Shetland Islands Council

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Date: 12 September 2018

Dear Sir/Madam

You are invited to the following meeting:

Special Shetland Islands Council
Council Chamber, Town Hall, Lerwick
Wednesday 19 September 2018 at 2.00pm

Apologies for absence should be notified to Leisel Malcolmson at the above number.

(Please note the time of this meeting)

Yours faithfully

Executive Manager – Governance and Law

Convener: M Bell
Depute Convener: B Wishart

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.

1. Annual Audit Report on the 2017/18 Audit – Shetland Islands Council and Zetland Educational Trust
F-072

	Shetland Islands Council	Agenda Item **1**

Meeting(s):	Audit Committee Shetland Islands Council	19 September 2018 19 September 2018
Report Title:	Annual Audit Report on the 2017/18 Audit – Shetland Islands Council and Zetland Educational Trust	
Reference Number:	F-072-F	
Author / Job Title:	Executive Manager - Finance	

1.0 Decisions / Action required:

1.1 That the Audit Committee:

a) NOTES the findings of the 2017/18 audit as contained in the external auditor's annual report at Appendix 1;

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

c) CONSIDERS a verbal report by the external auditor;

d) CONSIDERS the audited Annual Accounts for 2017/18 (Appendix 2) for Shetland Islands Council;

e) CONSIDERS the audited Annual Accounts for 2017/18 (Appendix 3) for Zetland Educational Trust; and

1.2 That Shetland Islands Council RESOLVES to:

a) NOTE the findings of the 2017/18 audit as contained in the external auditor's Annual Report at Appendix 1;

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

c) APPROVE the audited Annual Accounts for 2017/18 (Appendix 2) for Shetland Islands Council for signature; and

d) APPROVE the audited Annual Accounts for 2017/18 (Appendix 3) for Zetland Educational Trust for signature.

2.0 High Level Summary:

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

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

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

- results of work on key audit judgements;
- the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures;
- the auditor's internal control observations; and
- other matters which in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

2.4 Deloitte LLP's ISA260 findings are included in the Annual Audit Report at Appendix 1 and confirms their unmodified opinion, which means that the annual accounts are free from material misstatement and present a true and fair view of the Council's financial position at 31 March 2018.

2.5 The unaudited accounts for the year to 31 March 2018 were approved by Council on 27 June 2018 and there is no change to the accounting deficit in the audited annual accounts. Net assets in the balance sheet have changed by £0.55m as explained on page 53 of Appendix 1.

2.6 Deloitte LLP's Annual Audit Report (Appendix 1) includes an Action Plan relating to high and moderate level risks identified during the course of the audit; these are noted in paragraph 4.5 below.

2.7 The Annual Audit Report (page 14) also includes findings in relation to the audit of the Trustees' Annual Report and Financial Statements of Zetland Educational Trust. No issues were identified and no adjustments made to the unaudited statements.

3.0 Corporate Priorities and Joint Working:

3.1 The preparation and presentation of the annual accounts is a key element of the Council's overall governance and reporting arrangements.

4.0 Key Issues:

4.1 The Council's accounts for the year to 31 March 2018 were submitted to Deloitte LLP by the statutory deadline of 30 June 2018. The external auditor was required to complete the audit by 30 September 2018 and to report on certain matters arising to those charged with governance.

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

a) Recognition of grant income;

b) Valuation of property assets; and

c) Management override of controls.

4.3 Pages 9 to 12 of the report at Appendix 1 presents how, in each of these areas, the result of the audit control testing was satisfactory.

4.4 Two immaterial misstatements were discovered and corrected during the audit, as detailed on page 53 of Appendix 1. The first (£0.19m) related to the valuation method used to arrive at land values in the Balance Sheet. The second (£0.36m) involved a change to the treatment of debtors and creditors where the other party is the Zetland Transport Partnership or Shetland Islands Integration Joint Board..

4.5 Deloitte LLP present an agreed Action Plan at page 54 of Appendix 1, showing recommended improvements in certain Council processes for governance, compliance and efficiency purposes. An explanation of the recommendation, along with the Council's responses can be found here. The following are those identified as High Priority recommendations:

- Valuation of property assets;
- Workforce planning;
- Savings target;
- Transformation programme;
- Local government benchmarking;
- Long-term financial planning;
- Health and Social Care integration;
- Budget setting; and
- Performance reporting.

4.6 The progress of recommendations identified in the 2016/17 Action Plan are also noted in the Annual Audit Report. There are six items, three of which are fully implemented and three that are partially implemented. Details can be found at page 62 of Appendix 1.

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

- **Financial sustainability:** The planned use of reserves to fund services and investments will be sustainable in the short term, however, going forward the Council should ensure that such an approach is taken only where the level of reserves can continue to be maintained.
- **Financial management:** We are satisfied the Council has strong budget setting and financial monitoring arrangements which are robust enough to sufficiently manage financial activity and capture and address any challenges to the achievement of financial targets. However, we note there is limited reporting in the year of performance against savings targets in the year and recommend that improvements be made in this regard.
- **Governance and transparency:** We are satisfied that there are appropriate systems of internal control in place and no significant weaknesses have been identified. The Council has robust governance arrangements in place. However, there is room for improvement in the reporting calendar, rationalisation of the Committee structure and the presentation of performance monitoring reports to Committees. We further recommend that the Council align its strategic priorities with those of the Partnership Plan when preparing an updated Council Plan.

- **Value for money:** There is a clear framework in place to ensure that Council performance is monitored and reported. We consider that more work could be done to evidence the link between spend and outcomes delivered at both a Council and Partnership level.

5.0 Exempt and/or confidential information:

5.1 None.

6.0 Implications :

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

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

Contact Details:
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christine.mccourt@shetland.gov.uk
19 September 2018

Appendices:
Appendix 1: Annual Audit Report 2017/18 for Shetland Islands Council (incorporating the Zetland Educational Trust)
Appendix 2: Audited Annual Accounts 2017/18 for Shetland Islands Council
Appendix 3: Audited Trustee's Annual Report and Financial Statements 2017/18 for the Zetland Educational Trust

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

Shetland Islands Council

Report to the Audit Committee, Members of the Council and the Controller of Audit on the 2017/18 audit

Issued on 4 September 2018 for the meeting on 19 September 2018

Contents

Introduction

The key messages in this report

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

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

I have pleasure in presenting our final report to the Audit Committee and Council for the 2018 audit. The scope of our audit was set out within our planning report presented to the Audit Committee in February 2018.

This report summarises our findings and conclusions in relation to:

- The audit of the **financial statements**; and
- Consideration of the **four audit dimensions** that frame the wider scope of public sector audit requirements as illustrated in the following diagram. This includes our consideration of Best Value and the five Strategic Audit Priorities agreed by the Accounts Commission.

