal meeting would be arranged with Members of the Audit Committee to further discuss the findings of the Self-Assessment.

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### **Decision:**

The Committee:

- NOTED the contents of the report and the results of the recent Audit Committee Self-assessment;
- COMMENTED on the findings; and
- NOTED that the information from the Self-assessment will inform the review of Council Committees. This will be undertaken in response to the recommendation in the External Auditor's Annual Audit Report and will be the subject of a further report to the Audit Committee in due course.

21/18

### **Risk Assessments Update**

The Committee considered a report by the Executive Manager - Human Resources (HR-20-18-F) that provided an update on Risk Assessments, which included Fire Risk Assessments across the Council.

In summarising the main terms of the report, the Executive Manager - Human Resources advised on the arrangements, policies and processes to ensure risks are identified at all levels to protect services, service users, staff and assets. She informed on the work undertaken to ensure all Council premises has up to date Fire Risk Assessments. She referred to previous concerns at the lack of sprinkler systems in rural care homes but advised on the complete set of fire safety measures in place at the rural care homes.

In responding to questions, the Executive Manager – Human Resources advised that there are no sprinkler systems in the rural Care Homes, reporting that it has only been since May 2005, that new or slightly altered residential homes are required to have a sprinkler system to comply with Building Regulations. She advised on the systems to manage the spread of fire at the care homes, and with the Fire Risk



Assessments and good detection systems in place, clients can be moved to other parts of the building and to places of safety. She added that each resident has a personal evacuation plan, and that every individual's needs have been identified.

The Chair commented that he welcomed the excellent report, and in that regard he referred to the statement from the Scottish Fire and Rescue Service on the quality of the fire risk assessments and health and safety management at Edward Thomason House and Taing House. The Chair stated however that while he understood and accepted the views of the Care Inspectorate, he continued to have concerns that rural care homes run by the Council have no sprinkler systems installed. He said that the clients in care homes are mainly vulnerable and frail individuals, and his concern would be with the ratio of clients to staff, and also if the situation required fire appliances to attend, and the time this could take. He stated that he considered it essential to have a sprinkler system as an addition in all care homes, and in that regard he suggested the need for discussion between the Council and SCT, who own the buildings. In responding to the comment from the Chair, the Director of Corporate Services reminded the Committee that there is no evidence from any external bodies, or by law, that it is necessary to have sprinkler systems in place in the rural care homes. The Executive Manager – Human Resources advised also that the Care Inspectorate who are the experts in the care industry, and who carry out the annual inspections very much understand the vulnerability of the people in the care homes. The Scottish Fire and Rescue Service also visit the care homes at least annually, and she confirmed their view that controls in place exceed standards.

During the discussion, some Members sought guidance on how best the matter could be taken forward from the Audit Committee, to get professional advice to establish the benefits and costs of installing sprinkler systems at rural care centres. The Executive Manager – Governance and Law advised that as the Audit Committee had no remit for spend, any motion from the Audit Committee would have to be directed to another spending Committee. He went on to advise that as Policy and Resources Committee has the responsibility for properties and health and safety it would be for that Committee to decide whether or not a higher level of focus is needed into installing sprinkler systems and any associated spend.

During debate, comment was made on the reassurance given by the Executive Manager – Human Resources that sprinkler systems are not required, and also that spending was not within the remit of Audit Committee. Some Members however questioned how the Audit Committee could best seek professional advice to find out the benefits of sprinkler systems being installed in rural care homes. Mrs Manson referred to the reassurance that all residential properties listed are up to standard and that Fire Risk Assessments and procedures are as good as they can be, however she agreed that the Committee could benefit from being informed on the benefits of installing sprinkler systems. In that regard, Mrs Manson moved the recommendations in the report, with a

change to the wording of Recommendation 1.3 to read, “ADVISED Policy and Resources Committee and the Council of the Committee’s views in this regard, namely for Policy and Resources to consider commissioning an investigation into the benefits of installing sprinkler systems. Mr Scott seconded.

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**Decision:**

The Committee:

- NOTED the information set out in this report and the Appendices;
- ADVISED the Director of Corporate Services of any additional information required in order for the Committee to be able to provide assurance to the Council regarding the issues covered in the report; and
- ADVISED Policy and Resources Committee and the Council of the Committee’s views in this regard, namely for Policy and Resources to consider commissioning an investigation into the benefits of installing sprinkler systems

22/18

**Audit Committee Business Programme**

The Committee considered a report by the Director Corporate Services (CRP-22-18-F) that enabled the Committee to consider the business planned for Audit Committee in the remainder of financial year 2018/19.

The Director of Corporate Services introduced the report.

There were no questions or debate, and the Committee noted the business planned to 31 March 2019.

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**Decision:**

The Committee NOTED the contents of the report and business programme for 2018/19, as presented.

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The Chair advised on the retirement from the Council of Mr McIntyre, the Executive Manager – Audit, Risk and Improvement. The Chair paid tribute to Mr McIntyre, and wished him a very healthy and happy retirement. The Committee concurred with applause.

The meeting concluded at 12.35pm.

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Chair





# Shetland Islands Council

Agenda Item

# 1

<b>Meeting(s):</b>	Policy & Resources Committee Audit Committee	6 March 2019 7 March 2019
<b>Report Title:</b>	Scottish Household Survey	
<b>Reference Number:</b>	CPS-03-19-F	
<b>Author / Job Title:</b>	Robert Sinclair - Executive Manager – Assets, Commissioning and Procurement	

## 1.0 Decisions / Action required:

- 1.1 That the Audit Committee and Policy & Resources committee should discuss the content of the linked report and highlight any Indicators where further attention or explanation is required through this Committee, other Committees or by Council management.

## 2.0 High Level Summary:

- 2.1 The Scottish Household Survey is a continuous survey based on a sample of the general population in residences in Scotland.
- 2.2 The Scottish Household Survey Annual Report presents reliable and up-to-date information on the composition, characteristics and behaviour of Scottish households at a national level.
- 2.3 Local Authority Tables for 2017 have been published recently, providing comparable information at Local Authority level. The full 2017 report for Shetland is linked here: [Scotland's People Local Authority Report - SHETLAND](#)
- 2.4 The Shetland sample size for most indicators is 250 or higher (1 in 80 households). This is one of the highest proportionate sampling size in Scotland and produces consistent year-on-year results. Where sample size is too small to produce statistically significant results, these tables have been omitted from the survey report.

## 3.0 Corporate Priorities and Joint Working:

- 3.1 The indicators in this report cover areas directly influenced by the Authority, areas of joint working and also areas where the Authority has little or no influence.
- 3.2 Corporate Plan: *“Our performance as an organisation will be managed effectively, with high standards being applied to the performance of staff and services. Poor performance will be dealt with, and good service performance will be highlighted and shared.”*

## 4.0 Key Issues:

- 4.1 This report provides an opportunity for the Committee to discuss the Scottish Household Survey results, the trends in local indicators, and how local indicators compare with national indicators.
- 4.2 The report is comprehensive and analyses data in over 600 tables. Members may wish to consider the following results in particular:

### 4.2.1 Housing (Chapter 3 – Pages 25-36)

**Table 3.3f (p31) – How well household is managing financially**

12% of the Social Sector rented households “*do not manage well financially*”, the Scottish figure is 20%

**Table 3.6a (p33) – Rating of neighbourhood as a place to live**

99% of households rate their area as “*very good*” or “*fairly good*” places to live. This is the highest in Scotland, the Scottish average is 95%.

**Table 3.6b (p33) – Strength of belonging to immediate neighbourhood**

90% of households rate their “Strength of belonging to their immediate neighbourhood as “*very strong*” or “*fairly strong*”. The Scottish average is 78%

**Table 3.8a (p34) - Home adaptations that are already in place**

34% of households have adaptations in place, compared to a Scottish average of 21%

### 4.2.2 Neighbourhoods (Chapter 4 – Pages 37-50)

**Table 4.5 (p42) – A problem is very/fairly common in their neighbourhood**

22% of people said “Rubbish or litter lying around” was a problem in their area. 18% said “Animal nuisance such as noise or dog fouling” was a problem. Within Lerwick, these figures rose to 37% and 32%

**Table 4.12 (p47) – Experience of neighbourhood problems**

15% of Lerwick households have experienced problems with “Noisy neighbours / loud parties”, this compares to 10% for similar sized towns throughout Scotland.

### 4.2.3 Economic Activity (Chapter 5 – Pages 52-62)

**Figure 5.4 (p42) – Adults aged 16 and over currently in work**

In Shetland, two-thirds of women are “in work”, this compares to only half in Scotland. However, Members should note that 15% of people in Shetland are under-employed (they would like to work more hours given the opportunity to do so), the national average is 8% (Annual Population Survey, Scottish Government, 2016); and the cost of living to achieve an acceptable standard of living is 20-60% higher than the UK average.

**Figure 5.6 (p95) – Current economic situation of adults aged 16-64 by gender**

In Shetland 80% of male respondents were employed full-time, this compares to only 58% for Scotland.

#### **4.2.4 Finance (Chapter 6 – Pages 63-73)**

##### **Figure 5.6 (p95) – Current economic situation of adults aged 16-64 by gender**

In Shetland 80% of male respondents were employed full-time, compared to only 58% for Scotland.

#### **4.2.5 Internet (Chapter 7 – Pages 74-82)**

##### **Figure 7.1 (p76) – Households with home internet access by year**

For the past 3 years, Shetland has reported higher household connectivity than Scotland. This is now at 92% in Shetland compared to Scotland's 85%.

##### **Figure 7.7 (p78) & Table 7.2 (p79) – Internet Usage**

While Shetland's internet usage is higher (92% compared to 86%), internet access "on the move" is significantly less (41% compared to 58% in Scotland)

##### **Table 7.5 (p76) – Confidence in pursuing activities when using the internet**

In Scotland, 86% of respondents had confidence in accessing Public Services online, this drops to 78% for Shetland respondents.

#### **4.2.6 Physical Activity and Sport (Chapter 8 – Pages 83-96)**

##### **Figure 8.1 (p84) – participation in physical activity/sport in the last four weeks**

Shetland is broadly comparable to Scotland in most activity categories, apart from cycling. In Scotland, 14% of respondents had cycled for 30min in the last 4 weeks, this is only 4% for Shetland.

##### **Figure 8.4 (p96) – Satisfaction with local authority sport and leisure facilities**

Although there's been a slight decrease in the past 4 years, those "very/fairly satisfied" with "local authority" sport and leisure facilities remains significantly higher in Shetland (83%) compared to Scotland (51%). For the purposes of this survey, this included the Recreation Trust facilities. Actual users of the facilities (Table 8.5) shows a consistent 97% "very/fairly satisfied" rating.

#### **4.2.7 Local Services (Chapter 9 – Pages 97-103)**

Very or fairly satisfied with:	2008	2010	2012	2013	2014	2015	2016	2017
Shetland								
Local Health Services	84	84	82	77	73	74	80	77
Local Schools	92	93	94	92	86	87	89	89
Public transport	53	50	65	60	56	55	71	72
% satisfied with all 3	47	48	59	48	42	42	59	55
Scotland								
Local Health Services	83	86	87	85	86	83	83	82
Local Schools	80	83	83	81	79	74	73	70
Public transport	71	75	72	71	75	74	72	69
% satisfied with all 3	69	64	63	60	62	57	56	52

##### **Table 9.1 (p98 and above) – Percentage of people very or fairly satisfied with the quality of public services delivered**

Schools satisfaction remains significantly higher than Scotland, Public Transport satisfaction has risen significantly in the last 2 surveys and is now higher than Scotland. However, Local Health Services satisfaction remains lower than Scotland. Further

analysis in Table 9.3 shows Local Health Service satisfaction at 53% in Lerwick compared to similar towns in Scotland of 76%.

Agree with these statements:	2015	2016	2017	Scotland 2017
Shetland Islands Council				
Good at communicating services	51	59	51	43
High quality services	60	66	67	41
Good at communicating performance	50	46	43	34
Services designed for needs	38	48	43	37
Does its best with the money	31	34	33	39
Addressing key issues	43	43	41	33
Good at listening	23	26	22	24
I can influence decisions	28	27	32	23
I want more involvement in decisions	46	41	42	33

**Table 9.7** (full table p101, extract above) – **Percentage agreeing with various statements about local authority services by year**

Shetland scores higher in every category apart from “Does its best with the money” and “Good at listening”. Further analysis in Figure 9.3 (p102) shows that those in the 16-39 age category have a significantly higher desire to be “more involved in decisions” (62% in Shetland compared to 38% in Scotland).

#### **4.2.8 Environment** (Chapter 10 – Pages 104-122)

**Figure 10.5** (p109) – **“I understand what actions people like myself should take to help tackle climate change”**

In Shetland 92% agreed with the above statement compared to 74% in Scotland.

#### **4.2.9 Volunteering** (Chapter 11 – Pages 123-128)

**Figure 11.1** (p124) – **Whether provided unpaid help to organisations or groups in the last 12 months**

Shetland continues to report volunteering at around double the national rate (55% vs 28%). Further analysis in Figure 11.2 shows volunteering in the 16-39 age group at 65% compared to 27% nationally.

**Table 11.4** (p127) – Shows that, even when comparing Shetland to geographically similar areas elsewhere, Shetland still significantly outperforms in volunteering for groups.

#### **4.2.10 Culture and Heritage** (Chapter 12– Pages 129-153)

Satisfaction with Local Authority cultural services: “Very/fairly satisfied”	2015	2016	2017	Scotland 2017
Libraries	76	74	67	49
Museums and Galleries	83	85	81	46
Theatres and concert halls	77	77	74	47

**Table 12.7** (full table p152, extract above) – The figures above are for **all** respondents, not just those respondents who used the services. For users of the services in the last 12 months, table 12.8 (p153) shows the “very/fairly satisfied” results are: Libraries 94%, Museums & Galleries 96% and Theatres & Concert Halls 94%.



<b>5.0 Exempt and/or confidential information:</b>		
5.1 None		
<b>6.0 Implications :</b>		
<b>6.1 Service Users, Patients and Communities:</b>	The Scottish Household Survey Annual Report is compiled from responses from our community.	
<b>6.2 Human Resources and Organisational Development:</b>	The high employment rate will impact on the council's ability to recruit.	
<b>6.3 Equality, Diversity and Human Rights:</b>	Section 2 of the report contains some indicators related to protected characteristics. Tables 4.13 and 4.14 shows discrimination against some protected characteristics. The high proportion of women in work will be helped by the Council's support of flexible working arrangements including part-time work predominantly carried out by women throughout Shetland.	
<b>6.4 Legal:</b>	None	
<b>6.5 Finance:</b>	There are no financial implications arising directly from this report	
<b>6.6 Assets and Property:</b>	None	
<b>6.7 ICT and new technologies:</b>	None	
<b>6.8 Environmental:</b>	None	
<b>6.9 Risk Management:</b>	There is a risk that, due to the small sample size, the results are not a true representation of local issues. However, despite the sample size (250 people, around 1 in 80 households); results are consistent year-on-year.	
<b>6.10 Policy and Delegated Authority:</b>	The Audit Committee has responsibility for performance management. The linked report gives Members an opportunity to compare local performance against national averages. As outlined in Section 2.2.1.4 of the Council's Scheme of Administration and Delegations, the Policy & Resources Committee's remit includes " <i>Ensure the effectiveness of the Council's planning and performance management framework</i> ".	
<b>6.11 Previously considered by:</b>	N/A	

**Contact Details:**

Jim MacLeod  
Performance & Improvement Adviser  
[james.macleod@shetland.gov.uk](mailto:james.macleod@shetland.gov.uk)  
Cleared 22 February 2019

**Appendices:** None

**Background Documents:**

[Scotland's People Local Authority Report - SHETLAND](#)





<b>Meeting(s):</b>	<b>Audit Committee</b>	<b>07 March 2019</b>
<b>Report Title:</b>	<b>Audit Scotland and other External Audit Reports</b>	
<b>Reference Number:</b>	<b>CPS-06-19F</b>	
<b>Author / Job Title:</b>	<b>Robert Sinclair, Executive Manager – Capital Programme</b>	

### 1.0 Decisions / Action required:

- 1.1 That the Audit Committee considers the progress statements provided by Lead Officers in Appendix 1, and make any relevant comment on the reports / action plans.

### 2.0 High Level Summary:

- 2.1 This report, presented every second cycle, provides an opportunity for the Audit Committee to consider and monitor progress on any recommended actions resulting from Audit Scotland and External Audit body reports which have been or will be presented to the functional Committees. It also provides an opportunity for the Audit Committee to monitor compliance with the external advisors reports reporting policy and procedures.
- 2.2 The reports produced by the Council's External Auditors and Advisers provide valuable information for Committees and officers throughout the Council.
- 2.3 This report promotes good governance by helping to ensure all external advisors reports are considered by relevant officers and reported to the correct Committee.
- 2.4 It is expected that each report will result in a Council action plan that deals with all the report's recommendations. In the event that no action plan is required, that decision and the report should be reported to the relevant Committee.
- 2.5 Progress against the agreed action plan should be monitored by the relevant Service Committee and the Audit Committee.
- 2.6 It is for the Audit Committee to be satisfied that appropriate and timely action is being taken in relation to Audit Scotland and other external audit reports together with relevant action plans, in accordance with Council Policy.

