Special Audit Committee
Council Chamber, Town Hall, Lerwick
Wednesday 25 September 2019 at 10am

Present:

A Duncan	C Hughson
S Leask	R McGregor
I Scott	C Smith

Apologies:

J Fraser	A Manson

Also:

S Coutts	E Macdonald

In attendance (Officers):
C Ferguson, Director of Corporate Services
J Manson, Executive Manager – Finance
J Riise, Executive Manager – Governance and Law
R Sinclair, Executive Manager – Assets, Commissioning and Procurement
D Black, Chief Internal Auditor
C Anderson, Senior Communications Officer
K Collins, Financial Accountant
E Cripps, Internal Auditor
J Johnson, Senior Assistant Accountant
M Forrester, Senior Assistant Accountant
R McNeillie, Internal Auditor
M Mullay, Performance and Improvement Officer
L Geddes, Committee Officer

Also:
P Kenny, Deloitte
D Peuters, Deloitte *(by telephone)*

Chairperson
Mr Duncan, Chair of the Committee, presided.

Circular
The circular calling the meeting was held as read.

Declarations of Interest
Mr Duncan declared an interest in Agenda Item 2 “Annual Audit Report on the 2018/19 Audit – Shetland Islands Council Pension Fund” due to a family interest, and advised that he would vacate the chair and leave the room during the discussion.

09/19 **Annual Audit Report on the 2018/19 Audit for Shetland Islands Council and the Zetland Educational Trust**

The Committee considered a report by the Executive Manager – Finance (F-053-F) presenting the Annual Audit Report on the 2018/19 Audit for Shetland Islands Council and the Zetland Educational Trust (ZET).

The Executive Manager – Finance introduced the report, advising that there had been three minor changes to the accounts. Two of these changes reflected the recent resignation of Councillor Mark Burgess, and the other related to a change in the wording relating to the treatment of internal transactions.

With regard to the ZET, there had been no material changes to the unaudited accounts that had been considered by the Committee on 26 June. There had been some small disclosure corrections made to the Council's unaudited accounts - the accounting surplus had decreased by £2.71million and the net assets had decreased by £2.52million as a result of adjustments made. In addition to the recommendations made in the interim audit report, the External Auditor had made three further recommended improvements arising from the financial statements audit in relation to valuation of property assets, adoption of International Financial Reporting Standard 16, and review of financial statements. The External Auditor had confirmed an unmodified opinion, meaning that the accounts were free from material misstatement and presented a true and fair view of the Council's financial position.

He then introduced Mr Kenny, who outlined the key messages in the final report. The audit dimensions had included financial sustainability, financial management, governance and transparency, and value for money, and the detailed report presented in June had covered these elements in detail. The main conclusions were outlined in this report, and three significant risks had been identified in relation to recognition of grant income, valuation of property assets, and management override of controls. No instances had been identified in respect of the latter. The recognition of grant income related to a disclosure misstatement, and the income had been correctly recognised in the Comprehensive Income and Expenditure Statement. With regard to the valuation of property assets, the Shetland Leasing and Property Developments Limited (SLAP) transaction had been looked at in more detail. He was pleased to confirm a strong opinion that there had been a strong business case to support this. It should derive significant benefits to the Council in the medium to long term, and would be monitored to ensure that the benefits were realised. However there were some lessons to be learned in respect of due diligence, and he was pleased to note that the Council planned to have a full debrief. The action plan pertaining to recommendations for improvement was outlined in the report, and its implementation would be monitored going forward.

Responding to a question, Mr Kenny confirmed that the audit and the report had been carried out and prepared by a team of people, subject to review by himself and senior managers.

Some discussion took place with regard to the valuation of SLAP, and the Executive Manager – Finance advised that it was not possible to speculate whether or not Shetland Charitable Trust (SCT) would have accepted a lower price for SLAP, but there had been lengthy discussions in the lead up to the purchase. The report outlined Deloitte's view of the valuation, but he was assured that the Council had carried out due diligence in respect of the transaction and had been comfortable to proceed at that price.

It was questioned if a lower price could have been paid if the Council had undertaken an independent evaluation prior to the acquisition.