Introduction (continued)

The key messages in this report – financial statements audit

I would like to draw your attention to the key messages of this paper in relation to the audit of the financial statements:

Conclusions from our testing

- The significant risks, as identified in our audit plan, related to:
  - Recognition of grant income (page 10);
  - valuation of property assets (page 12); and
  - management override of controls (page 11).
- We have identified two internal control issues regarding financial reporting and the valuation of property assets, discussed on page 15. We are satisfied that these issues have already been addressed in 2018/19 and did not materially impact the annual accounts.
- We have identified two audit adjustments from our procedures to date, both of which have been corrected by management. This is detailed in the appendices at page 53.
- The management commentary and annual governance statement comply with the statutory guidance and proper practice and are consistent with the financial statements and our knowledge of the Council. A number of recommendations to bring the annual accounts more in line with good practice have been made at page 20.
- The auditable parts of the remuneration report have been prepared in accordance with the relevant regulation.
- Based on our audit work, we expect to issue an unmodified audit opinion.
- Our audit of Zetland Educational Trust is also complete, with an unmodified audit opinion, as discussed further on page 14.

Insights

- We have utilised Spotlight, Deloitte's patented analytics tool, to perform analytics on the journal entries posted in the year to profile the journal population which has helped us identify journals of audit interest, such as journals posted on non-business days or journals with key words. Comments from review of journals are included on page 16.
- Given the increasing importance of social media, we have included some insights from analysis of the Council's Twitter account on page 17.
- We have raised several insights for areas where improvements could be made to the Council's operations, detailed on pages 54 - 63.

Status of the audit

- The audit is substantially complete subject to the completion of the following principal matters:
  - Finalisation of our internal quality control procedures;
  - receipt of legal confirmation;
  - Submission of auditor return to Audit Scotland;
  - receipt of signed management representation letter; and
  - our review of events since 31 March 2018.

Introduction (continued)

The key messages in this report – audit dimensions

The following two pages set out the key messages of this paper in relation to the four audit dimensions:

Financial sustainability

The Council has achieved significant savings in the previous 5 years, as shown in the summary below. It has recognised that if it continues with current service levels and delivery models, there would be a funding gap over the next 5 years. The Business Transformation Strategy (2016-20), will require the Council to make major changes to the way it provides services in order to achieve the required savings. The programme is not currently at a sufficiently advanced and robust stage to deliver the required savings and the Council needs to redouble its efforts in this regard in the coming year.

2017/18 final outturn position reported an underspend against budget of **£8.57m (7.6%).** This included **£8.6m** use of revenue and capital reserves.	**At 31 March 2018, the Council held £39.81m of non earmarked reserves** (**32.3%** of net expenditure), which comprises the General Fund and the Equalisation Fund. This is significantly above the minimum recommended threshold (**2-4%**) due to the level of investments held by the Council arising from historic oil income.	A **balanced budget for 2018/19** was approved in February 2018. This included **£11.73m** use of reserves.	The Council achieved in excess of **£40 million** of **savings** during the period **2011-2017** by reducing costs across a number of areas at the same time as improving the delivery of services.	The Council's Medium Term Financial Plan estimates a **funding gap of £15.6m by 2023/24 with a cumulative funding gap to 2023/24 of £40.8m**.

Financial management

The Council has effective internal control systems, financial planning and management arrangements in place. However, improvements to the reporting calendar could be made to reduce the gap between the preparation of monitoring reports and their presentation to management and Committee to increase the relevance and timeliness of scrutiny.

The Council prepares medium and long-term financial plans and senior management and Councillors regularly review progress. Financial plans are linked to priorities and other strategic developments. The Council's spending is clearly linked to its priorities but it could improve how it shows that the spending makes a difference to these areas. The Council also needs to clearly report how it is performing against savings targets in year to enable scrutiny from Members.

We are satisfied that there is sufficient capacity and skill within the Finance Team to deliver the Council's responsibilities. The Council needs to ensure appropriate change management processes are in place given the change in Executive Manager – Finance in early September 2018, to ensure this does not have a negative impact on Council performance.

Introduction (continued)

The key messages in this report – audit dimensions (continued)

Governance and transparency

The Council and its partners have a clear and shared vision which is set out in the Shetland Partnership Plan. Councillors support this vision. The Partnership Plan has a good understanding of the challenges facing Shetland and is focussing on four priority areas: Participation; people; place; money. In the coming years, the development of delivery plans with clear targets and milestones to ensure the aims of the Partnership Plan are achieved will need to be a key focus for the Council and its partners.

The integration of health and social care continues to pose challenges for the Council, with issues relating to a lack of integration of budgets and significant funding gaps. Although there were a number of high profile resignations of Board members, we are satisfied this does not indicate any underlying issues. The Council have a well established partnership with NHS Shetland through the Shetland Islands Integration Joint Board ('IJB'). As is the case across Scotland, the Council (along with the IJB and NHS Shetland) should continue to work to resolve funding issues around shifting the balance of care between hospitals and communities. We also identified scope for improvement in the governance arrangement between the IJB and its partners to ensure that respective roles and responsibilities are clear.

The Council has strong executive leadership. Despite a number of changes in the senior team in 2018, we have not noted any negative impact on Council performance due to effective change management structures. The relationship between Councillors and Officers is good, and there is evidence of effective challenge from Councillors.

The Council is open and transparent in its decision making with all minutes available through the Council's website. The Council also encourages people to get involved in decisions about Council services and spending public money.

In addition to improvements to the reporting calendar outlined on the previous page, we have noted from our work that there is room for rationalisation of the Council's Committee structure and for improvement in the presentation of performance monitoring information.

Value for Money

The Council has a recently established Shetland Partnership Plan (replacing the Local Outcomes Improvement Plan) in place which sets out the framework for improvement. It is important that the Council focuses on developing delivery plans with clear, measurable targets and milestones to ensure that the aims of the plan are achieved.

Compared to other councils, the Council's overall performance has improved in recent years, and the majority of residents are satisfied with Council services. However, the Council and its partners need to demonstrate how their actions lead to improved outcomes for residents. Challenges remain in some currently topical areas, such as social care, gender balance and recycling.

The Council needs to improve how it reports its performance to residents, linking performance reports with the Council Plan and Shetland Partnership Plan and giving sufficient attention to areas of poor performance and remedial plans in place to address these areas.

Pat Kenny
Audit Director

Our audit explained

Area dimensions

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

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

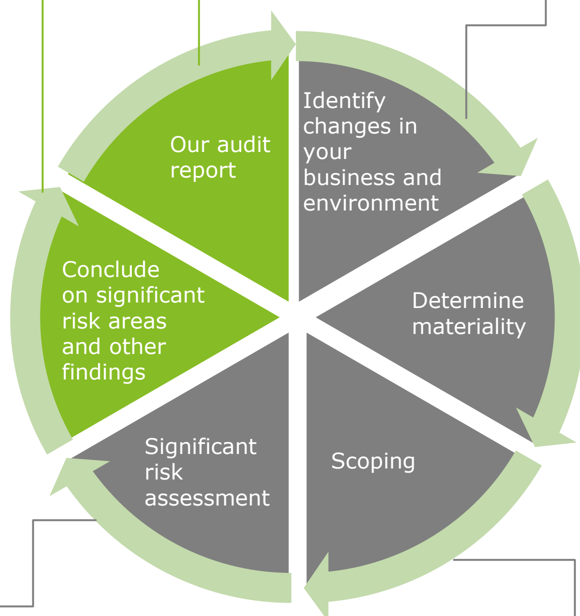
Final audit report

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

Key developments in your business

As noted in our planning report, the council continues to face significant financial challenges due to an increase in costs whilst facing increased demand for services.