### 3.0 Corporate Priorities and Joint Working:

- 3.1 Our Plan 2016 to 2020 states that, *"People who use our services will experience excellent standards of customer care."* and

*"Our performance as an organisation will be managed effectively, with high standards being applied to the performance of staff and services. Poor*

*performance will be dealt with, and good service performance will be highlighted and shared.”*

- 3.2 This report helps to improve the arrangements for Member engagement in monitoring Council performance and contributes to a high standard of governance.

#### **4.0 Key Issues:**

- 4.1 Appendix 1 contains a list of the current reports. The lead officer for each report is responsible for the Progress Statement and ensuring that policy deadlines are adhered to.
- 4.2 The Audit Committee is required to monitor the consideration of external audit reports by Committees. The role of the Joint Governance Group includes the provision of advice and support to staff, promotion of best practice in relation to clinical audit activity whilst monitoring, promoting and reporting on clinical audit, patient survey and service improvement for Shetland Health Board and Shetland islands Council.
- 4.3 One action is now overdue for completion, but is scheduled to be reported:
- EA176 Care Inspectorate – Mental Health Community Support Service – Annsbrae House. This report will be presented to Joint Governance Group in May 2019.

#### **5.0 Exempt and/or confidential information:**

- 5.1 None.

#### **6.0 Implications :**

<b>6.1 Service Users, Patients and Communities:</b>	This report helps to highlight and monitor that recommended actions advised by the external body are completed. This ensures that our customers are getting the best possible service and that we are committed to improving our services across Shetland.
<b>6.2 Human Resources and Organisational Development:</b>	None arising directly from this report.
<b>6.3 Equality, Diversity and Human Rights:</b>	None.
<b>6.4 Legal:</b>	None arising directly from this report.
<b>6.5 Finance:</b>	None arising directly from this report.
<b>6.6 Assets and Property:</b>	None arising directly from this report.
<b>6.7 ICT and new technologies:</b>	None arising directly from this report.
<b>6.8 Environmental:</b>	None arising directly from this report.

<b>6.9 Risk Management:</b>	External advisors reports provide useful information on best practice. A failure to deliver effective external engagement, comply with directions or to learn from best practice elsewhere increases the risk of the Council working inefficiently.	
<b>6.10 Policy and Delegated Authority:</b>	As outlined in Section 2.6 of the Council's Scheme of Administration and Delegations, the remit includes "... to consider a selection of performance and inspection reports from internal audit, external audit and other relevant agencies". This delegation supports the policy requirement and procedure for presenting External Adviser reports as set out above. It is a matter for the Audit Committee to monitor and ensure compliance with this policy.	
<b>6.11 Previously considered by:</b>	None	

**Contact Details:**

Melissa Mullay

Performance & Improvement Officer – Audit, Risk & Improvement

[melissa.mullay@shetland.gov.uk](mailto:melissa.mullay@shetland.gov.uk)

26 February 2019

**Appendices:** Appendix 1 – External Advisers Reports - Progress



# Audit Committee - All External Adviser's Reports - Progress

Generated on: 27 February 2019 09:51

Report Layout: External Advisers to Audit Committee

Rows are sorted by Original Due Date

## Audit Committee

Code & Report Title	Description		Dates		Progress Statement		Lead
EA179 Audit Scotland - The National Fraud Initiative in Scotland 2016/17	Present report to Audit Committee and complete action plan (if reqd) <a href="http://www.audit-scotland.gov.uk/uploads/docs/report/2018/nr_180705_national_fraud_initiative.pdf">http://www.audit-scotland.gov.uk/uploads/docs/report/2018/nr_180705_national_fraud_initiative.pdf</a>		Report Published	05-Jul-2018	No progress made as such on this particular action, which refers to the 2016/17 National Fraud Initiative. However, what is of more relevance/importance is the fact that we are currently participating in 2018/19 initiative with data submitted on time and the data matches recently received back for checking.		Andrew Hall; Jamie Manson
			Progress Bar	<div><div></div></div> 0%			
		Present report	Due Dates	02-Oct-2018	Complete		
		Complete action Plan		02-Apr-2019			
Code & Report Title	Description		Dates		Progress Statement		Lead
EA191 Audit Scotland - Best Value Assurance Report East Lothian Council	Present report to Audit Committee and complete action plan (if reqd) <a href="http://www.audit-scotland.gov.uk/uploads/docs/report/2018/bv_181101_east_lothian.pdf">http://www.audit-scotland.gov.uk/uploads/docs/report/2018/bv_181101_east_lothian.pdf</a>		Report Published	01-Nov-2018	A report will be presented to committee once 4 Best Value reports have been published and can be considered together, this is likely to be in Summer 2019.		James MacLeod
			Progress Bar	<div><div></div></div> 0%			
		Present report	Due Dates	07-Mar-2019	Complete		
		Complete action Plan		01-Jun-2019			
Code & Report Title	Description		Dates		Progress Statement		Lead
EA192 Audit Scotland - Best Value Assurance Report Dumfries and Galloway Council	Present report to Audit Committee and complete action plan (if reqd) <a href="http://www.audit-scotland.gov.uk/uploads/docs/report/2018/bv_181122_dumfries_galloway.pdf">http://www.audit-scotland.gov.uk/uploads/docs/report/2018/bv_181122_dumfries_galloway.pdf</a>		Report Published	22-Nov-2018	A report will be presented to committee once 4 Best Value reports have been published and can be considered together, this is likely to be in Summer 2019.		James MacLeod
			Progress Bar	<div><div></div></div> 0%			
		Present report	Due Dates	07-Mar-2019	Complete		
		Complete action Plan		07-Sep-2019			

Code & Report Title	Description	Dates		Progress Statement	Lead
EA193 Audit Scotland - Local Government in Scotland: Financial Overview 2017/18	Present report to Audit Committee and complete action plan (if reqd) <a href="http://www.audit-scotland.gov.uk/uploads/docs/report/2018/nr_181129_local_government_finance.pdf">http://www.audit-scotland.gov.uk/uploads/docs/report/2018/nr_181129_local_government_finance.pdf</a>	Report Published	29-Nov-2018	Report to be presented to Policy & Resources Committee on 5 March 2019. Key issues raised in the report will be considered when updating the Medium and Long Term Financial Plans. The MTFP is due to be updated in Autumn 2019.	Jamie Manson
		Progress Bar	<div><div></div></div> 0%		
	Present report	Due Dates	07-Mar-2019	Complete	
	Complete action Plan		07-Sep-2019		

## Development Committee

Code & Report Title	Description	Dates		Progress Statement	Lead
EA178 Audit Scotland - Scotland's Colleges 2018	Present Audit Scotland - Scotland's Colleges 2018 report to Development Committee, and where applicable implement action plan. Link to report: <a href="http://www.audit-scotland.gov.uk/uploads/docs/report/2018/nr_180621_scotlands_colleges.pdf">http://www.audit-scotland.gov.uk/uploads/docs/report/2018/nr_180621_scotlands_colleges.pdf</a>	Report Published	21-Jun-2018	Report was presented to Shetland College Board on 6th February 2019.	Willie Shannon
		Progress Bar	<div><div></div></div> 100%		
	Present report to Shetland College Board	Due Dates	01-Oct-2018	Complete	06-Feb-2019

## Education & Families Committee

Code & Report Title	Description	Dates		Progress Statement	Lead
EA169 Care Inspectorate - Fetlar Nursery	Present report to Education & Families Committee + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=296289">http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=296289</a>	Report Published	02-May-2018	Quality of care and support 5 - Very Good Quality of environment 5 - Very Good Quality of staffing 5 - Very Good Quality of management and leadership 3 - Adequate Report presented to Education and Families Committee on 21 May 2018. Two recommendations are being progressed, and one is complete	Robin Calder
		Progress Bar	<div><div></div></div> 50%		
	Present report	Due Dates	27-Aug-2018	Complete	21-May-2018
	Complete action plan (if reqd)		27-Feb-2019		

Code & Report Title	Description	Dates		Progress Statement	Lead
EA189 Care Inspectorate - Short Breaks for Children (Care Home Service)	Present report to Education & Families Committee + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=300779">http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=300779</a>	Report Published	12-Dec-2018	New Care Inspectorate published 12th December 2018. Report under consideration. Quality of care and support 5 - Very Good Quality of environment 4 - Good Quality of staffing 5 - Very Good Quality of management and leadership 4 - Good	Jordan Sutherland
		Progress Bar	<div><div></div></div> 0%		
	Present Report	Due Dates	04-Mar-2019	Complete	
	Complete Action Plan		12-Sep-2019		



Code & Report Title	Description	Dates		Progress Statement	Lead
EA190 Care Inspectorate - Urairith Early Years Daycare of Children	Present report to Education & Families Committee + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=300888">http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=300888</a>	Report Published	23-Jan-2019	New Care Inspectorate report published 23rd January 2019. Will be presented to Education & Families on 4th March 2019. Quality of care and support 5 - Very Good Quality of environment 4 - Good Quality of staffing not assessed Quality of management and leadership not assessed	Robin Calder
		Progress Bar	<div><div></div></div> 0%		
	Present Report	Due Dates	06-May-2019	Complete	
	Complete Action Plan		06-Nov-2019		

Code & Report Title	Description	Dates		Progress Statement	Lead
EA195 Care Inspectorate - Dunrossness Nursery Day Care of Children	Present report to Education & Families Committee + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=301170">http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=301170</a>	Report Published	11-Feb-2019	New Care Inspectorate published 11 February 2019. Will be presented to the Education and Families Committee on the 6 May. Quality of care and support 5 - Very Good Quality of environment 4 - Good Quality of staffing not assessed Quality of management and leadership not assessed	Robin Calder
		Progress Bar	<div><div></div></div> 0%		
	Present Report	Due Dates	06-May-2019	Complete	
	Complete Action Plan		06-Nov-2019		

Code & Report Title	Description	Dates		Progress Statement	Lead
EA184 Care Inspectorate - Happyhansel Primary School Nursery	Present report to Education & Families Committee + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=299680">http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=299680</a>	Report Published	16-Nov-2018	This report was presented to the Education and Families Committee on the 18 December 2018. There were no recommendations for Happyhansel Primary School Nursery. Quality of care and support 4 - Good Quality of environment not assessed Quality of staffing not assessed Quality of management and leadership 4 - Good	Robin Calder
		Progress Bar	<div><div></div></div> 100%		
	Present report	Due Dates	04-Mar-2019	Complete	18-Dec-2018

### Joint Governance Group (JGG)

Code & Report Title	Description	Dates		Progress Statement	Lead
EA176 Care Inspectorate - Mental Health Community Support Service - Annsbrae House	Present report to Joint Governance Group + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=298155">http://www.careinspectorate.com/berengCare/services/html/reports/getPdfBlob.php?id=298155</a>	Report Published	24-Jul-2018	Due to an oversight this Inspection has still to be reported to the JGG. To be presented to JGG in May 2019.	Jaine Best
		Progress Bar	<div><div></div></div> 0%		
	Present report	Due Dates	24-Sep-2018	Complete	
	Complete action plan (if reqd)		24-Jan-2019		

Code & Report Title	Description	Dates		Progress Statement		Lead
EA188 Care Inspectorate - Nordalea (Care Home)	Present report to Joint Governance Group + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCareServices/html/reports/getPdfBlob.php?id=298797">http://www.careinspectorate.com/berengCareServices/html/reports/getPdfBlob.php?id=298797</a>	Report Published	14-Aug-2018	Due to an oversight this Inspection has still to be reported to the JGG. To be presented to JGG in May 2019.		Jaine Best
		Progress Bar	<div><div></div></div> 0%			
	Present Report Complete Action Plan	Due Dates	22-Apr-2019	Complete		
			30-Apr-2019			
Code & Report Title	Description	Dates		Progress Statement		Lead
EA186 Care Inspectorate - Walter & Joan Gray (Care Home)	Present report to Joint Governance Group + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCareServices/html/reports/getPdfBlob.php?id=298937">http://www.careinspectorate.com/berengCareServices/html/reports/getPdfBlob.php?id=298937</a>	Report Published	28-Aug-2018	Care Inspectorate report has been reported to JGG on 6th November 2018. A continuous improvement plan has been developed to provide a framework for the Team. Increased monitoring has been initiated through Executive Manager.		Jaine Best
		Progress Bar	<div><div></div></div> 50%			
	Present Report Complete Action Plan	Due Dates	28-Oct-2018	Complete	06-Nov-2018	
			28-Mar-2019			
Code & Report Title	Description	Dates		Progress Statement		Lead
EA187 Care Inspectorate - Walter & Joan Gray (Support Service)	Present report to Joint Governance Group + action plan (if reqd) <a href="http://www.careinspectorate.com/berengCareServices/html/reports/getPdfBlob.php?id=298966">http://www.careinspectorate.com/berengCareServices/html/reports/getPdfBlob.php?id=298966</a>	Report Published	28-Aug-2018	Care Inspectorate report has been reported to JGG on 6th November 2018. A continuous improvement plan has been developed to provide a framework for the Team. Increased monitoring has been initiated through Executive Manager.		Jaine Best
		Progress Bar	<div><div></div></div> 50%			
	Present Report Complete Action Plan	Due Dates	28-Oct-2018	Complete	06-Nov-2018	
			28-Mar-2019			
Code & Report Title	Description	Dates		Progress Statement		Lead
EA194 Audit Scotland - Social Work in Scotland - Impact Report	Present report to Joint Governance Group and complete action plan (if reqd) <a href="http://www.audit-scotland.gov.uk/report/social-work-in-scotland-impact-report">http://www.audit-scotland.gov.uk/report/social-work-in-scotland-impact-report</a>	Report Published	05-Dec-2018	Report will be presented to JGG in May 2019 after being considered by the Social Work Governance Group.		Simon Bokor-Ingram
		Progress Bar	<div><div></div></div> 0%			
	Present report Complete action Plan	Due Dates	14-May-2019	Complete		
			14-Nov-2019			



<b>Meeting(s):</b>	Audit Committee	7 March 2019
<b>Report Title:</b>	Annual Audit Plans 2018/19 for Shetland Islands Council and Shetland Islands Council Pension Fund	
<b>Reference Number:</b>	F-016-F	
<b>Author / Job Title:</b>	Executive Manager - Finance	

## 1.0 Decisions / Action required:

- 1.1 That the Committee NOTE the contents of the Audit Plan 2018/19, and the Sector Developments paper for Shetland Islands Council, and the Audit Plan 2018/19 for Shetland Islands Council Pension Fund, from the Council's external auditors, Deloitte LLP.

## 2.0 High Level Summary:

- 2.1 The Annual Audit Plan 2018/19 (Appendix 1), the Sector developments paper (Appendix 2), and the Audit Plan 2018/19 for Shetland Islands Council Pension Fund (Appendix 3) provide information on the work that external auditors will undertake to review and assess the governance and performance of the Council and Pension Fund in 2018/19.

## 3.0 Corporate Priorities and Joint Working:

- 3.1 The audit process plays a key role in helping the Council to maintain good governance, accountability and provides assurance around financial stewardship.
- 3.2 There is a specific objective in the Corporate Plan to ensure that the Council continues to pursue a range of measures which will enable effective and successful management of its finances over the medium to long term. This involves correct alignment of the Council's resources with its priorities and expected outcomes, and maintaining a strong and resilient balance sheet.

## 4.0 Key Issues:

- 4.1 The Annual Audit Plans present the planned audit work by the Council's external auditors, Deloitte LLP, for the 2018/19 financial year; the third year of a five-year appointment. Their core audit work includes:
- perform an ISA (UK) compliant audit of the annual accounts;
  - audit and report on the audit dimensions of financial sustainability, financial management, governance and transparency, and value for money;
  - contribute to performance audits (including performance audit reports, overview reports and impact reports);
  - share audit intelligence with Audit Scotland including highlighting potential statutory reports;
  - provide assurance on Whole of Government Accounts (WGA)
  - carry out preliminary enquiries into referred correspondence (issues of concern raised with Audit Scotland);

- provide information on cases of fraud;
- provide information on cases of money laundering;
- contribute to National Fraud Initiative (NFI) report;
- contribute to technical guidance notes;
- contribute to technical databases (input to Audit Scotland on technical matters);
- audit and report on Best Value;
- consider and report on the Strategic Audit Priorities;
- lead the Local Area Network of regulators and prepare a Shared Risk Assessment if required;
- carry out Statutory Performance Information work;
- certify grant claims; and
- liaise with housing benefit performance auditor.

## **5.0 Exempt and/or confidential information:**

5.1 None.

## **6.0 Implications :**

<b>6.1 Service Users, Patients and Communities:</b>	None arising from this report.
<b>6.2 Human Resources and Organisational Development:</b>	None arising from this report.
<b>6.3 Equality, Diversity and Human Rights:</b>	None arising from this report.
<b>6.4 Legal:</b>	The Shetland Islands Council and the Shetland Islands Council Pension Fund are required to prepare accounts in accordance with the Local Government (Scotland) Act 1973 and the Code of Practice on Local Authority Accounting 2017/18.
<b>6.5 Finance:</b>	The audit fee for 2018/19 for Shetland Islands Council is £230,761 and the fee for Shetland Islands Council Pension Fund is £29,100. The work will also include the audit of Zetland Educational Trust at an additional fee of £400.
<b>6.6 Assets and Property:</b>	None arising from this report.
<b>6.7 ICT and new technologies:</b>	None arising from this report.
<b>6.8 Environmental:</b>	None arising from this report.