Mr Kenny advised that the art of property valuation was not perfect, and it would be very difficult to speculate what figure an independent valuer may have derived. However the Council's methodology was not one Deloitte would have used, based on advice from its own valuation experts. While the report stated the opinion that the price could have been up to £1.55million less, it was not possible to predict what conclusions an independent valuer would have come up with at the time, and there were a lot of forces that could apply in terms of valuation. While it was felt that the methodology had not been appropriate, it was not possible to come to a definite opinion in terms of the potential impact on the price. However there would have been merit in getting an independent valuation and, going forward, this would be a major lesson learned if the Council was ever to undertake a similar transaction.

The Director – Corporate Services advised that the approach undertaken by the Council was consistent with the approach that it used across its whole portfolio.

The Executive Manager – Assets, Commissioning and Improvement added that an independent valuation had been carried out a couple of years before the sale, and the Council either had to agree or not agree with that valuation. Commercial valuations were an extremely complex area of work – they were impacted by the purposes for which the valuation was being carried out, and the instruction and information given to the valuer. The issue here was that the value of assets and the value of the company were not necessarily the same thing.

Responding to questions regarding the Council's financial sustainability, Mr Kenny advised that the funding gap was fairly significant, based on current financial projections. It was also optimistic, based on the assumptions used. To rectify the funding gap over the medium term, the Council would have to prioritise and progress its transformation programme and other initiatives and proposals. It was something the auditors would continue to monitor, and he would expect the Council to update its financial strategy and base it on an up-to-date assessment of projections. It would be prudent for the Council develop its transformation programme to bridge the gap between the best and worst case scenarios.

The Executive Manager – Finance added that the Council would be presenting an updated medium-term financial plan in November. It would take account of everything that had changed, including external factors that the Council was not in control of. A longer term financial plan would be presented in March. The service redesign programme intended to bridge the funding gap, but it would require more work.

He went on to confirm that it was considered that a £3.5million draw on reserves in the medium-term financial plan was considered unsustainable. There was a limit around what could be drawn from reserves as they had to be protected to generate returns. The Council's investments were not guaranteed to generate a 7.3% return every year, but they were expected to generate that over the longer term. It had not been possible to balance the budget last year without dipping into reserves. There was a gap between how much the Council spent and how much services cost, and these costs were always increasing. The Council would need to bring spending more into line with what it could afford.

It was noted that it was stated that training should be provided to the finance function following recent changes in key financial posts, and it was questioned what this related to.

The Director of Corporate Services advised that all staff had to complete a full induction programme and a personal development plan. She was entirely comfortable that staff in the finance function were more than capable of doing their jobs, and their personal development plans were up-to-date. Changes in key posts in local authorities were nothing new.

Responding to questions, the Executive Manager – Finance advised that he accepted the findings of the external auditors. The report was not a negative one, and it contained very positive messages, There were a number of improvements that could be made to the process, and a response had been prepared and plans were being put in place to set the Council in the right direction.

He also confirmed that there was some crossover between the work of the internal auditors and the external auditors. However the Council's internal audit team did not have too much input into this report as it pertained to the work of external auditors who took an independent view.

Mr Black added that the internal audit plan was intended to provide assurance to stakeholders about the adequacy of the internal control environment, and the external auditors would have an interest in the overall opinion of that. The internal audit team carried out specific audits and undertook testing and controls, and the external auditors were able to use information about this work in specific areas.

It was questioned what the auditors would consider to be "lower-priority areas", as referred to in the "Value for Money" section in the key messages of the report.

Mr Kenny explained that given the restraints on local authority finances, Councils had to acknowledge they could not be above average in all service performance areas. Some local authorities were to be congratulated for having robust discussions about service priorities and how better to achieve them. One way of doing this would be to disinvest in services that were considered to be of lower priority. For example, one Council that was above average in roads maintenance had made a decision to bring performance down to average, and had used the funding to invest in priority areas.

In response to a query as to whether external impacts on Councils were taken into consideration, he went on to explain that auditors had to consider how the Council was performing within the constraints of the current financial envelope. However there was cognisance of external impacts.