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



Materiality

The materiality of £3.009m and performance materiality of £2.256m has been based on the benchmark of gross expenditure and is a slight decrease from what we reported in our planning paper due to updated final figures.

We have used these as the basis for our scoping exercise and initial risk assessment. We have reported to you all uncorrected misstatements greater than £0.15m.

Significant risks

Our risk assessment process is a continuous cycle throughout the year. Page 9 provides a summary of our risk assessment of your significant risks.

Quality and Independence

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

Scope of the audit

We will audit the financial statements of Shetland Islands Council and the Zetland Educational Trust for the year ended 31 March 2018.

Timeline 2017/18

November 2017 – February 2018
Meetings with management and other staff to update understanding of the processes and controls.

7 February 2018
Presented planning paper to the Audit Committee

March 2018
Year end

July – August 2018
Review of draft accounts, testing of significant risk and performance of substantive testing of results.

16 August 2018
Audit close meeting

19 September 2018
Audit Committee and full Council meeting

19 September 2018
Accounts sign off

Financial statements audit

Significant risks
Dashboard

Risk	Material	Fraud risk	Planned approach to controls testing	Controls testing conclusion	Consistency of judgements with Deloitte's expectations	Comments	Slide no.
Recognition of grant income	✓	✓	D+I	Satisfactory	●	Satisfactory	10
Valuation of property assets	✓	✗	D+I	Satisfactory	●	Satisfactory (see findings on page 15)	12
Management override of controls	✓	✓	D+I	Satisfactory	●	Satisfactory	11

Overly prudent, likely to lead to future credit − − ● + + Overly optimistic, likely to lead to future debit.

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

Significant risks (continued)

Risk 1 - Recognition of grant income

Risk identified

International Standards on Auditing (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, as summarised in the table below, are the Government Grant and non-domestic rates which are directed by the Scottish Government and not considered a significant risk as the process for receipt of this income is not complex and can be verified 100%.

The significant risk is pinpointed to the recognition of grant income (excluding General Revenue Grant income). Council tax, harbour income 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.

Type of income	2017/18 (£m)	Significant risk
Taxation and Non-Specific Grant Income		
Council tax income	9.04	
Non domestic rates	23.24	
Government Grant	57.43	
Capital grants and contributions	**7.65**	✓
Service Income		
Service Grant income	**8.20**	✓
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	

Key judgements and our challenge of them

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

Deloitte response

We have performed the following:

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

Deloitte view

We have concluded that grant income has been correctly recognised in accordance with the requirements of the CIPFA Code of Practice on Local Authority Accounting.

Significant risks (continued)

Risk 2 - Management override of controls

Risk identified
In accordance with ISA 240 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 judgments 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. This is inherently the areas in which management has the potential to use their judgment to influence the financial statements.

Deloitte view

- We have not identified any significant bias in the key judgements made by management.

Deloitte response
We have considered the overall sensitivity of judgements made in preparation of the financial statements, and note that:

- The Council's results throughout the year were projecting to stay within budget and this was closely monitored with confidence that the Council would be able to meet its overall financial targets.
- Senior management's remuneration is not tied to particular financial results.

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

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

Journals
We have made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

We performed design and implementation testing of the controls in place for journal approval.

We have used Spotlight data analytics tools to test a sample of journals, based upon identification of items of potential audit interest.

No issues have been noted from this testing.

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

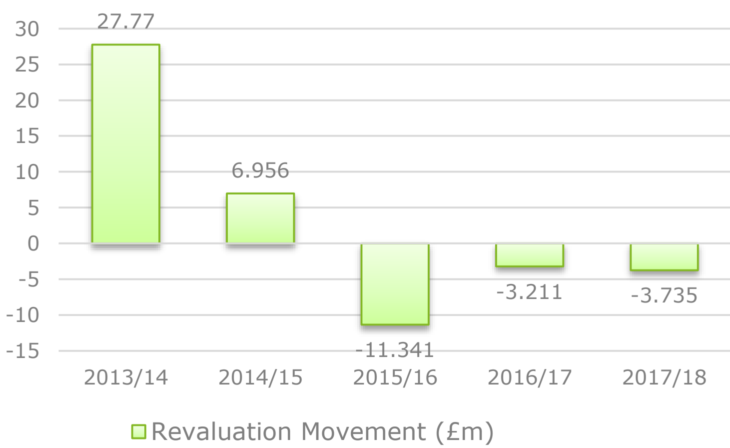
Significant risks (continued)
Risk 3 - Valuation of property assets

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

Key judgements and our challenge of them

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

Due to prevailing market conditions, there was an overall revaluation loss in the year, in line with 2016/17. This primarily impacted the new Anderson high school (£3.096m), town hall (£0.985m), Eric Gray centre (£0.586m) and the Edward Thomason & Taing care home (£0.756m). These losses have been offset to some degree by increases in areas such as the Staney Hill industrial estate (£0.821m) and the occupational therapy resource centre (£0.716m).



Deloitte response

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

Deloitte view
We have raised a number of recommendations in relation to the valuation of property assets which should be considered by the Council going forward, as discussed on page 62. We have identified a control deficiency as outlined on page 15 (which we note has been rectified in 2018/19) and an immaterial error of £0.19m (page 53) which has been corrected.

Overall, we have concluded that the net book value of property assets is not materially misstated. The Council's valuation assumptions are generally reasonable, in line with other Councils and fall within the expected range highlighted by Deloitte Real Estate.

Other matters
Defined benefits pension scheme

Background
The Council participates in two defined benefits schemes:
- Scottish Teachers' Superannuation Scheme, administered by the Scottish Government; and
- The Shetland Islands Pension Scheme, administered by the Council.

The net pension liability has decreased from £229.68m in 2016/17 to £165.17m in 2017/18 primarily as a result of changes arising from the triennial valuation, combined with a slight increase in the discount rates and a slight decrease in the salary increase rate applied.

Deloitte response
- We obtained a copy of the actuarial report produced by Hymans Robertson, the scheme actuary, and agreed in the disclosures to notes in the accounts;
- we reviewed and challenged the assumptions made by Hymans Robertson, including benchmarking as shown in the table opposite;
- we assessed the reasonableness of the Council's share of the total assets of the scheme with the Pension Fund financial statements;
- we reviewed the disclosures within the accounts against the Code; and
- we assessed the independence and expertise of the actuary supporting the basis of reliance upon their work.

	Council	Benchmark	Comments
Discount rate (% p.a.)	2.70	2.57	Reasonable, slightly optimistic
Retail Price Index (RPI) Inflation rate (% p.a.)	3.40	3.05	Prudent
Consumer Price Index (CPI) Inflation rate (% p.a.)	2.40	2.05	Prudent
Salary increase (% p.a.) (over RPI inflation)	(0.4)	Council specific	Prudent
Pension increase in payment (% p.a.)	2.40	2.05	Reasonable, slightly prudent
Pension increase in deferment (% p.a.)	2.40	2.05	Reasonable, slightly prudent
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 65)	22.10	21.20	Reasonable
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 45)	23.90	23.00	Reasonable

Deloitte view
We have reviewed the assumptions and, on the whole, the set of assumptions is reasonable and lies towards the middle of the range of assumptions when compared with the Deloitte benchmarks. The assumptions have been set in accordance with generally accepted actuarial principles and are compliant with the accounting standard requirements of IAS19.