<b>6.9 Risk Management:</b>	The annual audit work is focused on identifying and assessing the key challenges and risks to the Council and the Pension Fund in order to mitigate future risk.	
<b>6.10 Policy and Delegated Authority:</b>	The Audit Committee has terms of reference to be consulted on the external audit strategy and plan, review reports from the Council's external advisors and review action on external audit recommendations.	
<b>6.11 Previously considered by:</b>	n/a	n/a

**Contact Details:**

Kara Collins, Financial Accountant, [kara.collins@shetland.gov.uk](mailto:kara.collins@shetland.gov.uk), 20 February 2019

**Appendices:**

Appendix 1 – Shetland Islands Council Annual Audit Plan for 2018/19

Appendix 2 – Shetland Islands Council Sector Developments paper

Appendix 3 – Shetland Islands Council Pension Fund Annual Audit Plan for 2018/19





## **Shetland Islands Council**

### Planning report to the Audit Committee on the audit for the year ending 31 March 2019

Issued 19 February 2019 for the meeting on 7 March 2019

# Contents

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# Introduction

## The key messages in this report:

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

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

We have pleasure in presenting our draft planning report to the Audit Committee of Shetland Islands Council (the Council) for the year ending 31 March 2019 audit. We would like to draw your attention to the key messages of this draft audit plan:

### **Audit Plan**

We have updated our understanding of the Council including discussion with management and review of relevant documentation from across the Council.

Based on these procedures, we have developed this plan in collaboration with the Council to ensure that we provide an effective audit service that meets your expectations and focuses on the most significant areas of importance and risk to the Council.

### **Key Risks**

We have taken an initial view as to the significant audit risks the Council faces. These are presented as a summary dashboard on page 17.

- In accordance with auditing standards, we have identified a significant risk associated with income. This risk is pinpointed to the recognition of grant income (excluding General Revenue Grant and Housing Benefit subsidy) as this involves a degree of complexity and management judgement in determining whether or not grant conditions have been met and the income can be recognised in the year. In 2017/18 the total grant income received excluding the General Revenue Grant and Housing Benefit subsidy was £15.85m.
- In accordance with auditing standards, management override of controls has also been identified as a significant audit risk.
- We have also identified the valuation of property assets as a significant risk, given the degree of judgement and complexity involved, its material impact on the financial statements, and the internal control deficiency identified in 2017/18.

# Introduction (continued)

## The key messages in this report (continued):

### **Audit Dimensions**

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how the Council is addressing these and we will report our conclusions in our interim report to the Audit Committee in June 2019 and our annual report to the Audit Committee in September 2019. In particular, our work will focus on:

**Financial sustainability** – Shetland Islands Council continues to face significant financial challenges. The overall 2018/19 forecast position as at October 2018 is projecting an overspend of £1.8m (1.6%) against budget for the year. This overspend is primarily as a result of increased costs incurred in Children's Services and underachievement of savings anticipated from redesign projects.

The Council anticipates that there will be further significant cash reductions in the General Revenue Grant from the Scottish Government over the forthcoming years, and simultaneously the Council will have to manage an ever increasing demand for Council services and manage cost pressures that apply to the models of service delivery. In 2017/18, the Council forecasted a funding gap of £15.6m per annum by 2023/24. Given that the provisional allocation of funding for inter island ferry services is approximately £3m less than requested, the Medium Term Financial Plan (MTFP) will need to be updated to reflect this, as this will increase the cumulative funding gap to 2023/24 from £40.8m to approximately £56m.

We will monitor the Council's actions in respect of its MTFP, particularly in light of the above developments, including considering the robustness of the plan. We will also review the Business Transformation and Service Delivery programmes, considering if these areas are appropriately prioritised and progressed. Currently, there is a risk around how benefits are realised from service redesign projects and how this impacts on achieving financial targets.

**Financial management** – we will review the budget and monitoring reports to the Council during the year and liaise with internal audit in relation to their work on the financial control environment to assess whether financial management and budget setting is effective.

We will also assess the capacity of the finance team given changes in the Executive Manager – Finance and Financial Accountant positions, the complex financial environment (with anticipated impacts from EU withdrawal and changes in accounting standards), and the acquisition of Shetland Leasing & Property Developments Ltd (SLAP) in the year.

From our audit work in 2017/18, we found that the Council had robust financial management procedures in place. However, we noted that there was a lack of reporting on progress against savings targets and linking of spend to outcomes. We also noted that the timeliness of reporting to Committees was an area for improvement. We will review progress on these areas in 2018/19.

# Introduction (continued)

## The key messages in this report (continued):

**Governance and transparency** – from our review of Council papers and attendance at Committees, we will assess the effectiveness of governance arrangements. We will also review the governance arrangements in relation to the Integrated Joint Board (IJB). As the IJB faces significant challenge around long term financial sustainability, there is a risk that the governance arrangements between the Council and the IJB (and the partner NHS Board) are not effective.

In 2017/18, we identified improvements that could be made to performance monitoring reports (in terms of timeliness and relevance) and to the Committee structure. We will continue to monitor progress in these areas, particularly in light of the difficulties in filling vacancies on the Audit Committee.

The Council is a key member of the Shetland Partnership Plan and community engagement and participatory budgeting are essential to delivering the objectives set out in the plan. We will consider how the Council is progressing with these areas, particularly focusing on engagement with community councils.

**Value for money** – from our 2017/18 audit work we concluded that the Council had a well established performance management framework in place, with performance regularly considered by management, and the Council. We noted, however, that improvements could be made to how this performance is reported to residents. During 2018/19, we will review progress on this point and consider how the Council is addressing areas where targets are not being met.

We will consider how the implementation of transformational change is impacting on how the Council's performance is measured and reported. There is a risk that insufficient resources are targeted to areas of under performance.

We will also review whether decision making appropriately considers value for money in delivering transformational change, through a detailed review of the business case for the "Effective and sustainable tertiary education, research and training in Shetland" project.

The Council acquired SLAP in October 2018, following the approval of a business case by the Council in August 2018. We will review the business case for this acquisition to assess the robustness of the options appraisal for this decision.

Our audit work on the four audit dimensions incorporates the specific risks highlighted by Audit Scotland, in particular, the impact of EU withdrawal, the changing landscape for public financial management, dependency on key suppliers, care income and increased focus on openness and transparency.

### **Best Value and Strategic Audit Priorities**

As part of our best value work, we will consider the five Strategic Audit Priorities agreed by the Accounts Commission and update our assessment of the Council's performance established from our audit work over the last two years against these priorities.

# Introduction (continued)

## The key messages in this report (continued):

### **Regulatory Change**

New accounting standards on revenue and financial instruments will apply for 2018/19, and for leases from 2020/21.

Although IFRS 15 is not anticipated to have a material impact on the Council, the adoption of IFRS 9 will, given the long term investments held by the Council and the accumulated reserve of investment gains. The Council should undertake work early in 2018/19 to prepare for these changes, including calculating any adjustments that will be required as at 31 March 2018 for transition. We would suggest that the Audit Committee receive reporting from management on the implementation of the new standard, and we will report specifically on the findings from our audit work in this area.

The adoption of IFRS 16 will have a material impact on the Council and requires substantial time commitment from the Council in preparing for implementation of the standard, particularly in light of adjustments to operating lease disclosures noted in prior year audits. Despite this standard not being implemented in the public sector until 2020/21, we would urge the Council to review the requirements of the standard and begin the work needed to prepare for implementation in 2018/19 and 2019/20.

We have reported on other regulatory changes in our sector updates in our separate report.

### **Our Commitment to Quality**

We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience.

### **Adding value**

Our aim is to add value to the Council through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Council promote improved standards of governance, better management and decision making and more effective use of resources.

**Pat Kenny**  
Audit director

# Responsibilities of the Audit Committee

## Helping you fulfil your responsibilities

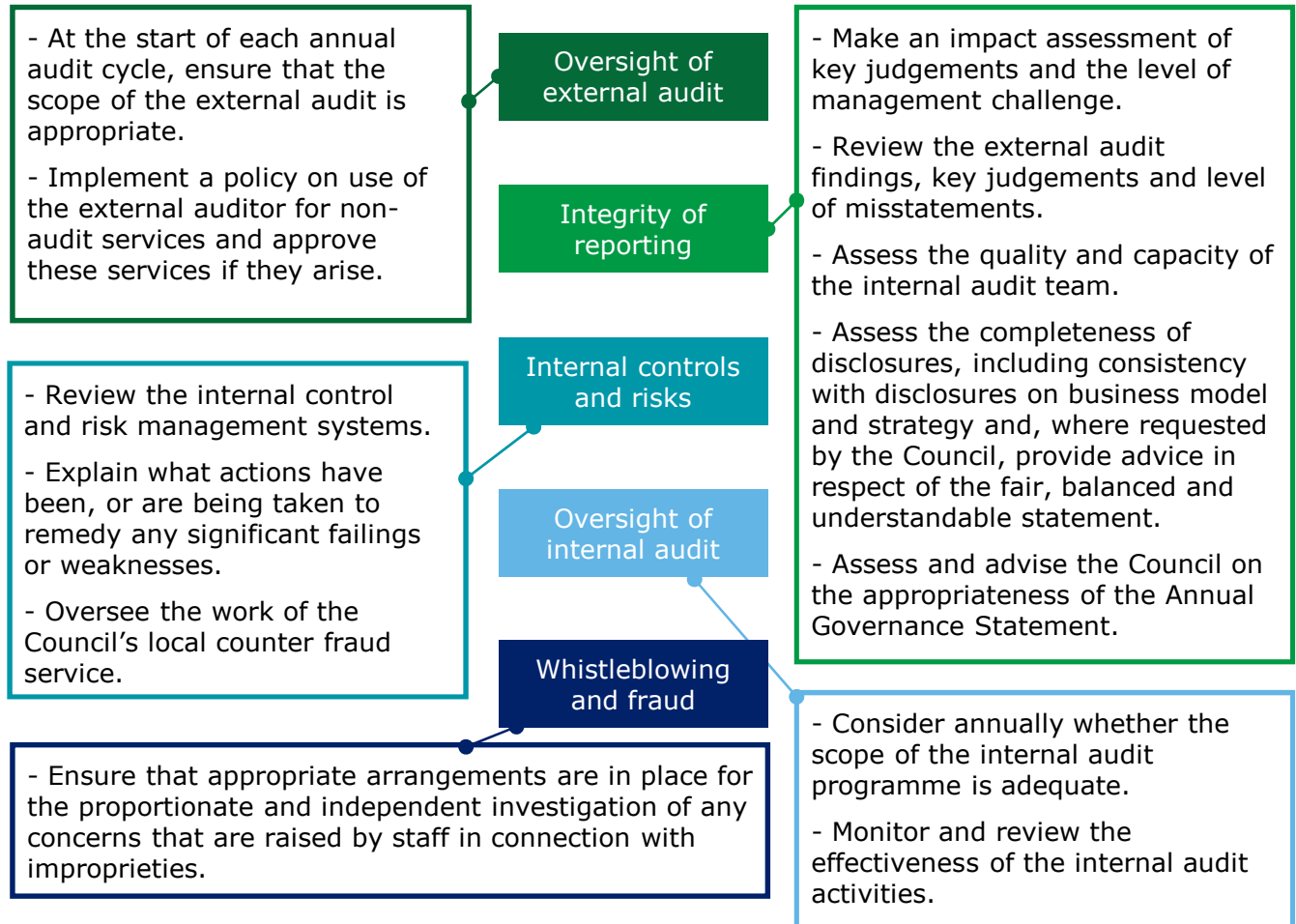
The primary purpose of the Auditor's interaction with the Audit Committee:

- 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 fulfil your broader responsibilities.

We use this symbol throughout this document to highlight areas of our audit where the Audit Committee need to focus their attentions.

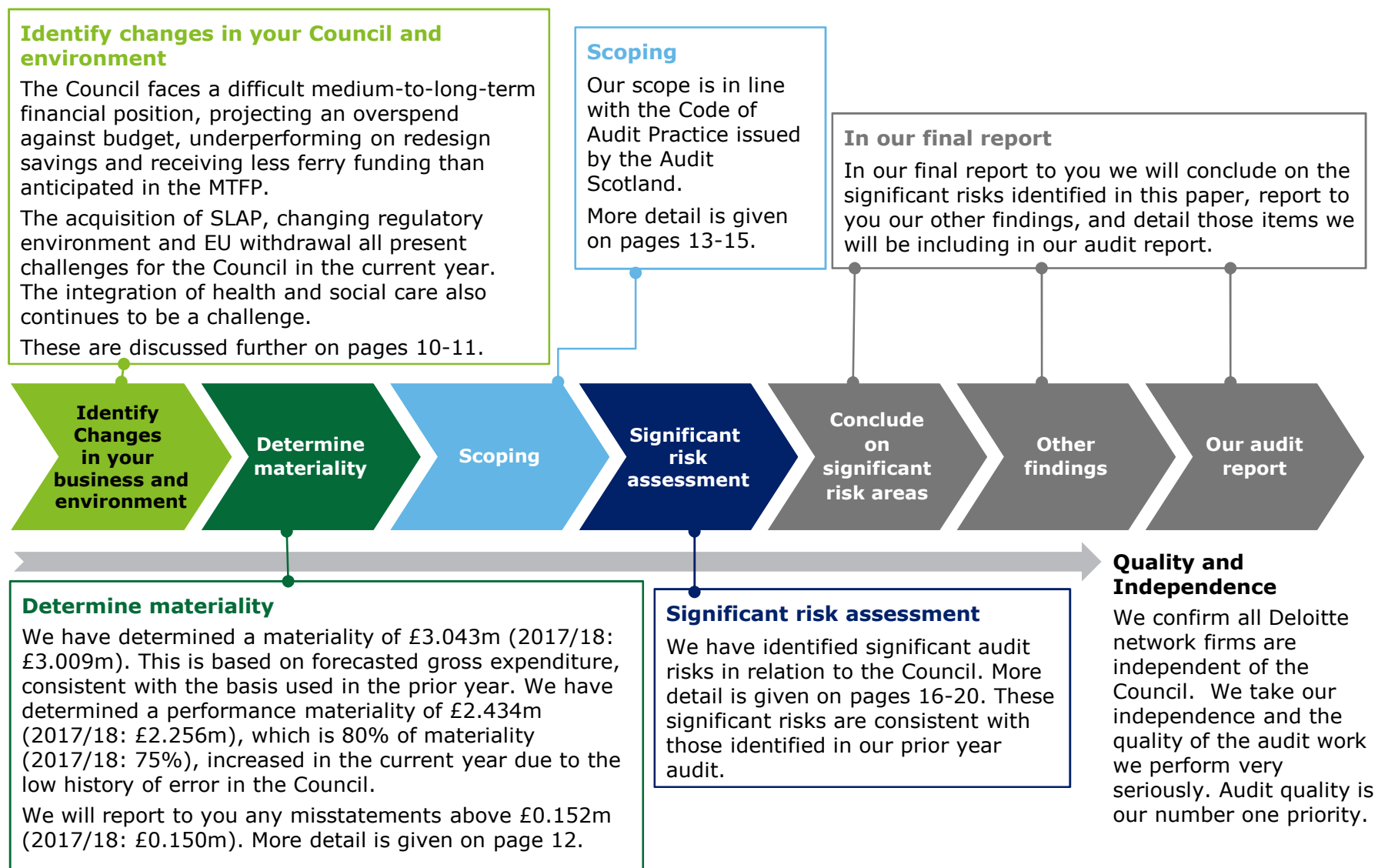


As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of Audit Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there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