It was questioned what stage the Council was at in developing its community empowerment arrangements, and the Executive Manager – Finance explained that the Council had identified its intentions in the report, and an update would be provided at the next meeting in November

During the discussion that followed, it was commented that the purchase of SLAP should be considered as a first-class deal that would benefit the people of Shetland, and that officers should be congratulated for getting SLAP within the Council's portfolio. The auditors had commented on the robustness of the business case and the longer-term benefits, and it could not be ascertained whether SCT would have accepted a lower price.

However concerns were also expressed about the short timescale and the way in which the purchase had been carried out, which could mean that the Council had spent £1.55million of public money on the purchase that could have instead been spent on public services. The difference in opinion on the price could have been resolved by having an independent valuation prior to purchase.

Concern was also expressed at the potential future funding gap, and the Chair commented that if the Scottish Government fulfilled its promise of full and fair ferry funding, this would reduce the gap and mean that the Council would not have to use its reserves. He went on to pay tribute to members and officers for the work they had carried out to date, but commented that there was more to be done to ensure that the Scottish Government fulfilled its obligations and did not treat Shetland differently to the other island groups in respect of lifeline ferry services.

Mr C Smith moved that the Committee approve the recommendations in the report, with the addition that a report detailing the timeframe for the Action Plan be presented within two cycles.

Mrs Hughson seconded.

Decision:

The Audit Committee:

- NOTED the findings of the 2018/19 audit as contained in the external auditor's annual report at Appendix 1
- NOTED the Action Plan as outlined in the Annual Report, and requested that a report detailing the timeframe be presented within two cycles
- CONSIDERED the verbal report by the external auditor
- CONSIDERED the audited Annual Accounts for 2018/19 (Appendix 2) for Shetland Islands Council
- CONSIDERED the audited Annual Accounts for 2018/19 (Appendix 3) for Zetland Educational Trust

(Mr Duncan vacated the Chair and left the meeting, and Mrs Hughson assumed the Chair)

10/19 **Annual Audit Report on the 2018/19 Audit – Shetland Islands Council Pension Fund**

The Committee considered a report by the Executive Manager – Finance (F-053-F) which presented the Annual Audit Report on the 2018/19 Audit for Shetland Islands Council Pension Fund.

The Executive Manager – Finance introduced the report and advised that there had been no material misstatements or errors identified since the unaudited accounts had been presented in June. The Pension Fund did not escape from the wider scope of the audit, and he was pleased to report that there were no additional concerns arising from this aspect of the audit.

He then introduced Ms Peuters who highlighted the significant risk – management override of controls – and the two areas of audit focus that were considered – completeness of investments and accuracy and timeliness of contributions. Management override of controls was a presumed significant risk for audits, and there were no issues arising from the testing performed. No significant issues had been identified in respect of completeness of investments, and a recommendation from the previous year had been adopted. There had been one issue identified with regard to accuracy and timeliness of contributions, and it was recommended that a monthly control was put in place so that contributions were amended accordingly for unauthorised sick leave. No significant deficiencies had been identified in respect of the wider audit dimensions, and no misstatements or disclosure deficiencies had been identified from the audit work to date. With regard to the outstanding items, it was now just the receipt of management representations letter that still required to be completed.

The Chair congratulated staff on the positive report received.

Decision:

The Audit Committee:

- NOTED the findings of the 2018/19 audit as contained in the External Auditor's annual report at Appendix 1

- CONSIDERED the verbal report by the External Auditor

- CONSIDERED the audited Annual Accounts for 2018/19 (Appendix 2) for Shetland Islands Council Pension Fund

(Mr Duncan returned to the meeting and assumed the Chair)

11/19 **Audit Scotland and other External Audit Reports**

The Committee considered a report by the Executive Manager – Assets, Commissioning and Procurement (APC-07-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, and to monitor compliance with the external advisors reports reporting policy and procedures.

The Executive Manager – Assets, Commissioning and Procurement summarised the main terms of the report, advising that in respect of EA194 Audit Scotland – Social Work in Scotland Impact Report, the report referred to had now been presented to the Employees' JCC.

The Chair requested that a briefing note be issued to Members to update them in respect of EA186 Care Inspectorate – Walter and Joan Gray (Care Home), and that a report be presented to the Committee at a later stage.

Decision:

The Audit Committee NOTED the report.

The meeting concluded at 11.15am.

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Chair