Other matters (continued)
Charitable trusts

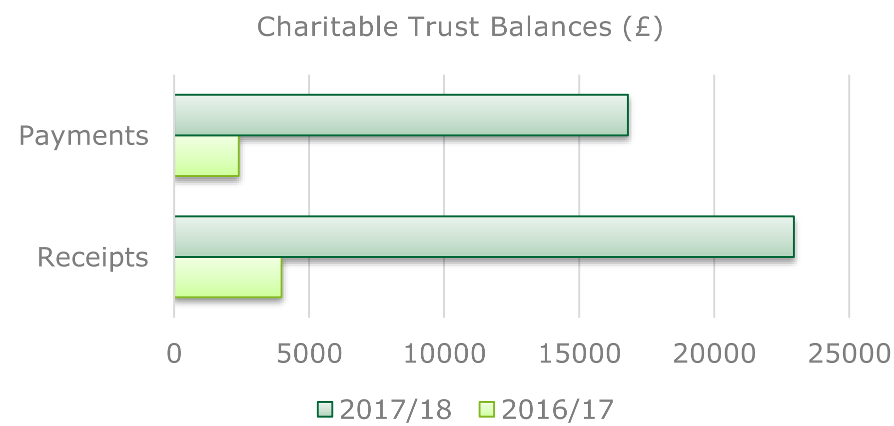
Risk identified
From 2013/14, all Scottish Councils who act as sole trustees for any registered charities have to fully comply with the Charities Accounts Regulations. This requires Charities SORP compliant accounts to be prepared for each charity, and a separate audit of each. Shetland Islands Council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

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

Deloitte response

We have assessed that the Statement of Receipts and Payments and the Statement of Balances have been prepared in accordance with the Charities Accounts (Scotland) Regulations 2006. No issues have been noted.

A summary is provided in the table adjacent. We note that there has been very little movement in the Trust over the last 12 months, with the movements largely relating to interest from investments held. We would encourage the Council to ensure that appropriate plans are in place to ensure these funds are used in accordance with the donors wishes.



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

Other significant findings

Internal control and risk management

During the course of our audit we have identified a number of internal control and risk management findings, which we have included below for information.

Area	Observation	Priority
Valuations of Property Assets	In the current year, as the Valuer left their position, the Team Leader both carried out the valuations and performed the initial review of methodology. Although there is a subsequent 'sense check' by the Capital Assets team, this team are not Royal Institute of Chartered Surveyors ('RICS') qualified and do not have the requisite competence to perform a detailed technical review of the methodology used in the valuations. This resulted in there being a lack of segregation of duties as the person carrying out the work was also responsible for the technical review of that work. As a consequence of this, a number of recommendations made in the prior year were not fully actioned in the current year – these have been reissued in the current year as outlined on page 62. Through our audit testing, we identified an immaterial error of £0.19m relating to an overstatement of land values, as outlined on page 53.	High
Financial Reporting	An adjustment was raised when the IJB/Zetland Transport Partnership ('ZetTrans') accounts were audited to remove the debtors/creditors between the Council and these bodies as they did not meet the definition of a debtor/creditor per accounting standards. The accounting policy that led to these being recorded as debtors/creditors was not in line with best practice. These adjustments were provided to the Council in early June 2018, before the unaudited accounts for the Council were issued. We appreciate the tight reporting deadline and that these changes may not have been able to be made in the unaudited accounts. Nonetheless, they should have been adjusted in the Council accounts prior to the Council audit commencing. However, the adjustments were not made until the equivalent error was identified from our audit of the Council accounts. This resulted in the debtors/creditors in the Council's unaudited accounts being materially misstated (£23.97m and £23.61m respectively), although the net impact on net assets is immaterial (£0.36m). This has been corrected by management, as discussed on page 53.	Medium

The purpose of the audit was for us to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters being reported are limited to those deficiencies that we have identified during the audit and that we have concluded are of sufficient importance to merit being reported to you.

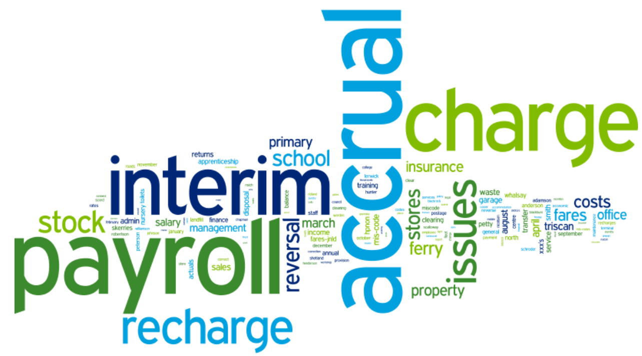
Other significant findings (continued)
Insights delivered

We have performed analytics on all of the journal entries processed during the year. We have highlighted some key themes arising from this work for your consideration.

The journal posting efficiency at the Council is commendable: 11.47% of journals posted accounted for 96.69% of the total value posted in the year. This suggests that little time is spent on accounting for small amounts and that journals are efficiently posted in batch as required.

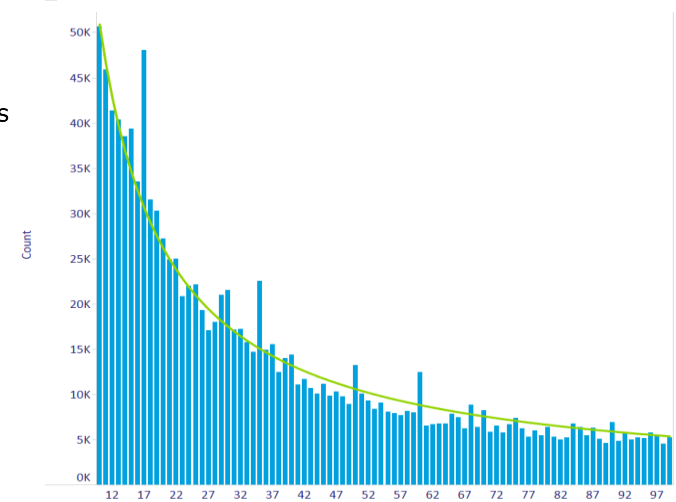
Value Band (EC)	Number of Journals	% Number of Journals	Gross Value (EC)	% Gross Value (EC)
0				
0.01 - 1	125	3.97%	134.46	0.00%
1.01 - 10	517	16.43%	13,632.64	0.00%
10.01 - 100	1,417	45.03%	640,035.63	0.02%
100.01 - 1,000	1,743	55.39%	5,557,218.31	0.17%
1,000.01 - 10,000	1,245	39.56%	20,809,802.86	0.62%
10,000.01 - 100,000	730	23.20%	83,988,987.51	2.50%
100,000.01 - 1,000,000	231	7.34%	244,696,179.12	7.29%
1,000,000.01 - 10,000,000	101	3.21%	896,057,454.87	26.71%
10,000,000.01 - 100,000,000	29	0.92%	2,103,322,756.70	62.69%

We have reviewed the main descriptions used in journals, as shown below. These are in line with our expectations and do not present a cause for concern.