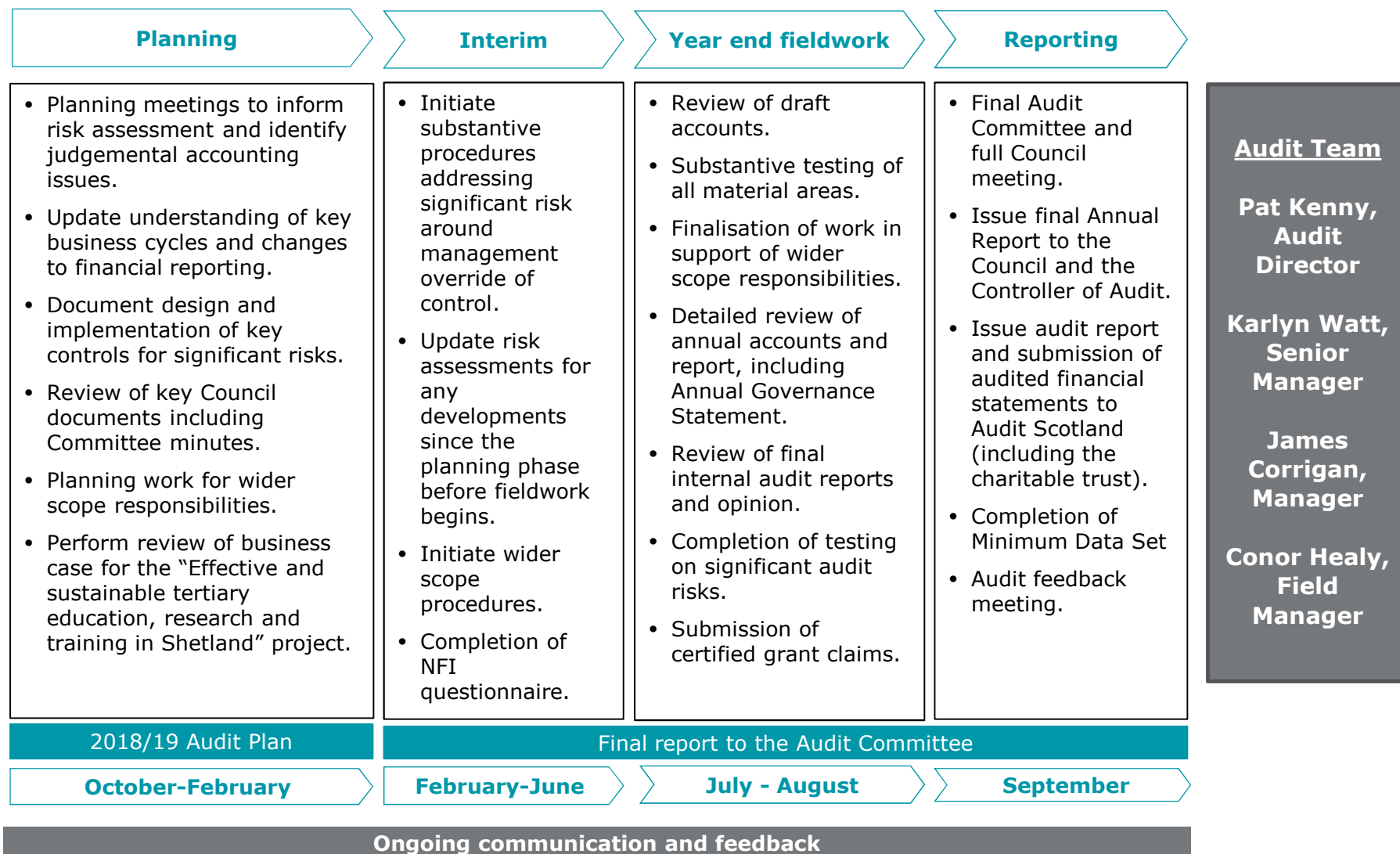
# Our audit explained

## We tailor our audit to your Council and your strategy



# Continuous communication and reporting

## Planned timing of the audit





# An audit tailored to you

## Focusing on your business and strategy

### Impact on our audit

#### Future financial strategy and sustainability



Our prior year audit report noted that the Council has effective financial planning arrangements in place and has achieved significant savings in excess of £40m in the previous 5 years. The Council's MTFP identified a funding gap of £15.6m per annum by 2023/24 – and a cumulative funding gap of £40.8m to that period. This assumed that funding for ferry services would be in line with the request submitted to the Scottish Government. In the 2019/20 budget, it was provisionally announced that funding for ferry services will remain at £5m, approximately £3m lower than requested. The MTFP needs to be reconsidered in light of this outcome. The Council will need to consider the impact that the cumulative effect of this decision – potentially increasing the funding gap by £15m – will have on service provision. We will consider the robustness of the MTFP and the Council's wider medium-to-longer-term financial planning as part of our audit (page 23).

The Business Transformation Strategy and Service Redesign Programme require the Council to make major changes to its methods of operation and service provision in order to achieve the required savings. The savings anticipated from transformation and redesign have to date not been achieved, with this having knock on effects for the Council's current year performance, short-term budgeting, and medium-term planning. We will review progress made in these areas in our 2018/19 audit, considering whether the Council is effectively planning for and prioritising transformation and redesign (page 23). We will additionally consider the wider ability of the Council to absorb any underachievement of these savings targets.

#### Purchase of SLAP



In August 2018, the Council approved in principle the decision to purchase SLAP. The purchase was agreed in October 2018, with the purchase price still to be finalised pending the outcome of due diligence work. The Council intends to 'hive up' the company into the Council, with the company being subsequently dissolved (anticipated to be in early 2019/20). As part of our audit work on value for money, we will review the business case behind the decision to purchase (page 27).

As part of the financial statements audit, we will consider the accounting implications of the transaction (page 22). The acquisition of SLAP will require the Council to prepare group accounts for 2018/19, meaning substantially more work will need to be completed as part of the year-end process with regards to group disclosures. We will consider these areas as part of our accounts compliance checks and as part of the financial management considerations of the wider scope audit.



New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements



# An audit tailored to you

## Focusing on your business and strategy

### Impact on our audit

#### Health and social care integration



In 2017/18, the IJB recorded an overspend of £2.4m (5.4%) against budget, with this overspend being funded on a 'one-off' basis by NHS Shetland. The 'Health and Social Care Integration' report released by Audit Scotland in November 2018 noted that the Shetland IJB required the highest level of savings in Scotland.

In order to close the IJB's short-term funding gap (£4.2m forecast for 2018/19), difficult decisions will need to be taken and transformational change will need to be progressed, with the Council being a key partner in the achievement of this – particularly in relation to moving forward on integrated budget setting.

We further note that the Integration Scheme requires a recovery plan to balance any overspend to be agreed with the constituent authority. This requires that both the IJB and the constituent authority agree how an overspend will be managed in the circumstance that recovery plans are unsuccessful. We will monitor the compliance of the Council – and the IJB and NHS Shetland – with the Integration Scheme in addressing these issues going forward.

#### College Merger



In December 2018, the Council approved a decision to proceed with the merger of Train Shetland, Shetland College and the NAFC Marine Centre. This will result in the creation of a new college, currently planned for August 2020, at which point the Council will no longer directly provide tertiary education. The proposal to merge forms a key pillar of the Council's Business Transformation Programme. We will consider the implementation of the decision to merge and the work undertaken since that decision as part of our review of the Council's wider transformation and service redesign work (page 23).

As part of this work, we considered the financial case for the merger, issuing our report on this to the Council in December 2018. Further due diligence was carried out on human resources, tax and legal considerations. As part of our audit, we will review the full business case for the merger as part of our value for money considerations (page 26).



New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements

# Materiality

## Our approach to materiality

### Basis of our materiality benchmark

- The audit director has determined materiality as £3.043m (2017/18: £3.009m) and a performance materiality of £2.434m (2017/18: £2.256m), based on professional judgement and risk factors specific to Shetland Islands Council, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 1.6% of forecasted gross expenditure (adjusted for net contributions to the IJB) as the benchmark for determining materiality and applied 80% (2017/18: 75%) as performance materiality.
- This approach is consistent with our prior year materiality calculation. We have increased the percentage applied as performance materiality given the low history of error by the Council.

### Reporting to those charged with governance

- We will report to you all misstatements found in excess of our clearly trivial threshold which is £0.152m (2017/18: £0.150m).
- We will report to you misstatements below this threshold if we consider them to be material by nature.

- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £0.250m.

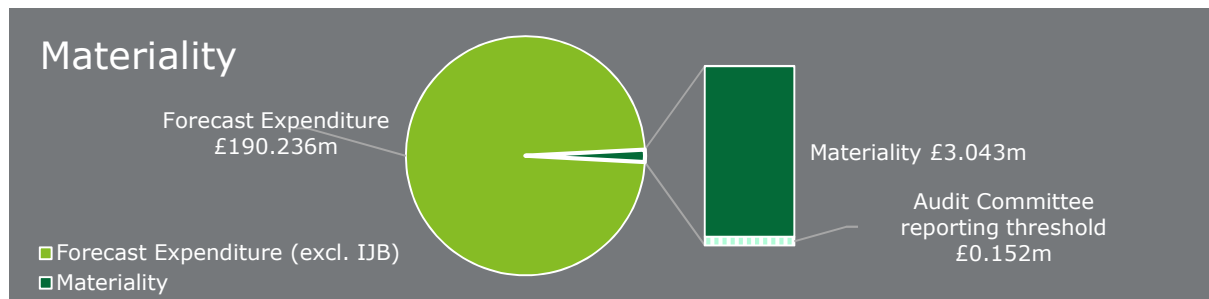
### Our annual audit report

We will:

- Report the group materiality, Council only materiality and the range we use for component materialities;
- provide comparative data and explain any changes in materiality, compared to prior year, if appropriate; and
- explain any normalised or adjusted benchmarks we use, if appropriate.

### Group considerations

- Whilst we note that group accounts will be prepared for 2018/19, the full impact of this is currently unknown. We will update the Audit Committee with group materiality considerations in our final paper.
- We anticipate that the only material component (other than the Council) in the group will be SLAP. We anticipate being appointed as auditors and will perform a full statutory audit for that component.



Although materiality is the judgement of the audit director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

# Scope of work and approach

## Our key areas of responsibility under the Code of Audit Practice

Core audit work	Planned output	Timeline
Perform an ISA (UK) compliant audit of the annual accounts	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Independent auditor's report</li> </ul>	<ul style="list-style-type: none"> <li>March 2019</li> <li>September 2019</li> </ul>
Audit and report on the audit dimensions	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Interim report</li> <li>Annual audit report</li> </ul>	<ul style="list-style-type: none"> <li>March 2019</li> <li>June 2019</li> <li>September 2019</li> </ul>
Contribute to performance audits (including performance audit reports, overview reports and impact reports)	<ul style="list-style-type: none"> <li>Minimum datasets</li> <li>Data returns</li> </ul>	<ul style="list-style-type: none"> <li>September 2019</li> <li>As required</li> </ul>
Share audit intelligence with Audit Scotland including highlighting potential statutory reports	<ul style="list-style-type: none"> <li>Current issues returns</li> </ul>	<ul style="list-style-type: none"> <li>January, March, August and October 2019</li> </ul>
Provide assurance on Whole of Government Accounts (WGA)	<ul style="list-style-type: none"> <li>Assurance statement on WGA returns</li> </ul>	<ul style="list-style-type: none"> <li>September 2019</li> </ul>
Carry out preliminary enquiries into referred correspondence	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>
Provide information on cases of fraud	<ul style="list-style-type: none"> <li>Fraud returns</li> </ul>	<ul style="list-style-type: none"> <li>November 2018, February, May and August 2019</li> </ul>
Provide information on cases of money laundering	<ul style="list-style-type: none"> <li>Audit Scotland to advise</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>
Contribute to National Fraud Initiative (NFI) report	<ul style="list-style-type: none"> <li>NFI audit questionnaire</li> <li>Reference, if necessary, in annual audit report</li> </ul>	<ul style="list-style-type: none"> <li>June 2019</li> </ul>
Contribute to technical guidance notes	<ul style="list-style-type: none"> <li>Consultation comments on draft technical guidance notes</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>
Contribute to technical databases	<ul style="list-style-type: none"> <li>Database returns</li> </ul>	<ul style="list-style-type: none"> <li>July 2019</li> </ul>

# Scope of work and approach (continued)

## Our key areas of responsibility under the Code of Audit Practice (continued)

Core audit work	Planned output	Timeline
Audit and report on Best Value	<ul style="list-style-type: none"><li>• Annual audit report</li></ul>	<ul style="list-style-type: none"><li>• September 2019</li></ul>
Consider and report on the Strategic Audit Priorities	<ul style="list-style-type: none"><li>• Annual audit plan</li><li>• Annual audit report</li></ul>	<ul style="list-style-type: none"><li>• March 2019</li><li>• September 2019</li></ul>
Lead the Shared Risk Assessment	<ul style="list-style-type: none"><li>• Any locally agreed output</li></ul>	<ul style="list-style-type: none"><li>• As required</li></ul>
Carry out Statutory Performance Information work	<ul style="list-style-type: none"><li>• Annual audit plan</li><li>• Annual audit report</li></ul>	<ul style="list-style-type: none"><li>• March 2019</li><li>• September 2019</li></ul>
Certify grant claims	<ul style="list-style-type: none"><li>• Certificate in support of grant claims</li></ul>	<ul style="list-style-type: none"><li>• As required</li></ul>
Liaise with housing benefit performance auditor	<ul style="list-style-type: none"><li>• None</li></ul>	<ul style="list-style-type: none"><li>• N/A</li></ul>

# Scope of work and approach (continued)

## Our approach

### Liaison with internal audit

The Auditing Standards Board's version of ISA (UK) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Given the change in internal audit in the year, we will review the objectivity, competence and quality control of the internal audit function. We will further consider the appropriateness of the nature and the scope of internal audit for the Council.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

### Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D&I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

### Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We will utilise the Code of Practice on local authority accounts in the UK disclosure checklist to support the Council in preparing high quality drafts of the annual report and financial statements, which we would recommend the Council complete during drafting.

The Disclosure Checklist reflects the cutting clutter agenda and includes a "not material" column. We would encourage the Council to exclude disclosure if the information is not material.

Audit Scotland has published good practice guides in relation to the Annual Accounts to support the Council in preparing high quality drafts of the Annual Report and financial statements, which we would recommend the Council consider during drafting.

Obtain an understanding of the Council and its environment including the identification of relevant controls.

Identify risks and controls that address those risks.

Carry out "design and implementation" work on relevant controls.

If considered necessary, test the operating effectiveness of selected controls.

Design and perform a combination of substantive analytical procedures and tests of details that are most responsive to the assessed risks.

# Significant risks

## Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality;
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements; and
- the Council's actual and planned performance on financial and other governance metrics compared to its peers.

### Principal risk and uncertainties

- Infrastructure maintenance
- Pension Fund funding

### Changes in your business and environment

- Acquisition of SLAP (page 22)
- Change in Executive Manager – Finance (page 24)
- Implementation of IFRS 9 (page 21)
- EU withdrawal (page 27)

### IAS 1 Critical accounting estimates










- Pension liability
- Fishing quota
- Fair value measurement of investments
- Valuation of property, plant and equipment
- Arrears

The next page summarises the significant risks that we will focus on during our audit. All the risks mentioned in the prior year Audit Committee report are included as significant risks in this year's audit plan.



# Significant risks (continued)

## Dashboard

Risk	Material?	Fraud risk identified?	Planned approach to controls testing	Level of management judgement	Page no.
Recognition of grant income			Design and implementation		18
Management override of controls			Design and implementation		19
Valuation of property assets			Design and implementation		20



Some degree of management judgement



Limited management judgement

# Significant risks (continued)

## Risk 1 – Recognition of grant income

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

Key components of income for the Council, are summarised in the table below. The Revenue Support Grant and Non-Domestic Rates income are directed by the Scottish Government and not considered a significant risk as the process for receipt of this income is not complex and can be verified 100%. Council tax and housing rent income are set through the annual budget process with no management judgement and therefore have a low risk of fraud. Similarly, other Service Income includes fees and charges across all Services, which are set through formal approval processes, with no history of fraud or error.

The significant risk is pinpointed to the recognition of grant income, comprising capital grants and contributions and service specific grants.

Grant income is a significant risk due to:

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

Type of income	2017/18 (£m)	Significant risk
<b><u>Taxation and Non-Specific Grant Income</u></b>		
Council Tax income	9.04	
Non domestic rates	23.24	
Government Grant	57.43	
Capital grants and contributions	<b>7.65</b>	✓
<b><u>Service Income</u></b>		
Service Specific Grant income	<b>8.20</b>	✓
Housing Benefit Subsidy	3.09	
Housing Revenue Account	7.14	
Harbour Account	28.76	
IJB commission income (book entry)	21.70	
Other Service Income	16.67	

**Our response** We will perform the following:

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



# Significant risks (continued)

## Risk 2 – Management override of controls

We will use computer assisted audit techniques, including Spotlight, to support our work on the risk of management override

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### **Risk identified**

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

The key judgements in the financial statements are those which we have selected to be the significant audit risks around recognition of grant income and valuation of property assets. These are inherently the areas in which management have the potential to use their judgement to influence the financial statements.

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### **Planned audit challenge**

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

#### **Journal testing**

- We will test the design and implementation of controls over journal entry processing.
- Using our Spotlight data analytics tool, we will risk assess journals and select items for detailed follow up testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest.
- We will test the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting.

#### **Accounting estimates**

- We will test the design and implementation of controls over key accounting estimates and judgements.
- We will review accounting estimates for biases that could result in material misstatements due to fraud. This will include both a retrospective review of 31 March 2018 estimates and a review of the corresponding estimates as at 31 March 2019.

#### **Significant and unusual transactions**

- We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the entity, or that otherwise appear to be unusual, given our understanding of the entity and its environment.
-

# Significant risks (continued)

## Risk 3 – Valuation of property assets

We will engage Deloitte Real Estate specialists to assist our testing of the revaluation of the £270m property asset portfolio.

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### **Risk identified**

The Council held £269.54m (gross book value) of property assets at 31 March 2018. The financial year to 31 March 2019 will represent year one of a five year rolling programme in which 20% of the portfolio will be revalued along with 100% of Council dwellings.