As an additional check for unusual transactions, we performed a Benford's Analysis as shown across, which identifies unusual number distributions, and note that the Council's postings (the blue columns) did not differ from what was expected (the green line) by a statistically significant amount. The 'X-Axis' shows the number distribution (e.g., numbers that begin with 12, 17, 22, etc.) and the 'Y-Axis' shows how common that is amongst the Council's postings.

We performed a review of the posting frequency of staff with access to the system and noted that all staff have taken long holidays (>5 consecutive days) in the year, reducing concern of potential fraudulent behaviour or finance function stress and fatigue.

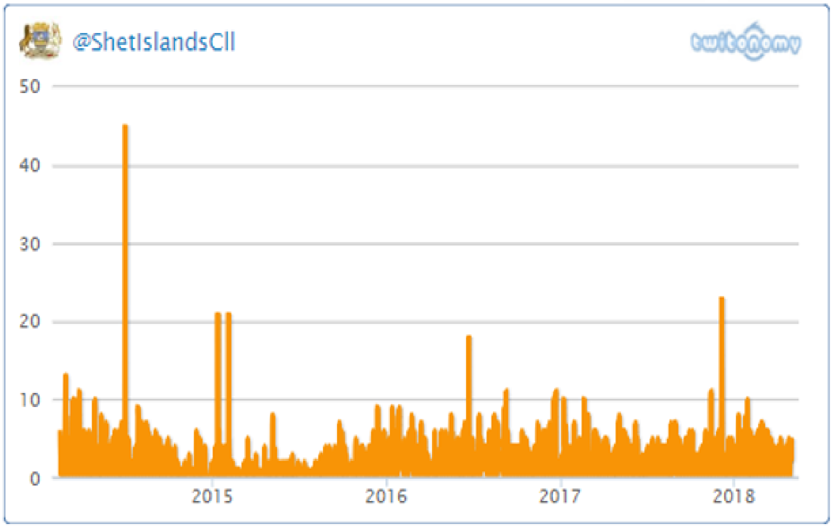


16

Other significant findings (continued)

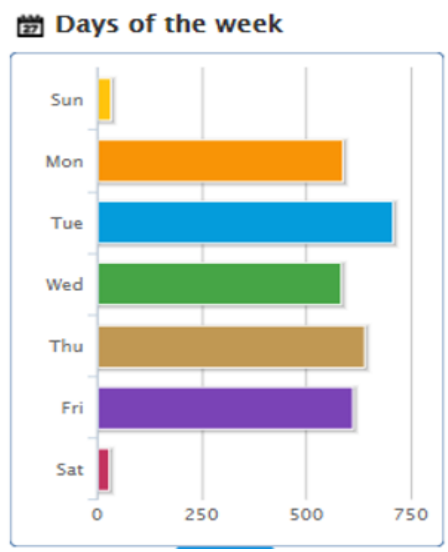
Insights delivered

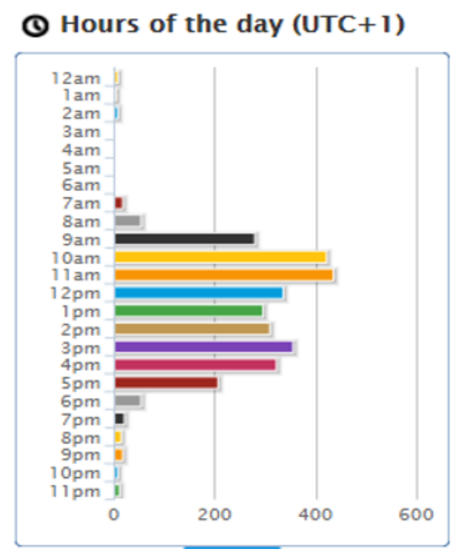
Given the increasing importance of social media for community engagement and accessibility, we have reviewed the Council's Twitter account for any areas where improvements can be made.



Activity on social media has remained relatively consistent throughout the year, as shown to the left.

The 'hashtags' most used by the Council are as expected and would be clearly accessible by Shetland residents.





Twitter reports that the time most people checked Twitter is 1 – 3 PM Monday to Thursday, with the lowest amount checking in after 8 PM every day and 3 PM on Fridays. We note that the Council's posts occur evenly throughout the working week, with the timing of the posts also spread evenly.

We noted from review of the Council's Twitter account that it regularly posts images and this practice should be continued: according to Twitter, this increases retweets by 41% and favourites by 48%.

From our review, we are satisfied that the Council is utilising social media appropriately to increase its visibility and the accessibility of information for the residents of Shetland.

Our audit report

Other matters relating to the form and content of our report

Here we discuss how the results of the audit impact on other significant sections of our audit report. The revisions to ISA (UK) 700 have changed the form and content of audit report, including how different sections are presented.

Our opinion on the financial statements

Our opinion on the financial statements is unmodified.

Material uncertainty related to going concern

We have not identified a material uncertainty related to going concern and will report by exception regarding the appropriateness of the use of the going concern basis of accounting.

Emphasis of matter and other matter paragraphs

There are no matters we judge to be of fundamental importance in the financial statements that we consider it necessary to draw attention to in an emphasis of matter paragraph.

There are no matters relevant to users' understanding of the audit that we consider necessary to communicate in an other matter paragraph.

Other reporting responsibilities

The Annual Report is reviewed in its entirety for material consistency with the financial statements and the audit work performance and to ensure that they are fair, balanced and reasonable.

Our opinion on matters prescribed by the Controller of Audit are discussed further on page 19.

Your annual accounts

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

	Requirement	Deloitte response
Management Commentary	The Management Commentary comments on financial performance, strategy and performance review and targets. Deloitte note that the Management Commentary has been prepared in line with issued guidance. The commentary included both financial and non financial KPIs and made good use of graphs and diagrams. The Council also focusses on the strategic planning context.	We have assessed whether the Management Commentary has been prepared in accordance with the statutory guidance. We have also read the Management Commentary and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading. Our review identified a number of areas where the annual accounts needed revising in order to comply with statutory guidance and to ensure that they were fair, balanced and understandable. We are pleased to note that these changes have been made. We have made a number of recommendations for changes to the annual accounts in line with good practice. We have included elements of good practice for your consideration at page 20.
Remuneration Report	The remuneration report has been prepared in accordance with the 2014 Regulations, disclosing the remuneration and pension benefits of Senior councillors and Senior Employees of the council.	We have audited the disclosures of remuneration and pension benefits, pay bands, and exit packages and confirmed that they have been properly prepared in accordance with the regulations.
Annual Governance Statement	The Annual Governance Statement reports that Shetland Islands Council governance arrangements provide assurance, are adequate and are operating effectively.	We have assessed whether the information given in the Annual Governance Statement is consistent with the financial statements and has been prepared in accordance with the accounts direction. No exceptions noted.

Your annual accounts (continued)

Audit Scotland has issued a series of Good Practice notes to highlight where annual reports can be improved. We would encourage the Council to use the findings to assess and enhance their own disclosures to ensure they provide high quality information to stakeholders in their annual accounts.

We have provided below some extracts which should be considered by the Council in drafting future annual reports.