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

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### **Planned audit challenge**

- We will test the design and implementation of key controls in place around the property valuation.
- We will engage early with the Council, using our valuation specialists to challenge the assumptions applied by management in the valuations.
- We will use our valuation specialists, Deloitte Real Estate, to review and challenge the appropriateness of the assumptions used in the year-end valuation of the Council's property assets, including considering movements compared to those of other Councils performing valuations for 2018/19.
- For valuations performed prior to the year end, where the valuer confirms to the Council that there are no significant differences between the valuation date and 31 March 2019, we will challenge whether any potential impact of a "Brexit shock" (depending on the final deal outcome) has been included in the estimates and judgements, owing to the timing of the Brexit date and year end date.

# Other areas of audit interest

## Implementation of IFRS 9 – Financial Instruments

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### Risk identified

In July 2014, the IASB published a final version of IFRS 9. The Standard has a mandatory effective date for periods beginning on or after 1 January 2018. The 2018/19 accounting code requires public bodies to disclose information on the transition to IFRS 9. Any impact of transition will be recognised as a reserves movement in 2018/19.

The Council has built up £108.464m in its Available for Sale Financial Instruments Reserve ('ASFI Reserve'), arising from movement in the value of long term investments held by the Council. Under IFRS 9, this reserve requires to be cleared out and recycled through the Comprehensive Income and Expenditure Statement ('CIES'). All future movements will be recognised through the CIES rather than through reserves. Although the quantum involved in this transaction is significant, the complexity is not, and as such this is not considered to be a significant risk area for the audit. However, it will remain a key focus area for the audit due to the stringent disclosure requirements and the impact of the change on the CIES and Balance Sheet.

The other key change affecting the Council is from an incurred losses model for receivables, to an expected credit losses ('ECL') model. This requires that the Council recognise an ECL creditor when a receivable is recorded (on a portfolio basis, rather than arrangement by arrangement), with this creditor being reversed if the receivable is paid in full. Given the complex accounting and management judgement involved in determining the ECL to be applied, this will be a key focus for our audit. However, this area is not considered to be a significant risk area due to the anticipated quantum of the ECL, given the historically low levels of bad debt incurred by the Council.

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### Planned audit challenge

In considering the risk associated with the transition to IFRS 9, we will:

- confirm that the ASFI Reserve has been appropriately recycled through the CIES;
  - review the annual accounts against the transition and ongoing disclosure requirements of the accounting code; and
  - consider the appropriateness of management judgements in determining the ECL against receivables.
-

# Other areas of audit interest (continued)

## Accounting for purchase of SLAP

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### Risk identified

In August 2018, the Council approved a decision in principle to purchase SLAP. The agreement to purchase was finalised in October 2018. The Council intends to 'hive up' the company into the Council, with the company being subsequently dissolved in early 2019/20.

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

Despite involving substantial complexity, this has not been identified as a significant risk given that the valuation of properties will be addressed through our significant risk on valuation of property assets (page 20) and there is anticipated to be minimal goodwill or bargain purchase as the purchase price is to be finalised following completion of due diligence work.

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### Planned audit challenge

In considering the Council's accounting for the purchase of SLAP, we will:

- review the annual accounts for compliance with group reporting requirements;
  - review the valuation of SLAP and the price paid, recalculating any goodwill or bargain purchase arising;
  - use our valuation specialists, Deloitte Real Estate, to review and challenge the valuations of investment properties acquired by the Council;
  - review the Council's fixed asset register and lease disclosures to ensure that assets previously leased from SLAP are not double counted or incorrectly recorded following acquisition and transfer; and
  - consider the Council's compliance with legal requirements on hiving up SLAP into the Council.
-

# Wider scope requirements

## Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. We will consider how the Council is addressing these areas, including any risks to their achievement, as part of our audit work as follows:

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Financial sustainability</b> looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"> <li>• The financial planning systems in place across the shorter and longer terms.</li> <li>• The arrangements to address any identified funding gaps.</li> <li>• The affordability and effectiveness of funding and investment decisions made.</li> <li>• Workforce planning.</li> </ul>	<p>The Council anticipates further significant cash reductions in the General Revenue Grant from the Scottish Government. In 2018/19, the Council's MTFP forecast an annual funding gap of £15.6m by 2023/24. The MTFP will need to be revised in 2018/19 given the allocation of £5m for ferry funding, some £3m lower than the amount anticipated by the Council. We will review the MTFP and underlying assumptions to determine if it is relevant and robust.</p> <p><b>Audit Risk:</b> The Council's medium-term financial planning is insufficiently robust and does not reflect current and reasonably foreseeable circumstances.</p> <p>The Council is forecasting an overspend against budget of £1.8m (1.6%) in 2018/19, requiring an additional draw on reserves. This overspend is substantially due to an underachievement of savings anticipated from redesign projects. We will consider the Council's Business Transformation and Service Delivery programmes to consider their achievability.</p> <p><b>Audit Risk:</b> The Council's Business Transformation and Service Delivery programmes are not appropriately progressed, resulting in benefits not being realised and financial targets being missed.</p> <p>In view of the Scottish Government's Medium Term Financial Strategy (MTFS) (discussed further on page 28) we will consider the extent to which the Council has reviewed the potential implications of the MTFS for its own financial planning and whether it is taking these into account in its arrangement for financial management and financial sustainability.</p> <p><b>Audit Risk:</b> The Council's long-term financial planning is inconsistent with the Scottish Governments five-year plan.</p>

# Wider scope requirements (continued)

## Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Financial management</b> is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<ul style="list-style-type: none"> <li>• Systems of internal control.</li> <li>• Budgetary control system.</li> <li>• Financial capacity and skills, including changes in Executive Manager – Finance and financial accountant roles.</li> <li>• Arrangements for the prevention and detection of fraud.</li> </ul>	<p>We will monitor financial performance and outturn reports prepared by the Council in 2018/19. We will specifically consider the changes in the finance team in the year, monitoring the impact this has on ongoing financial management, including the year-end annual accounts process. No issues were identified with financial management in the 2017/18 audit.</p> <p><b>Audit Risk:</b> Finance team capacity is insufficient to deal with the scale of work required.</p> <p>In 2017/18, we noted that there was a lack of reporting on progress against savings targets and linking of spend to outcomes. In view of the Scottish Government's new budget process (discussed further on page 28) we will confirm that underlying financial performance – including any in-year changes to funding agreed with the Scottish Government – is transparently presented.</p> <p><b>Audit Risk:</b> The underlying financial performance of the Council is not transparently reported.</p> <p>Our fraud responsibilities and representations are detailed on pages 38 and 39.</p>

# Wider scope requirements (continued)

## Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Governance and transparency</b> is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<ul style="list-style-type: none"> <li>• Governance arrangements.</li> <li>• Scrutiny, challenge and transparency on decision making and financial and performance reports.</li> <li>• Quality and timeliness of financial and performance reporting.</li> </ul>	<p>In 2017/18, we noted that the Council had robust governance arrangements in place. However, we recommended that the Council review its committee and reporting structure to ensure that reporting and monitoring is timely, relevant and appropriate. We will consider progress in this area in 2018/19.</p> <p><b>Audit Risk:</b> The Council's governance arrangements are not sufficient.</p> <p>As part of our audit planning work in 2018/19, we noted that the Audit Committee is the only committee on the Council which has a vacancy. We further note that the committee calendar includes four meetings of the Audit Committee, with other committees pencilled in to have at least six meetings. We will review actions to address the Audit Committee vacancy and consider the appropriateness of the committee calendar.</p> <p><b>Audit Risk:</b> There is insufficient governance and scrutiny of Council actions.</p> <p>In view of the increased focus on how public money is used and what is achieved (as discussed further on page 28), we will consider how the Council has reviewed its approach to openness and transparency.</p> <p><b>Audit Risk:</b> The Council's approach is not keeping pace with public expectation and good practice.</p>

# Wider scope requirements (continued)

## Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Value for money</b> is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> <li>• Value for money in the use of resources.</li> <li>• Link between money spent and outputs and the outcomes delivered.</li> <li>• Improvement of outcomes.</li> <li>• Focus on and pace of improvement.</li> </ul>	<p>In our 2017/18 audit, we noted that the Council had a clear framework in place for monitoring performance. We will review current data and assess the Council's actions to address areas of declining performance and where targets are not being achieved.</p> <p><b>Audit Risk:</b> The Council does not appropriately prioritise areas of poor performance.</p> <p>In line with the Council's Business Transformation programme, SLAP was purchased in October 2018, and a decision to approve and progress the merger of Shetland College, Train Shetland and NAFC Marine Centre was made in December 2018. These decisions were made based on full business cases presented to the Council. We will review these business cases as part of our audit to assess their robustness.</p> <p><b>Audit Risk:</b> The Council has not achieved value for money in progressing its Business Transformation programme.</p> <p>In view of the Scottish Government's new budget process (discussed further on page 28) we will consider the extent to which the Council performance report provides an accessible account of the Council's overall performance and impact of its public spending.</p> <p><b>Audit Risk:</b> The Council does not clearly report on its contribution towards the national outcomes.</p>



# Wider scope requirements (continued)

## Specific risks

As part of the 2018/19 planning guidance, Audit Scotland have identified the following areas as significant risks faced by the public sector. Any specific risks in relation to these areas for the Council have been included in our audit risk under the audit dimensions, discussed on the previous pages. We will continue to monitor these areas as part of our audit work.

Risk	
<b>EU withdrawal</b>	<p>There are uncertainties surrounding the terms of the UK's withdrawal from the European Union in March 2019. Some arrangements have been provisionally agreed, such as a transition period to the end of 2020, although they are dependent on a final deal being reached between the UK Government and the remaining EU countries. The outcome of negotiations should become clearer in the months up to March 2019.</p> <p>Whatever the outcome, EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. Audit Scotland has identified three areas where EU withdrawal may have the most significant impact as summarised below:</p> <ul style="list-style-type: none"><li>• <b>Workforce</b> – Many public services are dependent on workers from EU countries, including health, social care and education. A decline in migration from the EU could potentially result in vacancies and skills gaps in some areas of the public sector. There is a risk that this could impact on some public bodies' ability to deliver 'business as usual' particularly given existing workforce and service pressures.</li><li>• <b>Funding</b> – Funding from the EU makes an important contribution to the Scottish public sector. The main sources of funding provide support to farmers and rural businesses, projects to encourage economic growth and support for research and education. The UK Government has made guarantees to meet some funding commitments to the end of existing programmes, but there are uncertainties about what any replacement funding may look like.</li><li>• <b>Regulation</b> – The EU Withdrawal Bill will transpose existing EU law into UK law immediately after the UK leaves the EU. Legislation in many devolved areas will transfer to the Scottish Parliament. The UK government has identified 24 devolved policy areas where it seeks to retain temporary control until UK-wide common legislative frameworks are developed.</li></ul> <p>In addition, some public bodies may be affected directly by changes to trade and customs rules, which could impact on supply chains and the procurement of goods or services from EU countries. This could influence the availability and cost of supplies and services (e.g. specialist medical equipment or drugs) with potential implications for public bodies' finances and their ability to deliver specific services.</p> <p>While there are considerable uncertainties about the detailed implications of EU withdrawal, at a minimum by the end of 2018/19, we would expect public bodies to have assessed the potential impact of EU withdrawal on their operations and identified any specific risks and how they will respond to them. We will assess how the Council has prepared for EU withdrawal and how it continues to respond to any emerging risk after March 2019. Some suggested key questions for the Audit Committee are included in our separate Sector Update paper.</p> <p>In addition, in accordance with the FRC guidance, the Council should consider the disclosure within its annual accounts, distinguish the specific and direct challenges that it faces from the broader economic uncertainties. In some circumstances this may mean recognising or re-measuring certain items in the Balance Sheet. A comprehensive post balance sheet events review must be reflected in accounts and disclosures. The Council will need to be particularly alert to this given the susceptibility of investments to sudden fluctuations and the possibility of fishing quotas becoming obsolete.</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Changing landscape for public financial management</b>	<p>Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for 11 social security benefits worth over £3 billion a year. This provides the Scottish Parliament with more policy choices but also means that the Scottish budget is subject to greater volatility, uncertainty and complexity.</p> <p>Parliamentary scrutiny of the public finances is increasingly important in this changing landscape. A new Scottish budget process has been introduced, which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. This involves parliamentary committees looking back to explore what public spending has achieved, looking forward to longer-term objectives and challenges, and considering what this should mean for future budgets.</p> <p>As part of the new budget process, the Scottish Government published an initial five-year Medium Term Financial Strategy (MTFS) in May 2018. This five-year outlook for the Scottish budget provides useful context for audited bodies' financial planning. As part of our wider scope audit work on financial management and financial sustainability (discussed further on page 23), we will consider how Shetland Islands Council has reviewed the potential implications of the MTFS for its own finances, including longer-term financial planning.</p> <p>The new budget process places greater emphasis on assessing outcomes and the impact of spending. There is an expectation that the Scottish Government and public bodies will report on their contributions towards the national outcomes in their published plans and performance reports, including their annual reports. Increased complexity and volatility is also likely to mean that the Scottish Government will be increasingly active in managing its overall budget position in-year, engaging with public bodies closely on their anticipated funding requirements. As part of our wider scope audit work on financial sustainability (page 23) and value for money (page 26) we will consider the extent to which Shetland Islands Council's performance report provides an accessible account of the body's overall performance and impact of its public spending. We will also confirm that underlying financial performance, including any in-year changes to funding agreed with the Scottish Government, is transparently presented.</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Care income, financial assessments and financial guardianship</b>	<p>The experience from some Scottish local government audits indicates there may be wider issues with the systems and processes for collecting care income, undertaking financial assessments on individuals receiving care and financial guardianship.</p> <p>In some cases, responsibility for financial assessment on those receiving care has transferred from social care to finance and this has revealed issues with backlogs of financial assessment and under-recovery of care charges over long periods. Each individual case may have different circumstances contributing to a delay and some of these delays are not within the councils' control, but there are examples where inadequate focus on this area has led to delays that are attributable to the council. After taking legal advice, Audit Scotland does not believe these statutory debts are subject to prescription periods, so are generally collectable even where delays are considerable. In some cases, the Council will take charge over property, where income is insufficient to meet care costs.</p> <p>We will undertake a review of the arrangements for financial assessment of those requiring care and assess whether these are subject to a significant backlog and the reporting of this.</p> <p>Audit Scotland has also identified that officers within the Council may be operating as financial guardians for individuals with a lack of capacity to act in their own interest. This financial guardianship role is distinct from a welfare guardian (usually the chief social work officer) and is subject to approval by a Sherriff. Financial guardianship by a council officer is the solution of last resort when no other member of a family, friend, neighbour or local solicitor is willing to act in this role. This may give risk to a potential conflict of interest when finance officers are in a senior position and the council is issuing invoices to a person for their care and the officer is also acting as financial guardian for the individual.</p> <p>We will be requested to complete a questionnaire to provide intelligence on the extent to which officers undertake financial guardianship roles and the reasons for this.</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Dependency on key suppliers</b>	<p>It has become clear that the collapse of Carillion has had a significant impact across the public sector. This has brought into focus the risk of key supplier failure and the risk of underperformance in suppliers that are experiencing difficult trading conditions. The risk exists on two levels:</p> <ul style="list-style-type: none"><li>• Individual public sector bodies are dependent on key suppliers; and</li><li>• The Scottish public sector as a whole is subject to significant systematic risk.</li></ul> <p>We will determine as part of our detailed risk assessment the extent to which Shetland Islands Council is dependent on key supplier relationships. Where dependency is significant, we will consider this as part of our audit work and report back to the Audit Committee.</p> <p>We will also be requested to complete a short questionnaire to establish the extent, value and nature of key supplier dependencies that can inform the national position.</p>
<b>Openness and transparency</b>	<p>There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny. We will consider this as part of our wider scope work on governance (discussed further on page 25).</p> <p>We would expect to see public bodies reviewing their approach to openness and transparency to ensure they are keeping pace with public expectations and good practice. Evidence of progress might include:</p> <ul style="list-style-type: none"><li>• increased public availability of board papers;</li><li>• more insight into why some business is conducted in private; and</li><li>• Development of the form and content of annual reports.</li></ul>

# Wider scope requirements (continued)

## Other responsibilities

### Best Value

In June 2016 the Accounts Commission formally agreed the overall framework for a new approach to auditing Best Value (BV). This framework introduced a five year approach to auditing BV. 2018/19 represents year three of the BV audit plan. Under this approach, the Controller of Audit will provide a Best Value Assurance Report (BVAR) to the Commission for each Council at least once in a five year period. The national five year BVAR programme is updated each year reflecting changes to risk assessments identified from the SRA process or annual audits. Shetland Islands Council has not been identified for a BVAR report in 2018/19.

Our BV audit work in 2018/19 will be integrated into our audit approach, including our work on the audit dimensions discussed on pages 23 to 26, and will be reported in our annual audit report.

### Strategic audit priorities

In its Strategy, which is updated annually, the Accounts Commission sets out an overall aim of holding councils to account for their pace, depth and continuity of improvement facilitated by effective governance. Within this, the Commission also sets out five Strategic Audit Priorities that will be built into audit expectations, which are set out below.

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

We will consider each of these areas as part of our audit dimensions work and report within our annual audit report.