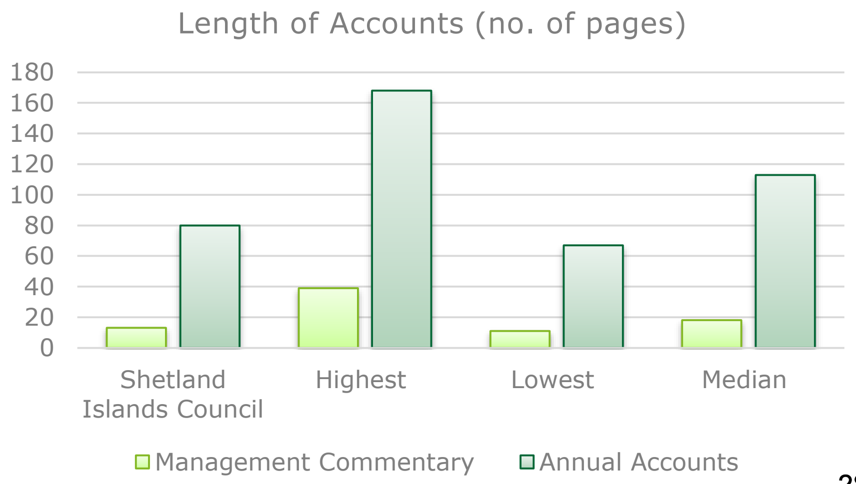
Management Commentary
The following areas for improvement were identified when reviewing the Council's management commentary:

- Explanation of Council performance could be improved by discussing the objectives in a table-style format, including the objective, status against that objective, current performance, and future plans.
- Include a list of financial and non financial KPIs, performance against them in the year, and whether they have been achieved or not. Any areas where they have not been achieved should include a reason and plan to remedy.
- A section on key risks/uncertainties should be clearly differentiated. The risks should explain why they are risks, specific to Shetland. This should include a description, likelihood, impact and mitigating actions.

Governance Statement
The following areas for improvement were identified when reviewing the Council's governance statement:

- An action plan should be included which outlines key issues arising (e.g., the areas highlighted in the significant governance issues section).
- If any significant governance issues were identified in the prior year, they should be followed up in the current year governance statement.

A list of comments for improvement, including the above, have been provided to management at the Council with a recommendation that these be implemented for the 2018/19 annual accounts. Deloitte are satisfied that the accounts are compliant with statutory guidance and all required changes have been made.



We have reviewed the annual accounts of the Council against other Councils across Scotland.

This shows that the Council is in the lower end of the scale – with the management commentary the third shortest in Scotland, and the accounts as a whole the fourth shortest in Scotland. Despite this, there is scope to remove immaterial information from the accounts, which we are pleased to note the Council has accepted and improved in the current year.

We would note that given this, there is room for the Council to amend the annual accounts going forward to take account of the good practice recommendations.

Despite having annual accounts at the lower end of the scale, the Council complies with all statutory guidance.

Audit dimensions

Audit dimensions

Overview

Public audit in Scotland is wider in scope than financial audit. This section of our report sets out our findings and conclusion on our audit work covering the following:

Audit dimensions

- The Code of Audit Practice sets out four audit dimensions which, alongside Best Value in the local government sector, set a common framework for all the audit work conducted for the Auditor General for Scotland and for the Accounts Commission.

Strategic audit priorities

- In its Strategy, which is updated annually, the 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 (SAPs).

Shared risk assessment

- Local Area Networks (LANs) bring together scrutiny body representatives to agree and write a Shared Risk Assessment (SRA). The output of the SRA process informs an annual Local Scrutiny Plan (LSP) which summarises the results of the SRA of the council and the proposed scrutiny response.

Best value

- The Commission formally agreed the overall framework for the approach to auditing Best Value (BV) in Councils in June 2016. Best Value is assessed over the five year audit appointment, as part of the annual audit work. The BVAR for Shetland Islands Council is planned for future years. We have followed up on the areas reported in our 2016/17 annual audit report and considered these as part of the work on the four audit dimensions to focus on the Council's arrangements for demonstrating Best Value.

Statutory performance indicators

- The 2015 Statutory Performance Information (SPI) Direction published by the Commission requires Councils to report a range of information in accordance with, but not confined to, the requirements of the Local Government Benchmarking Framework. One of the Accounts Commission's Strategic Audit Priorities is "the quality of Councils' reporting of their performance to enhance accountability to citizens and communities". Accordingly, we have considered this as part of our work within this areas. It is also to be addressed in more depth in those Councils subject to a Best Value Assurance Report.

Specific risks

- As set out in our Annual Audit Plan, Audit Scotland had identified a number of specific risks (SRs) faced by the public sector which we have considered as part of our work on the four audit dimensions.

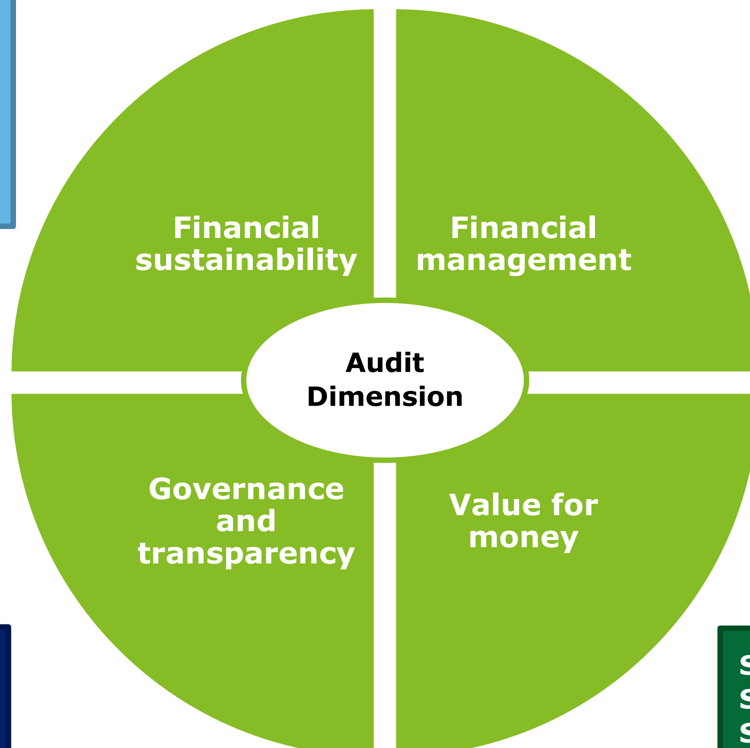
Audit dimensions (continued)

Overview (continued)

This section of our report is structured in accordance with the four audit dimensions, but also covers our specific audit requirements on SAPs, BV, SR, LSP and SPI's, as summarised below.

Strategic Audit Priorities (SAP)
SAP 1 - Council priorities and long-term planning
SAP 2 - Changes in service delivery
SAP 3 - Members and officers knowledge, skills and support
SAP 4 - Citizen involvement
SAP 5 - Quality of reporting

Best Value (BV)
BV 1 – Improvement
BV 2 – Financial Governance and Resource Management



SPI's

Local Scrutiny Plan (LSP)
LSP 1 – Financial sustainability and transformation
LSP 2 – Social care services
LSP 3 – Education services
LSP 4 – Housing services

Specific risks (SR)
SR 1 – EU Withdrawal
SR 2 – New Financial Powers
SR 3 – Ending public sector pay cap
SR 4 – Cyber security risk
SR 5 – Openness and transparency

Audit dimensions (continued)

Financial sustainability

Audit dimension

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

Areas considered

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

Deloitte response

From our work in 2016/17 we found that the Council had been successful in making significant savings over the previous 5 years, however estimated further savings of £53m were required between 2018/19 and 2021/22 to meet future budget restraints.