# Wider scope requirements (continued)

## Other requirements (continued)

### Shared Risk Assessment and Joint Scrutiny Planning

The Accounts Commission, supported by Audit Scotland, chairs the Strategic Scrutiny Group (SSG). The SSG is made up of scrutiny bodies from across the public sector to make their work on local government more co-ordinated, better targeted and more proportionate to identified risks.

The arrangements for coordinating scrutiny at a local level include a Local Area Network (LAN) for each Council. LANs are led by each Council's appointed auditor. LANs bring together relevant scrutiny bodies, typically Audit Scotland, Care Inspectorate, Education Scotland and the Scottish Housing Regulator, to share information and intelligence on an ongoing basis and to carry out a Shared Risk Assessment (SRA). The purpose of the SRA is to inform discussions between the LAN and its Council and to inform the National Scrutiny Plan (NSP) for local government.

A number of changes have been made to the process for 2018/19, the most notable being there is no requirement for LANs to produce local scrutiny plans. LANs can produce local outputs if they determine, in consultation with the Council, that this would be useful. The new approach looks to embed a discussion about risks and responses between scrutiny bodies across the year, rather than a specific one-off approach.

### Councils' Statutory Performance Indicators

The Accounts Commission has a statutory responsibility to define the performance information that Councils must publish to allow citizens to gauge their performance comparatively. This responsibility links with the Commission's BV audit responsibilities. In turn, Councils have their own responsibilities, under their BV duty, to report performance to the public. The 2015 Statutory Performance Information Direction published by the Commission requires Councils to report a range of information in accordance with, but not confined to, the requirements of the LGBF. The Commission has committed to reviewing its 2015 Direction after three years, this will be updating its Direction at the end of 2018.

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

# Wider scope requirements (continued)

## Other responsibilities (continued)

### Performance Audits

In accordance with Audit Scotland planning guidance, we will be requested to provide information to support performance audits that Audit Scotland intends to publish during 2018/19 and 2019/20, as summarised below:

Title and planned publication date	Local auditor input
Digital progress in local government – Spring 2020	We will be asked to inform the performance audit team of any significant ICT and digital developments within their audited body.
Education outcomes – Winter 2019	Scoping work for the audit will take place in early 2019 and will inform any specific input required from auditors. This is likely to be providing an update on governance arrangements and operation of the Regional Improvement Collaboratives.
Value for money of non-profit distributing models of capital financing – Summer 2019	Scoping work for this audit is underway and it is not anticipated that a formal data return will be required from auditors. The performance audit team will consider national data and liaise with local auditors around potential case studies as appropriate.
Waste management	Guidance will be provided to auditors, but would typically seek information in relation to local, regional and national waste management arrangements, including cost, investment, volume and Landfill Tax data.

### Impact reports

We will also be requested to provide information to support assessing the impact of previously published performance audit reports as follows:

- Supporting Scotland’s economic growth (Winter 2018)
- Early learning and child care (Summer 2019)
- Equal pay in Scottish Councils (Spring 2019)
- Transport Scotland’s ferry services (Summer 2019)
- Self-directed support: 2017 progress report (Spring 2019)

# Wider scope requirements (continued)

## Other requirements (continued)

### Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into force on 26 June 2017 and replace the Money Laundering Regulations 2007. The regulations impose an obligation of the Auditor General to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist financing. As part of our audit work, we will ensure we are informed of any instances of money laundering at the Council so that we can advise the Auditor General.

### National Fraud Initiative (NFI)

All Council's are participating in the NFI 2018/19. All data was required to be submitted in October 2018 and Councils will receive matches for investigation in January 2019. Audit Scotland expects bodies to investigate all recommended matches based on findings and the risk of error or fraud. Match investigation work should be largely completed by 30 September 2019 and the results recorded on the NFI system.

We will monitor the Council's participation and progress during 2018/19 and into 2019/20 and, where appropriate, include references to the NFI in our annual audit reports for both years. We will also complete an NFI audit questionnaire and submit to Audit Scotland by 30 June 2019.



# Audit Quality

## Our commitment to audit quality



Our objective is to deliver a distinctive, quality audit to you. Every member of the engagement team will contribute, to achieve the highest standard of professional excellence.

In particular, for your audit, we consider that the following steps will contribute to the overall quality:

- We will apply professional scepticism on material issues and significant judgements identified, by using our expertise in the local government sector and elsewhere to provide robust challenge to management.
- We have obtained a deep understanding of your business, its environment and of your key business processes, enabling us to develop a risk-focused approach tailored to the Council.
- Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. We will involve specialists to support the audit team in our work.

In order to deliver a quality audit to you, each member of the core audit team will receive tailored learning to develop their expertise in audit skills, delivered by Pat Kenny and other sector experts. This includes sector specific matters, and audit methodology updates.



### **Engagement Quality Control Review**

We have developed a tailored Engagement Quality Control approach. Our dedicated Professional Standards Review (PSR) function will provide a 'hot' review before any audit or other opinion is signed. PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.

# 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 establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope;
- Key regulatory and corporate governance updates, relevant to you.

### What we don't report

As you will be aware, our audit is 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, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

### Other relevant communications

We will update you if there are any significant changes to the audit plan.

This report has been prepared for the 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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

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



**Pat Kenny, CPFA**

for and on behalf of Deloitte LLP

Glasgow

19 February 2019

# Appendices



# Fraud responsibilities and representations

## Responsibilities explained



### **Your 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.



### **Our responsibilities:**

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- 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.
- As set out in the significant risks section of this document, we have identified the risk of fraud in the recognition of grant income and management override of controls as key audit risks for your organisation.



### **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 auditors – 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 Council:**

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control 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 that affects the entity or group 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 entity's financial statements communicated by employees, former employees, analysts, regulators or others.

# Fraud responsibilities and representations

## Inquiries

We will make the following inquiries regarding fraud:



### **Management**

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.

### **Internal audit and local counter fraud specialist**



- Whether internal audit and the Council's local counter fraud specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain their views about the risks of fraud.

### **Those charged with governance**



- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.

# Independence and fees

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

## Independence confirmation

We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Council and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2019 in our final report to the Audit Committee.

## Fees

The audit fee for 2018/19 has been increased from the fee range provided from Audit Scotland. This is due to the additional scope of the audit work to include the 'Effective and sustainable tertiary education, research and training in Shetland' review, the implementation of IFRS 9, and the acquisition of SLAP. The fee is £230,761, as analysed below:

	£
Auditor remuneration	161,451
Audit Scotland fixed charges:	
Pooled costs	13,560
Performance Audit and Best Value	46,970
Audit support costs	8,780
<b>Total proposed fee</b>	<b>230,761</b>

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

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

Following its acquisition by the Council, we anticipate being appointed as statutory auditor for SLAP for 2018/19, for which fees of £30,000 (plus VAT) have been provisionally agreed. This fee will be levied on and paid by SLAP as a distinct entity, rather than being paid through the Council.

## Non-audit services

In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Council'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 have no other relationships with the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.





# Our approach to quality

## AQR team report and findings

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2018 the Financial Reporting Council ("FRC") issued individual reports on each of the eight largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2017/18 cycle of reviews.

We take the findings of the AQR seriously and we listen carefully to the views of the AQR and other external audit inspectors. We remediate every finding regardless of its significance and seek to take immediate and effective actions, not just on the individual audits selected but across our entire audit portfolio. We are committed to continuously improving all aspects of audit quality in order to provide consistently high quality audits that underpin the stability of our capital markets.

We have improved the speed by which we communicate potential audit findings, arising from the AQR inspections and our own internal reviews to a wider population, however, we need to do more to ensure these actions are embedded. In order to achieve this we have launched a more detailed risk identification process and our InFlight review programme. This programme is aimed at having a greater impact on the quality of the audit before the audit report is signed. Consistent achievement of quality improvements is our aim as we move towards the AQR's 90% benchmark.

All the AQR public reports are available on its website. <https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

### The AQR's 2017/18 Audit Quality Inspection Report on Deloitte LLP

"The overall results of our reviews of the firm's audits show that 76% were assessed as requiring no more than limited improvements, compared with 78% in 2016/17. Of the FTSE 350 audits we reviewed this year, we assessed 79% as achieving this standard compared with 82% in 2016/17. We are concerned at the lack of improvement in inspection results. The FRC's target is that at least 90% of these audits should meet this standard by 2018/19."

"Where we identified concerns in our inspections, they related principally to aspects of group audit work, audit work on estimates and financial models, and audit work on provisions and contingencies. During the year, the firm has continued to develop the use of "centres of excellence", increasing the involvement of the firm's specialists in key areas of the audit. We have no significant issues to report this year in most of the areas we reported on last year."

"The firm has revised its policies and procedures in response to the revised Ethical and Auditing Standards. We have identified some examples of good practice, as well as certain areas for improvement."

#### The firm has enhanced its policies and procedures in the following areas:

- Increased use of centres of excellence ("CoE") involving the firm's specialists, including new CoEs focusing on goodwill impairment (established in response to previous inspection findings) and corporate reporting, to address increasing complexity of financial reporting.
- Further methodology updates and additional guidance issued to the audit practice including the audit approach to pension balances, internal controls, data analytics, group audits and taxation.
- A new staff performance and development system was implemented with additional focus on regular timely feedback on performance, including audit quality.
- Further improvements to the depth and timeliness of root cause analysis on internal and external inspection findings.

#### Our key findings in the current year requiring action by the firm:

- Improve the group audit team's oversight and challenge of component auditors.
- Improve the extent of challenge of management's forecasts and the testing of the integrity of financial models supporting key valuations and estimates.
- Strengthen the firm's audit of provisions and contingencies.

#### Review of firm-wide procedures. The firm should:

- Enhance certain aspects of its independence systems and procedures.



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## **Shetland Islands Council** Sector developments paper

For the Audit Committee meeting on 7 March 2019

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# The State of the State

## Government beyond Brexit

### Overview

Now in its seventh year, **The State of the State** has once again brought together Deloitte LLP and Reform to reflect on the most pressing public sector issues along with new, exclusive research. Central to the report is our citizen survey, which provides a platform for the most important voices of all in the public sector: that of the public. Also exclusive to the report is our research with the people who know the public sector's challenges best: the people who run it.

This year, we interviewed fifty senior figures including civil servants, police leaders, NHS directors and Council Chief Executives, producing the most extensive qualitative research of its kind in the sector.

This year's The State of the State finds the UK government amid the complex and politically-charged challenge of leaving the EU. But while Brexit may dominate daily headlines, our report finds a wider set of challenges – and opportunities – for government and the public services as they gear up for a Spending Review.

Key findings	
<b>Scotland's government has now been led by the Scottish National Party for three consecutive terms in office</b>	- In those eleven years, the administration has taken forward the possibilities of devolution to shape a Scottish public sector landscape that now differs substantially from the rest of the UK – in its public finances, its policy priorities and its ethos.
<b>Austerity has flipped public attitudes to tax and spending</b>	- As austerity began in 2010, more than half of the public backed spending cuts to restore the public finances. In 2018, as the Prime Minister calls a formal end to the austerity years, our exclusive citizen survey finds that support has dwindled to less than one fifth of the public.
<b>People are increasingly concerned about public services and their future provision</b>	- Our survey finds that the public is increasingly concerned about public services. It suggests that the past four years have seen a decline in the number of people who think that public bodies understand their needs, listen to their preferences and involve them in decisions – perhaps driven by perceptions of austerity. Looking to the future, the number of people who are worried that the state will provide too little support for them in the years ahead has risen from fifty per cent in 2010 to seventy per cent this year.
<b>Citizen views differ significantly across the UK's four countries</b>	- Recent years have seen an acceleration in the public policy differences between the devolved administrations, and our survey finds that citizen attitudes also differ. For example, people in Scotland are more likely to believe that taxes should be higher to pay for more public services, people in Northern Ireland are less likely to say they have felt the effects of austerity, and people in Wales are the most likely to say that public services listen to their needs. These differing views underscore the diverging political and policy landscapes across the UK.
<b>The public back penalty fines for wasting public sector time</b>	- Our citizen survey explored the circumstances in which the public would find charges reasonable, and found that the most acceptable would be penalty fines for wasting public sector time, like missing NHS appointments or wrongly calling out the emergency services.

### Next steps

The report is available at <https://www2.deloitte.com/content/campaigns/uk/the-state-of-the-state/the-state-of-the-state/the-state-of-the-state.html>. The Council should consider the findings of this report when formulating its budget and whilst determining its objectives and developing strategies to achieve those objectives.

# The Health and Social Care Interface

The National Audit Office has published a landscape review of key barriers to overcome to achieve greater integration in how care is provided.

## Issue

Despite the wide consensus of the need to change how health and social care services are delivered, there continue to be significant barriers to integration that have slowed progress of previous initiatives in England. The NAO has drawn together findings from across its previous work in *"The Health and Social Care Interface"*, highlighting positive case studies but also the barriers that prevent integration and lead to gaps, duplication and wasted resources. The report is intended to inform the debate on the future of health and social care in England, ahead of green papers on funding adult social care and the 2019 Spending Review. As the Health and Social Care Partnership's in Scotland are still developing, this can also provide a useful reference point on good practice and barriers to avoid.

The report identifies 16 barriers, which we have reproduced below. Although many are familiar issues, they provide a summary of issues that should be considered as part of the ongoing development of the Health and Social Care Partnerships.

## Extract of findings from "The Health and Social Care Interface":

Financial challenges	Culture and structure	Strategic issues
Both the NHS and local government are under financial pressure, which can make closer working between them difficult. This could deter organisations in partnerships from seeking system-wide benefits that may be detrimental to them as individual organisations.	Traditional boundaries between the NHS and local government, and between individual organisations within these sectors, lead to services being managed and regulated at an organisational level.	Differences in national influence and status, as well as public misunderstanding of how social care is provided and funded, have contributed to social care not being as well represented as the NHS.
Short-term funding arrangements and uncertainty about future funding make it more difficult for health and social care organisations to plan effectively together.	The NHS and local government operate in very different ways, and can have a poor understanding of how the other side's decisions are made.	Organisations across a local system may have misaligned strategies, which can inhibit joint local planning.
Additional funding for health and social care has at times been used to address the immediate need to reduce service and financial pressures in the acute sector.	Complex governance arrangements are hindering decision-making within local health and social care systems. Problems with local leadership can destabilise or hold back efforts to improve working across health and local government.	Central government in the past has had unrealistic expectations of the pace at which the required change in working practices can progress.
Current accountability arrangements, set by legislation, emphasise the need for individual organisations to balance their books.	The geographical areas over which health and local government services are planned and delivered often do not align, which can make it difficult for the relevant organisations and their staff to come together to support person-centred care.	Progress to date has demonstrated that joining up health and social care can support a greater focus on preventative services and the wider determinants of health.
Different eligibility requirements for health and social care make it difficult to plan services around the needs of the individual.	Problems with sharing data across health and social care can prevent an individual's care from being coordinated smoothly.	
	New job roles and new ways of working could help to support person-centred care, but it is difficult to develop these because of the divide between the health and social care workforces.	

## Next steps

The Council will note many of these issues have been highlighted in prior audit reports and in the Audit Scotland national report released in November 2018. The Council, in partnership with NHS Shetland and the Integration Joint Board, needs to consider how these issues will be addressed as part of the development of the Partnerships.

# FRC areas of focus for 2018/19 Annual Reports

## Clear, concise, informative disclosures that are specific to your Council

In October 2018 the FRC sent a letter to the Audit Committee Chairs and Finance Directors of listed companies to outline the areas of reporting that the FRC would like companies to focus on for the 2018/19 reporting season, and to highlight changes in reporting requirements. It also published its annual review of corporate reporting and supporting technical findings. While not directly applicable to local government bodies, a number of the themes are relevant for consideration when drafting the Council's Annual Accounts, to take into account wider best practice. The key areas included in the publications are set out below.

### Critical judgements and estimates

Key judgements and estimates disclosures remain a key FRC focus area. The FRC expects to see:

- judgements other than those involving estimates and sources of estimation uncertainty shown separately;
- disclosure of sensitivity of carrying amounts to assumptions and estimates or the range of reasonably possible outcomes within the next year; and
- voluntary disclosure of longer-term estimation uncertainties distinguished from those required where the risk of material adjustment within the next year is significant.

### Brexit

The FRC encourages disclosures which distinguish between specific and direct challenges to a business model and broader economic uncertainties attached to Brexit. The FRC reminds entities that a comprehensive post-balance sheet review must be reflected in accounting and disclosure.

### New accounting standards on revenue and financial instruments

The FRC is encouraging entities to invest sufficient time to ensure:

- explanations of the impact of transitioning to IFRS 9 and IFRS 15 are comprehensive and linked to other relevant information, including the impact on performance metrics where comparatives are not restated;
- changes to policies are clearly described and explained;
- relevant assumptions, judgements and sources of estimation uncertainty are explained;
- performance obligations are identified and explained, with a focus on how they have been determined and timing of delivery to the customer;
- the extended scope of IFRS 9 impairment requirements is taken into account; and
- new disclosure requirements are properly and meaningfully addressed.

These areas are discussed further on pages 7 and 8 of this report.

### Strategic report

The strategic report remains a frequent area for FRC challenge. For the report to be fair, balanced and comprehensive, the FRC expects the narrative to explain significant amounts in the financial statements.

# UK exit from the EU

## Navigating uncertainty – key questions for the Audit Committee

Whilst nobody can predict the outcome of negotiations, we can be sure that Brexit will require all organisations to take some big decisions. As we have seen, some will require lengthy and complicated preparations, and we advise keeping track of the negotiations and thinking what this means for the Council sooner rather than later.



### Is the Council set up to navigate the change?

Have you assessed the impact of potential changes and identified key decision points?

Does your assessment include how Brexit could impact on your users, supply chain and people?

Have you defined the options there are to respond? e.g. scenario or contingency planning?

Are you monitoring developments and are you ready to act proportionately at the right time?

Are all the right people involved? Does this include discussion with key stakeholders?

Are channels of communication clear, both internally and externally, and have company spokespeople been fully briefed?



### Impact on internal planning, forecasting and strategy

Is management using forward-looking indicators such as forward bookings, contact conversion rates and supplier forward pricing?

Have cash reserves, financing requirements and longer-term viability all been assessed?

Have opportunities as well as risks been considered?



### Impact on internal and external audit

Should the scope and plan for internal audit be amended to include contingency planning, or testing key risk indicators?

Should internal audit be asked to perform work on longer term viability?

Is there an impact on critical accounting judgements and areas of estimation uncertainty that need to be discussed with the external auditor?



### Impact on external reporting

Will disclosures on principal risks and uncertainties need to be reconsidered now Article 50 has been triggered and be revisited based on the current status of negotiations?

Have you developed a plan for appropriately detailed disclosure in management commentary?

"We encourage companies to provide disclosure which distinguishes between the specific and direct challenges to their business model and operations from the broader economic uncertainties which may still attach to the UK's position when they report. Where there are particular threats, for example the possible effect of changes in import/export taxes or delays to their supply chain, we expect these to be clearly identified and for management to describe any actions they are taking, or have taken, to manage the potential impact. In some circumstances this may mean recognising or remeasuring certain items in the balance sheet.

The broad uncertainties that may still attach to Brexit when companies report will require disclosure of sufficient information to help users understand the degree of sensitivity of assets and liabilities to changes in management's assumptions."

(FRC Letter to CFOs and Audit Committee Chairs, October 2018)

# Appendix: New Accounting Standards

## IFRS 9 *Financial Instruments*

### In a nutshell

- In July 2014, the IASB published a final version of IFRS 9. This version supersedes all previous versions.
- IFRS 9 *Financial Instruments* will replace IAS 39 *Financial Instruments: Recognition and Measurement*, and has three main impacts:
  - *Classification and measurement* - introduces new approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. This classification determines how financial assets are accounted for in financial statements and, in particular, how they are measured on an ongoing basis.
  - *Amortised cost and impairment of financial assets* - introduces an "expected losses" impairment model where entities are required to account for expected credit losses from when financial instruments are first recognised.
  - *Hedge accounting* - introduces new general hedge accounting model that aligns the accounting treatment with risk management activities and allows for better reflection of the hedging activities in the financial statements.
- HM Treasury has adopted IFRS 9 from 2018/19 onward, with a number of interpretations and adaptations for the public sector, generally simplifying the requirements.
- The key practical change in IFRS 9 for most local government bodies is the introduction of a new approach to recognising impairments of debtors and other financial instruments.
  - The key change to IFRS 9 affecting the Council will be the movement from an incurred losses model for receivables to an expected credit losses (ECL) model. The move is intended to reflect that there is always a risk of late/non-payment when granting credit and that this should be reflected in the value of receivables upon recognition.
  - If the debt is later repaid in full, the ECL creditor can be reversed. ECL creditors should be set up on a portfolio rather than arrangement-by-arrangement basis.
  - A further change from IAS 39 to IFRS 9 will be that all financial assets are recognised as Fair Value through Profit or Loss, unless where there are specific business cases to designate alternative treatment.

### Effective date

The Standard has a mandatory effective date for annual periods beginning on or after 1 January 2018, with earlier application permitted.

HM Treasury have decided that on transition there will be no restatement of comparatives, and any impact of transition will be recognised as a reserves movement in 2018/19.

The 2018/19 accounting code requires bodies to disclose information in 2018/19 on the transition to IFRS 9.



Find out more on our UK Accounting Plus website  
[www.iasplus.com/en-gb](http://www.iasplus.com/en-gb)  
by following the links to Standards -> IFRS 9

### Potential impact on the Council

The Council is in a unique position whereby the implementation of this standard is anticipated to have a material impact on the accounts. This is due to the long-term investments held by the Council and the requirement under IFRS 9 for the Council to clear the Available for Sale Financial Instrument Reserve, which had a value of £108.464m as at 31 March 2018. Future movements in investment value will need to be processed through the Comprehensive Income & Expenditure Statement.

The Council needs to consider the impact on policies, processes, systems and people. This will include reviewing how entries are posted for impairment of assets. The Council will also need to calculate any adjustments that will be required as at 31 March 2018 for transition. We would suggest that the Audit Committee receive reporting from management on the implementation of the new standard, and we will report specifically on the findings from our audit work in this area.

# Appendix: New Accounting Standards

## IFRS 15 *Revenue from Contracts with Customers*

### In a nutshell

- IFRS 15 establishes a new framework for revenue recognition, replacing all existing standards and interpretations, and applies to effectively all contracts with customers with very limited exceptions. This provides a single, principles based five step model for revenue recognition. The five steps are as follows:



- IFRS 15 Introduces several new concepts, including:
  - Replacing existing distinction between provision of good and services with a single model for determining whether revenue should be recognised at a point in time or over time.
  - Contracts are split into 'performance obligations' by considering whether different elements are capable of being distinct and also whether they are distinct in the context of the particular contract.
  - A new approach to recognising variable consideration – amounts are initially constrained so that future significant revenue reversal is highly improbable.
- It also provides significantly more detailed guidance than existing standards in many areas, including dealing with contract modifications, and introduces new disclosure requirements.
- The local government accounting code (section 2.7) requires local government bodies to recognise income from contracts with service recipients in accordance with IFRS 15. Section 2.7 applies to a contract only if the counterparty to the contract is a 'service recipient'. The accounting code contains the following key definitions:
  - Service recipient** – A party that has contracted with a local government body to obtain goods or services that are an output of the body's normal operating activities in exchange for consideration
  - Contract** – An agreement between two or more parties that creates enforceable rights and obligations. They can be written, oral or implied.
- Section 2.7 requires bodies to recognise revenue from contracts with service recipients in accordance with the above 5 steps.

### Effective date

Periods commencing on or after 1 January 2018. HM Treasury has applied IFRS 15 for the Public Sector from 2018/19 onward.

HM Treasury have decided that on transition there will be no restatement of comparatives, and any impact of transition will be recognised as a reserves movement in 2018/19. This is reflected in the 2018/19 accounting code.



Find out more on our **UK Accounting Plus website** [www.iasplus.com/en-gb](http://www.iasplus.com/en-gb) by following the links to **Standards -> IFRS 15**

### Potential impact on the Council

The changes to IFRS 15 are unlikely to have a significant impact on the Council as local authority income transactions are not normally complex and do not normally involve substantial recognition or measurement issues. We would recommend that the Council review the impact of IFRS 15 in the year, including calculating any adjustments that will be required as at 31 March 2018 for transition. We would suggest that the Audit Committee receive reporting from management on the implementation of the new standard, and we will report specifically on the findings from our audit work in this area.



# Appendix: New Accounting Standards

## IFRS 16 *Leases*

### In a nutshell

- The new Standard supersedes IAS 17 *Leases* and its associated interpretative guidance.
- For lessees the distinction between operating and finance leases disappears.
- A lease conveys the right to control an identified asset for a period of time in exchange for consideration.
- The accounting for all leases is similar to finance lease accounting in IAS 17, which means all leases are recognised on the balance sheet (with some exceptions).
- The lease liability is measured at the present value of the future lease payments, using a lease term that includes periods covered by extension options if exercise is reasonably certain. Variable lease payments are only included in the liability if based on an index or rate.
- That right-of-use asset is initially measured at the amount of the lease liability, plus initial direct costs and adjustments for lease incentives, payments at or prior to commencement and dilapidations provisions.
- The right-of-use asset is subsequently accounted for by applying IAS 16 *Property, Plant and Equipment*, at cost less depreciation and impairment (unless it is an investment property that is fair valued or it belongs to a class of property, plant and equipment that is revalued).
- A lessee can elect to keep the following leases off-balance sheet and typically straight line the expense:
  - leases with a lease term of 12 months or less and containing no purchase option – this election is made by class of underlying asset; and
  - leases where the underlying asset has a low value when new, such as personal computers or small office furniture – this election is made on a lease-by-lease basis.
- Operating lease expenses, typically straight line, will be replaced with interest on the liability and depreciation of the asset, producing a front-loaded expense profile.
- Although any individual lease will have a front-loaded expense, portfolios of leases containing both new and mature leases may produce an overall expense profile similar to straight line expensing.
- HM Treasury has consulted across government and is considering specific interpretations and adaptations for consistency across the public sector, but which will follow the overall principles of IFRS 16.

### Effective date

Periods commencing on or after 1 January 2019. It was announced by CIPFA/LASAAC that implementation in the public sector will be delayed until 2020/21.



Find out more on our UK Accounting Plus website [www.iasplus.com/en-gb](http://www.iasplus.com/en-gb) by following the links to Standards -> IFRS 16

### Potential impact on the Council

CIPFA/LASAAC announced in 2018/19 that the implementation of IFRS 16 would be delayed until 2020/21. We would recommend that the Council review the impact of IFRS 16 during 2019/20, so that the impact can be understood and reflected in budgeting for 2020/21. Given the extensive nature of the Council's lease portfolio, a material impact is anticipated as operating leases are brought 'on balance sheet'. The complexities associated with the acquisition of Shetland Leasing and Property Developments Ltd and the issues identified in prior year audits with the operating lease register mean that preparation for implementation of this standard will require a substantial amount of management and staff time, and this needs to be factored in to 2019/20 work plans and budgeting.

We would suggest that the Audit Committee receive reporting in 2019/20 from management on the expected impact of the new standard, to support the disclosure in the financial statement on accounting standards not yet effective. We will report to the Committee on any observations on the Council's approach in 2018/19, and on findings from our audit work in 2019/20 onwards.



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## **Shetland Islands Council Pension Fund**

Planning report to the Audit Committee on the audit for the year ending  
31 March 2019

Issued 8 February 2019 for the meeting on 5 March 2019

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# Introduction

## The key messages in this report:

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

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

We have pleasure in presenting our draft planning report to the Audit Committee of Shetland Islands Council Pension Fund (the "Fund") for audit of the year ending 31 March 2019. We would like to draw your attention to the key messages of this draft audit plan:

<b>Fund changes</b>	<p>Following discussions with the Fund's finance team, we have not identified any significant changes to the Fund itself during the year, other than changes to sponsoring employer rates of contribution as outlined in the latest triennial valuation. We will continue to liaise with the finance team to identify any changes between the date of this report and the Fund's year end, and will update our audit plan accordingly should any occur.</p> <p>There have been no significant regulatory changes to the accounting of the Fund in the current year. The Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 ("the 2018/19 Code") applies in the current year.</p>
<b>Significant audit risk</b>	<p>We have identified management override of controls as our significant audit risk. Auditing standards require us to assume that management override of controls is an audit risk for all of our audits.</p> <p>Further details of this significant risk, including our proposed testing can be found on page 12.</p>
<b>Areas of audit focus</b>	<p>The following areas of audit focus have not been identified as significant risks, but will be considered as part of the audit:</p> <ol style="list-style-type: none"><li>1. Accuracy and timeliness of contributions payable to the Fund</li><li>2. Existence of investments</li></ol> <p>Further details of the areas of audit focus, including our proposed testing, are outlined on pages 13 and 14.</p>

# Introduction (continued)

## The key messages in this report (continued):

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### Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how the Fund is addressing these and report our conclusions in our annual report to the Members and Controller of Audit in September 2019. In particular, our work will focus on:

- **Financial sustainability** – we will monitor the Fund’s actions in respect of its medium and longer term financial plan to assess whether short term financial balance can be achieved, whether there is a long-term financial strategy and if the investments are in line with the 2014-2027 investment strategy.
- **Financial management** – we will review the budget and monitoring reports of the Fund during the year to assess whether financial management and budget setting is in line with good practice.
- **Governance and transparency** – from our review of the Fund’s Audit Committee papers and attendance at Audit Committee meetings, we will assess the effectiveness and scrutiny of governance arrangements. We will also share best practice examples, where it is deemed appropriate.
- **Value for money** – we will gain an understanding of the Fund’s self-evaluation arrangements to assess how it demonstrated value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.

### Our Commitment to Quality

We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience.

### Adding value

Our aim is to add value to the Fund through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Fund promote improved standards of governance, better management and decision making and more effective use of resources.

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Yours Faithfully,

**Pat Kenny**  
Audit Director

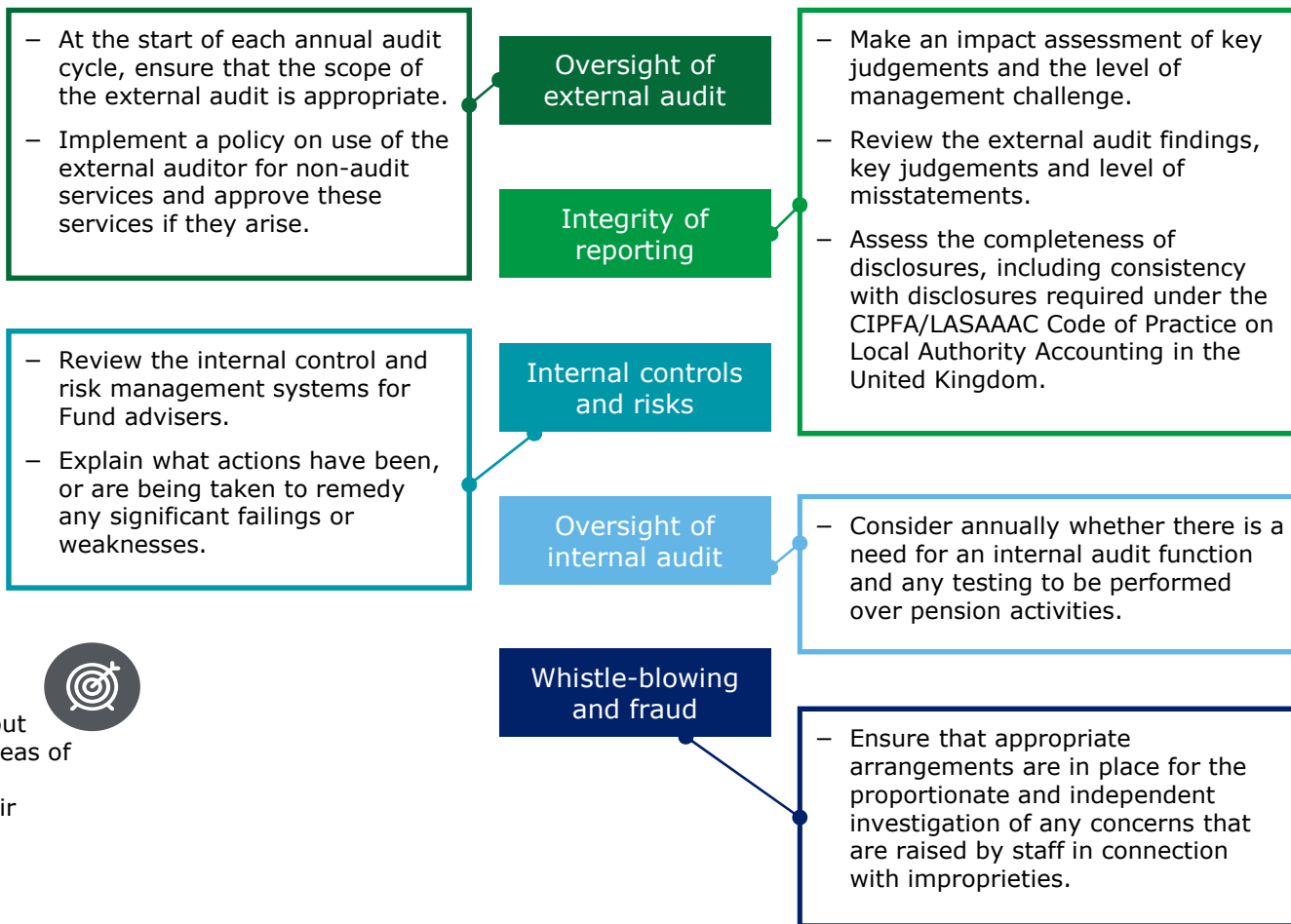
# Responsibilities of the Audit Committee

## Helping you fulfil your responsibilities

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

- Provide assurance over the financial statements;
- Provide timely observations arising from the audit that are significant and relevant to the Audit Committee's responsibility to oversee the financial reporting process; and
- In addition, we seek to provide the Audit Committee with additional information to help fulfil your 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.



We use this symbol throughout this document to highlight areas of our audit where the Audit Committee need to focus their attentions.