We have assessed whether the Council continues to have effective short, medium and long-term financial planning systems in place so it can achieve financial sustainability over the next 5-10 years.

We have also assessed the effectiveness of the Council's efforts to achieve further sustainable efficiencies, in particular through the Business Transformation and Service Redesign Programmes.

Deloitte view

The Council has a clear process in place for long-term and medium-term financial planning and the current level of reserves held is in excess of the recommended minimum, given the Council's investments. The planned use of reserves to fund services and investments will be sustainable in the short term, however, going forward, the Council should ensure that such an approach is taken only where the level of reserves can continue to be maintained.

The Council theoretically can meet the identified funding gap in the medium term purely from reserves, although it accepts this is not sustainable and has set a savings target of 4.5% per annum in order to reduce the net draw on reserves over the period to a more sustainable £2.055m. However, the feasibility of this savings target needs to be considered given the current stage of transformation programmes, which are not considered to be sufficiently robust to generate the required savings. The Council should consider how it delivers services as a whole, rather than taking an ad-hoc approach to transformation, with this involving a high level of community engagement given the nature of services in Shetland.

The Council is in the fortunate position of having a high level of reserves and could use the existence of this 'buffer' to take radical steps to change its service delivery model so that it is fit for the future given anticipated demographic and financial changes. Shetland is expected to have the highest rate of >75 year olds by the mid 2020s with a corresponding increase in demand for services. The Council is in the position that it can invest in the short term in these changes, rather than having to take a purely 'cost cutting' approach to transformation.

Audit dimensions (continued)
Financial sustainability (continued)

Short-term financial position

For **2017/18**, the Council approved a balanced budget of £110.14m (2016/17: £110.28m), which included the use of £12.25m from reserves (2016/17: £8.10m). The final position for 2017/18 was an underspend against budget of £8.57m million. The underspend has primarily been earmarked for capital programmes planned for the current year which were delayed. Although there are substantial variances in the actual results against the budget, these are monitored regularly throughout the year, with the reasons for these variances being well understood and documented and reported to Committee and Council as appropriate.

The **2018/19** budget was approved by the Council on 14 February 2018. This budgeted net expenditure of £107.76m, which incorporates £1.89m of savings to be made through redesign projects and plans for a draw on reserves of £11.73m.

In setting its budget, the Council has recognised that a number of risks exist, such as demand and demographic changes. The impact of these changes results in growth of 5.1% in service costs, with this level of growth being unsustainable and presenting a specific concern around the achievability of savings targets given the Directorates within the Council are instructed to operate on a 'no growth' basis.

The budget includes pay awards which have been aligned to the thresholds set out by the Cabinet Secretary in the Stage 1 debate on 31 January 2018. It is noted that the local government pay is outwith the remit of the Scottish Government and negotiations for 2018/19 remain live. A pay award in excess of the level provided for would require further savings to be made.

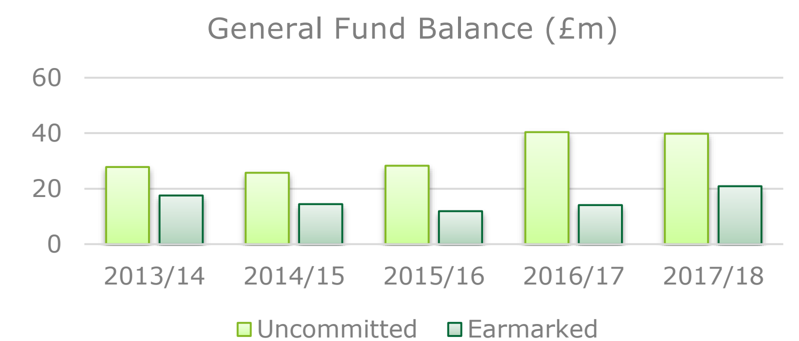
The Council has adopted a **Reserve Strategy** that is in line with the current economic climate. Good practice recommends that local authorities should retain uncommitted reserves of between 2% and 4% of their annual running costs, which is equivalent to between £2.46m and £4.93m for the Council.

Uncommitted reserves (consisting of the General Fund and Equalisation Fund) were £39.81m as at 31 March 2018, representing 32.3% of net expenditure.

The General Fund earmarked balance at 31 March 2018 was £20.51m. This includes the following:

- £16.25m Local Investment Fund for investment in local businesses and distributing income to local charities;
- £2m Revenue Spend to Save Fund to fund savings initiatives upfront, to be repaid when a saving is realised.

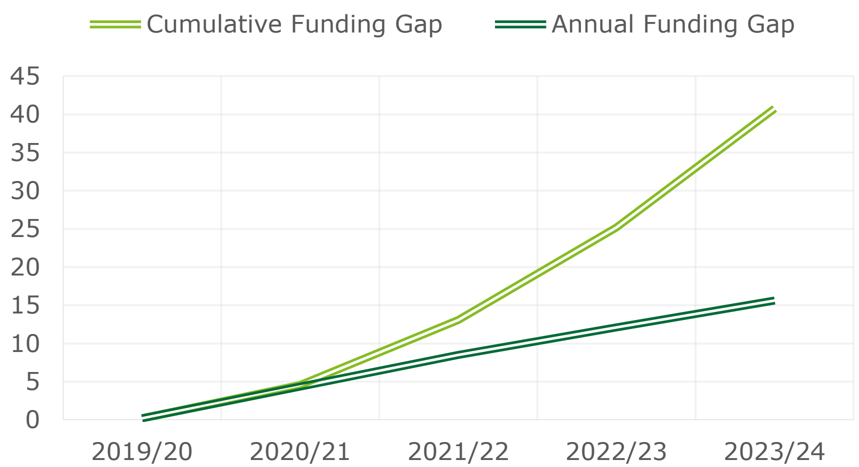
The movement in uncommitted and earmarked reserves over the last five years is illustrated below. The current year uncommitted balance of £39.81m is up from £27.81m in 2013/14, which demonstrates commendable financial management in a period of reducing income and increasing demand.



Audit dimensions (continued)
Financial sustainability (continued)

Medium to long-term financial sustainability

The Council has achieved significant savings over the last 5 years, however due to increasing demand for services and the continuing restraint in relation to Council funding settlements, it will have to consider how it can fundamentally transform service delivery in order to continue to meet citizen needs with reducing budgets.



In order to help deliver this change, the Council has developed a Medium-Term Financial Plan ('MTFP') for the period to 2023/24, which has recently been refreshed.

The MTFP recognises that if the Council continues with current service levels and delivery models, there will be a funding gap over the next five years. Based on a number of assumptions, including grant funding, Council tax, pay inflation, demand pressures and known policy positions, it has estimated a funding gap of £15.61m by 2023/24. This would require savings of around 12% of the Council's current departmental budget.

Addressing the funding gap

We are unable to conclude on whether the savings target of 3.4% per annum in the MTFP is realistic or achievable given the lack of detail in how these savings will be delivered. Although the Council has a history of making required savings, this is becoming increasingly difficult as costs continue to grow (anticipated at 5.1% growth in 2018/19) against a backdrop of flat or reducing funding. The transformation programmes are anticipated to provide recurring savings going forward, however these are not at a sufficiently robust level to rely on to deliver these savings at present.