# Our audit explained

## We tailor our audit to your Fund and your strategy

### Identify changes in your Fund and environment

We have not identified any significant changes to the Fund during the year, with the exception of changes to the sponsoring employer rates of contribution as outlined in the latest triennial valuation. The 2018/19 Code is applicable in the current year.

### Scoping

We have performed our initial scoping based on current requirements and Audit Scotland planning guidance. More details are given on page 8.

### In our final report

In our final report to you we will conclude on the significant risk and areas of audit focus identified in this paper, including how we have assessed them together with any misstatements or control observations identified.



### Determine materiality

Financial statement materiality will be based on 1% of net assets (2017/18: 1% of net assets or £4,602,000). We will report to you any misstatements above 5% of financial statement materiality (2017/18: 5% of financial statement materiality or £230,000). Further information around our materiality calculation can be found on page 7.

### Significant risk assessment

We have identified the significant audit risk and areas of audit focus in relation to the Fund, based on our knowledge of the Fund. More detail is given on pages 12 to 14. These risk areas are consistent with those identified in our prior year audit.

### Quality and Independence

We confirm all Deloitte network firms are independent of the Fund. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

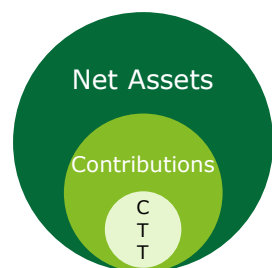


# Materiality

## Approach to materiality



### Basis of materiality - benchmark



We set materiality for our opinion on the financial statements at 1% (2017/18: 1%) of the Net Assets of the Fund and performance materiality at 90% of our materiality based on professional judgement, the requirements of auditing standards and the financial measures most relevant to the users of the financial statements.

As a reference our materiality and performance materiality for the 2017/18 Annual Report and Accounts was determined as £4,602,000 and £4,141,800 respectively.

We will update our materiality assessment following receipt of the draft 2018/19 financial statements and will communicate this to the Audit Committee in our final report.

### Reporting to the Audit Committee

We report to the Audit Committee any unadjusted misstatements greater than 5% of materiality ("reporting threshold") and other adjustments we consider to be qualitatively material. Based on the 2017/18 Annual Report and Accounts, we determined reporting threshold ("RT") to be £230,000.

Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £250,000.

We will report to you misstatements below this threshold if we consider them to be material in nature.

### Our audit report

The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.



Although materiality is the judgement of the Audit Director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

# Scope of work and approach

## Our key areas of responsibility under the Code of Audit Practice



### Core audit

Our core audit work as defined by Audit Scotland comprises:

- Providing the **Independent Auditor's Report** on the annual accounts;
- Providing the **annual report** on the audit addressed to the Pension Fund Audit Committee;
- Communicating **audit plans** to the Audit Committee;
- Providing **reports to management**, as appropriate, in respect of the auditor's responsibilities in the Code;
- Identifying **significant matters arising from the audit**, alert the Controller of Audit and support Audit Scotland in producing statutory reports as required; and
- Undertaking work requested by Audit Scotland or local performance audit work.

### Wider scope requirements

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland:

- **Financial sustainability** – looking forward to the medium and longer term to consider whether the Fund is planning effectively to continue to deliver its services or the way in which they should be delivered.
- **Financial management** – financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Governance and transparency** – the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.
- **Value for money** – using resources effectively and continually improving services.

# 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 will consider how the Fund addresses these areas, including any risks to their achievement, as part of our audit work as follows:

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Financial sustainability</b> looks forward to the medium and longer term to consider whether the Fund is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"> <li>• The financial planning systems in place across the shorter and longer terms.</li> <li>• The arrangements to address any identified funding gaps.</li> <li>• The affordability and effectiveness of funding and investment decisions made.</li> </ul>	<p>We will review arrangements and financial planning systems in place by the Fund regarding investments to ensure that its services can continue to be delivered. This will include a review of the latest actuarial valuation of the Fund and the plans in place to reduce the deficit over the shorter and medium term. In addition, we will review the funding policy as set out in the Shetland Islands Council Pension Fund Investment Strategy 2014-2027, which aims to secure the long term solvency of the Fund, so that there are sufficient funds available to meet all benefits as they fall due.</p> <p><b>Audit Risk:</b> The Fund's investment strategy is inconsistent with the long term solvency of the Fund.</p>
<p><b>Financial management</b> is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<ul style="list-style-type: none"> <li>• Systems of internal control.</li> <li>• Budgetary control system.</li> <li>• Financial capacity and skills.</li> <li>• Arrangements for the prevention and detection of fraud.</li> </ul>	<p>We will review the budget and monitoring reporting by the Fund during the year to assess whether financial management and budget setting is in line with good practice.</p> <p>In addition, we will also review whether 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.</p> <p><b>Audit Risk:</b> The underlying financial performance of the Fund is not transparently reported.</p> <p>Our fraud responsibilities and representations are detailed on pages 19 and 20.</p>

# Wider Scope Requirements (continued)










## Audit Dimensions (continued)

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. We will consider how the Fund addresses these areas, including any risks to their achievement, as part of our audit work as follows:

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Governance and transparency</b> is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<ul style="list-style-type: none"> <li>• Governance arrangements.</li> <li>• Scrutiny, challenge and transparency on decision making and financial and performance reports.</li> <li>• Quality and timeliness of financial and performance reporting.</li> </ul>	<p>We will review the Fund's papers and use our attendance at Audit Committee meetings to assess the effectiveness and scrutiny of governance arrangements.</p> <p>We will also review other aspects of governance around the Fund including Codes of Conduct for officers and members, fraud and corruption arrangements for reporting regulatory breaches to the Pensions Regulator.</p> <p>In addition, we will review the Annual Governance Statement and Governance Compliance Statement to confirm the governance arrangements observe the guidance issues by Scottish Ministers.</p> <p><b>Audit Risk:</b> The Fund's approach is not keeping pace with good practice.</p>
<p><b>Value for money</b> is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> <li>• Value for money in the use of resources.</li> <li>• Link between money spent and outputs and the outcomes delivered.</li> <li>• Improvement of outcomes.</li> <li>• Focus and pace of improvement.</li> </ul>	<p>We will gain an understanding of the Fund'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.</p> <p>We will also review the scrutiny that is in place to challenge the Fund's investment managers on fees and performance.</p> <p><b>Audit Risk:</b> The Fund does not have sufficient scrutiny over the expenditure of the Fund.</p>

# Significant audit risk and areas of focus dashboard

We welcome the Audit Committee's input into this risk assessment to ensure that any new or emerging risks or focus areas are considered for inclusion as a significant audit risk or area of audit focus.

Risk	Material?	Fraud risk identified?	Planned approach to controls testing	Level of management judgement	Page no.
<b>Significant audit risk</b>					
<b>Management override of controls</b>			Design and implementation		12
<b>Areas of audit focus</b>					
Accuracy and timeliness of contributions payable to the Fund			Design and implementation		13
Existence of investments			Operating effectiveness		14



Moderate management judgement



Low management judgement

# Significant audit risk

## Management override of controls



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### **Risk identified**

In accordance with ISA 240 (UK) management override of controls is always a significant risk for financial statement audits. The primary risk areas surrounding the management override of internal controls are over the processing of journal entries and the key assumptions and estimates made by management.

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### **Deloitte response**

In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk:

#### **Journal testing**

- We will make enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- We will test 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;
- We will test 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 will perform an analysis of the journal entries, which will enable us to focus on journals meeting specific pre-determined parameters determined during our audit planning;
- We will test the design and implementation of controls surrounding the segregation of duties over processing journal entries to the financial statements throughout the year.

#### **Accounting estimates**

- We will test the design and implementation of controls over key accounting estimates and judgements.
- We will review the financial statements for any accounting estimates which could contain management bias, and assess the judgements taken against supporting evidence.

#### **Significant and unusual transactions**

- We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of the Fund's operations, or that otherwise appear to be unusual, given our understanding of the Fund and its environment.
  - We will make enquiries of management in relation to the identification of related parties.
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# Areas of audit focus

## Accuracy and timeliness of contributions



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### Risk identified

The correct deduction and timely payment of contributions depends on system-based processing of membership data and salary details, together with a robust internal controls framework. Errors in processing contributions can lead to issues such as non-compliance with the Local Government Pension Scheme Regulations 2014 (“LGPS Regulations”) and the recommendations of the actuary. Deducting incorrect amounts from the active members’ payroll can be costly to rectify and cause reputational damage.

In addition, while no opinion is issued on the timely payment of contributions, it remains an area of focus, as LGPS Regulations stipulate due dates for payment. Late payments could cause reputational damage.

Due to the changes in employer primary contribution rates in the current year, there is a risk that contributions are not paid to the Fund accurately or in a timely manner.

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### Deloitte response

In order to address this area of audit focus, we will perform the following audit procedures:

- Review the design and implementation of key controls over the contribution process;
- Perform an analytical review of the employer and employee 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 will recalculate individual contribution deductions to ensure these are being calculated in accordance with the rates stipulated in the LGPS Regulations for employee contributions and the recommendations of the actuary for employer contributions;
- Test that the correct definition of pensionable salary is being used per the LGPS Regulations to calculate contribution deductions;
- Test the reconciliation of the total number of active members between the membership records and the employer payroll records; and
- For a sample of monthly contributions paid, check that they have been paid within the due dates per the LGPS Regulations.

# Areas of audit focus (continued)

## Valuation and existence of investments



<b>Risk identified</b>	<p>There is a risk that investments do not exist or are not valued accurately in the Fund's financial statements due to the potential levels of judgement involved in pricing such investments.</p> <p>The Fund holds investments primarily in pooled funds, pooled property unit trusts and fixed income unit trusts with a range of investment managers.</p>
<b>Deloitte response</b>	<p>In order to address this area of audit focus, we will perform the following audit procedures:</p> <ul style="list-style-type: none"><li>• Review the design and implementation and operating effectiveness of key controls over the valuation of investments by obtaining the investment manager internal controls reports and evaluating the implications for our audit of any exceptions noted;</li><li>• Independently request confirmations from all investment managers for balances held per the financial statements;</li><li>• Agree year end valuations, sales proceeds and purchases in the financial statements to the reports received directly from the investment managers;</li><li>• Perform a full unit reconciliation of investments held during the year;</li><li>• Agree a sample of investment sales and purchases to cash movements and/or transfers between funds where possible.</li><li>• Perform valuation testing by using a range of techniques depending on the type of investment:<ul style="list-style-type: none"><li>• Where the investment held is directly quoted on an exchange, we will obtain an independent price of the investment asset using our own internal pricing systems e.g. Bloomberg.</li><li>• Where the investment is not directly quoted on an exchange, we will confirm if it is registered on the Financial Conduct Authority website and obtain an independent price, or use sales transactions close to the year end as an estimate of the price.</li><li>• Where the investment is a unit linked insurance policy, we will confirm that the investment is held under the form of a unit linked insurance policy, that the insurance provider is authorised to provide insurance services and obtain confirmation that the provider would be willing to transact at the unit price stated on the confirmation received.</li><li>• Where none of these options are available we will obtain audited financial statements and assess the year end price against the audited accounts, and benchmark movements where the date of the audited financial statements is not coterminous with the Fund's financial year.</li></ul></li></ul>



# Audit quality

## Our commitment to audit quality

We set out below a summary of our commitments to both the Audit Committee and Fund management in key areas and we will actively seek feedback on how we have performed against them.



### AUDIT QUALITY PROMISE

The quality and distinctiveness of our audit delivery is of great importance to us.

**Key aspects of this delivery are:**

- how we ensure that the team is delivering the best quality audit at every level;
- how we continue to be insightful; and
- how we use technology to improve the quality of our audit and the insight we bring to you.



### INSIGHT

We will continue to use specialists in the audit of areas of audit interest. Our audit procedures and use of technology are designed to provide the Audit Committee with an insightful audit.

We will report our insights and results of the testing performed to the Audit Committee in our final paper following the completion of the audit.



### CULTURAL FIT

**We commit to:**

- giving you the best team with the right mix of industry knowledge and experience - the audit team consists of pension audit specialists, led by Pat Kenny (audit Director) and Graeme McCrum (Pensions accredited Director) with over 20 years of experience in the pensions industry;
- Pat is committed to meeting with the Audit Committee on a regular basis; and
- embedding Specialists into the audit team in order to provide you with the best advice in a timely manner and constructive audit challenge.



### PROFESSIONAL STANDARDS REVIEW

Our dedicated Professional Standards Review ("PSR") function will provide a 'hot' review before any audit or other opinion is signed.

PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.

# 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 establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope;
- Key regulatory and corporate governance updates, relevant to you.

### What we don't report

As you will be aware, our audit is 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, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

### Other relevant communications

We will update you if there are any significant changes to the audit plan.

This report has been prepared for the 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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

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



**Pat Kenny, CPFA**

for and on behalf of Deloitte LLP

Glasgow

8 February 2019

# Appendices



# Prior year audit adjustments

## Uncorrected and disclosure misstatements

We identified the following uncorrected and disclosure misstatements from our prior year audit work.

	Debit/ (credit) in Fund Account £'000	Debit/ (credit) in net assets £'000	If applicable, control deficiency identified
<b>Uncorrected misstatements</b>			
None			
<b>Corrected misstatements</b>			
None			
<b>Total</b>			

### Disclosure misstatements

[1] The Schroder Liquidity Fund was disclosed under Cash income due in note 11a of the financial statements. As this is a Pooled Investment Vehicle, it should have been disclosed under that heading. The result of the current classification is that £973,000 of sales were not presented in note 11a.

# Fraud responsibilities and representations

## Responsibilities explained



### **Your 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.



### **Our responsibilities:**

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- 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.
- As set out in the significant risks section of this document, we have identified the risk of management override of controls as a key 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 auditors – 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 Fund:**

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control 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 that affects the 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 entity's financial statements communicated by employees, former employees, analysts, regulators or others.

# Fraud responsibilities and representations

## Inquiries

We will make the following inquiries regarding fraud:



### **Management**

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.



### **Internal audit and local counter fraud specialist**

- Whether internal audit and the Fund's local counter fraud specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain their views about the risks of fraud.



### **Those charged with governance**

- How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.

# Independence and fees

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

Independence confirmation	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Fund and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2019 in our final report to the Audit Committee.
Fees	<p>The fee for the 2018/19 audit has been agreed as £29,100 (2017/18: £29,486).</p> <p>There are no non-audit services fees proposed for the period.</p>
Non-audit services	In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Fund'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 have no other relationships with the Fund, the Audit Committee, or management, and have not supplied any services to other known connected parties.





# Our approach to quality

## AQR team report and findings

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2018 the Financial Reporting Council ("FRC") issued individual reports on each of the eight largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2017/18 cycle of reviews.

We take the findings of the AQR seriously and we listen carefully to the views of the AQR and other external audit inspectors. We remediate every finding regardless of its significance and seek to take immediate and effective actions, not just on the individual audits selected but across our entire audit portfolio. We are committed to continuously improving all aspects of audit quality in order to provide consistently high quality audits that underpin the stability of our capital markets.

We have improved the speed by which we communicate potential audit findings, arising from the AQR inspections and our own internal reviews to a wider population, however, we need to do more to ensure these actions are embedded. In order to achieve this we have launched a more detailed risk identification process and our InFlight review programme. This programme is aimed at having a greater impact on the quality of the audit before the audit report is signed. Consistent achievement of quality improvements is our aim as we move towards the AQR's 90% benchmark.

All the AQR public reports are available on its website. <https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

### The AQR's 2017/18 Audit Quality Inspection Report on Deloitte LLP

"The overall results of our reviews of the firm's audits show that 76% were assessed as requiring no more than limited improvements, compared with 78% in 2016/17. Of the FTSE 350 audits we reviewed this year, we assessed 79% as achieving this standard compared with 82% in 2016/17. We are concerned at the lack of improvement in inspection results. The FRC's target is that at least 90% of these audits should meet this standard by 2018/19."

"Where we identified concerns in our inspections, they related principally to aspects of group audit work, audit work on estimates and financial models, and audit work on provisions and contingencies. During the year, the firm has continued to develop the use of "centres of excellence", increasing the involvement of the firm's specialists in key areas of the audit. We have no significant issues to report this year in most of the areas we reported on last year."

"The firm has revised its policies and procedures in response to the revised Ethical and Auditing Standards. We have identified some examples of good practice, as well as certain areas for improvement."

#### The firm has enhanced its policies and procedures in the following areas:

- Increased use of centres of excellence ("CoE") involving the firm's specialists, including new CoEs focusing on goodwill impairment (established in response to previous inspection findings) and corporate reporting, to address increasing complexity of financial reporting.
- Further methodology updates and additional guidance issued to the audit practice including the audit approach to pension balances, internal controls, data analytics, group audits and taxation.
- A new staff performance and development system was implemented with additional focus on regular timely feedback on performance, including audit quality.
- Further improvements to the depth and timeliness of root cause analysis on internal and external inspection findings.

#### Our key findings in the current year requiring action by the firm:

- Improve the group audit team's oversight and challenge of component auditors.
- Improve the extent of challenge of management's forecasts and the testing of the integrity of financial models supporting key valuations and estimates.
- Strengthen the firm's audit of provisions and contingencies.

#### Review of firm-wide procedures. The firm should:

- Enhance certain aspects of its independence systems and procedures.





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