The Council should implement detailed savings plan to ensure savings targets can be met. Accountability and monitoring of progress is vital in achieving savings targets.

The Council accepts that Service Redesign and the Business Transformation Programme has not delivered financial results as yet. This has been due to change previously being put on the 'back burner'. There is an acceptance that a full team is required to drive transformational change and the Council intends to implement this going forward. Clear targets and milestones should be set to aid in the monitoring of this process.

While the Council has a Business Transformation Programme, it has not yet considered what external support it might require to mitigate any internal skills gaps. Given the complexity of the changes required, the Council also needs to consider the supporting infrastructure required to deliver the strategy such as:

- A programme management office (PMO);
- its change management approach; and
- tools and templates to assess whether intended benefits of change have been achieved.

Audit dimensions (continued)
Financial sustainability (continued)

Medium to long-term financial sustainability (continued)

The Council agreed eight transformational workstreams in the Business Transformation Programme 2016-2020. Despite this programme now being over half way complete, the Council accept that the programme is not sufficiently advanced and robust to deliver the required savings.

- Customer First
- Commissioning and Procurement Framework
- Workforce Strategy
- Accommodation Rationalisation
- Broadband and Connectivity
- Information Management and Improvement
- Digital First
- Performance and Management Reporting

Given the current status of the programme, we consider that in order to address the funding gap, the Council should continue to develop a single, unified transformation programme that considers how services are delivered across the Council. This should consider the potential for upfront investments in redesigning service delivery, if a business case can demonstrate that this will deliver longer-term savings and value.

This could be helped through the development of a single medium-term strategy to address the funding gap, which could look at various options such as service redesign, service stoppage, income generation and efficiency cost savings. Each of these should be sufficiently robust to demonstrate the feasibility of the savings target and the sustainability of Council services going forward.

The progress of these projects should be regularly monitored to ensure savings are being delivered and in order to evaluate whether the project delivered the intended outcome. In addition, progress should be reported to Members, as Member involvement is key in ensuring the success of a transformation programme. Consequently, we would expect to see Members playing a very active role in the transformation programme.

Best practice
English councils that have delivered and sustained transformational change on the scale required by Shetland Islands Council have tended to focus on the following six key requirements:

- A strategic driven response;
- Being a 'place' leader;
- Digital data analytics and insights;
- Efficiency, productivity and income generation;
- Outcome-focused partnership working; and
- Reframing the relationship between the citizen and the state.

We have included case studies of transformational change for the Council's consideration at pages 43 – 45.

Audit dimensions (continued)
Financial sustainability (continued)

Long-term financial planning

The Council has a Long Term Financial Plan (‘LTFP’) covering the period to 2050. Management should consider, in conjunction with Members, whether the LTFP should include additional detail on how the Council can continue to provide services and deliver outcomes in line with its current and anticipated objectives, given the anticipated longer-term demographic and technological changes that will impact Shetland.

Although Deloitte accept that the LTFP is used currently to identify how current trends will impact on the financial health of the Council in the longer term, this could be more useful to Members and have more impact on current decision making if it was made clearer how current and medium-term decisions will impact on the longer term, especially on the ability of the Council to achieve its vision and priorities. This would provide Members with a greater ability to take a 'future focused' approach to decision making, as opposed to giving undue weight to the short/medium-term impacts of decisions and regarding the longer term as more of an afterthought - the result of the decision, rather than the driver of it.

We also noted that there was minimal community engagement in the development of the LTFP. The Council should consider at the next revision of the LTFP whether community engagement would result in better information for Members on the longer-term aspirations and expectations of the community and how this should be built into financial projections and considerations of future trends.

Insofar as sufficient information is provided to the community to make informed decisions, this process could result in the LTFP being better aligned with these aspirations and expectations, with this information potentially being a useful tool to combine with 'current trends' and 'future decision making' - the community the Council serves, their aspirations and expectations should be a key consideration in the LTFP as this will undoubtedly have an impact on decision making and consequent financial health of the Council.

Aligned with the other recommendation on the LTFP, this would allow Members to make more 'future focused' decisions - driving longer-term change, rather than being subject to it.

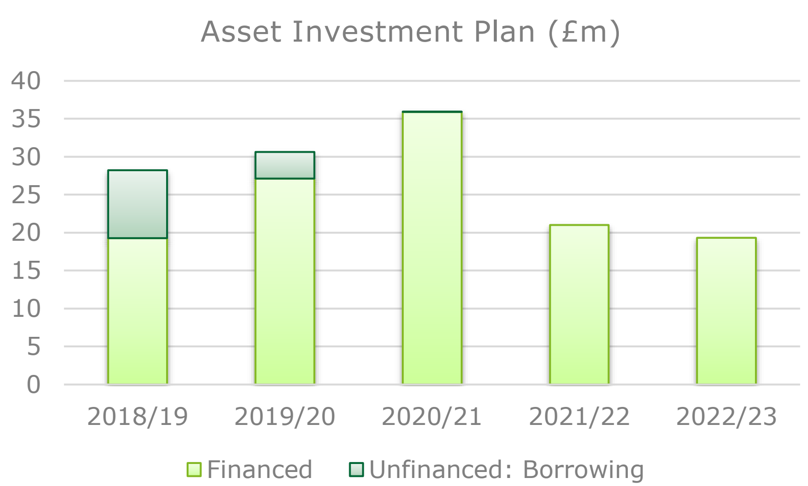
Further, this information could also be combined with current Council vision and priorities to consider whether these remain appropriate in a changing environment.

Audit dimensions (continued)
Financial sustainability (continued)

Treasury management

The Council updates its Investment and Treasury Strategy on an annual basis. This, in conjunction with the five-year Asset Investment Plan, details the Council's expected borrowing requirement compared to its operational boundaries and details interest rates. The strategy notes that the Council is in the position that it can use reserves to fund expenditure rather than borrowing when the interest on borrowing is in excess of the long-term average return achieved on investments.

Given this, the Council intends to use borrowing on an increasingly limited basis, aiming to eliminate the need for additional borrowing entirely by 2021/22, reducing each year from the £10.16m obtained in 2017/18.



Evaluation of projects

The Council has approved an Asset Investment Plan to 2022/23, outlining anticipated capital expenditure over the period and how this will be funded. Given the cost of the Asset Investment Plan, totalling £135m to 2022/23, the Council should carry out self-evaluation on completion of projects, to confirm whether the project achieved its stated aims, delivered value for money, and how it performed against budget (in terms of cost and time). This will also allow 'lessons learned' to be shared across the Council to ensure that good work is repeated and areas for improvement are actioned.

As highlighted in 'Best Value' audits conducted at other councils, the Council needs to demonstrate how its actions actually make a difference to the lives of residents - the Council should ensure such a section is included on any post-completion evaluation of projects.

Long-term capital planning

Given the high level of assets held by the Council and that the Council accepts that it will need to reduce its asset base in the longer term (or deal with the increasing cost of maintenance and keeping these assets), a longer-term capital plan should be developed (with this clearly linked to the Business Transformation Programme), looking at:

- The current asset base;
- anticipated additional assets to be acquired in the medium to longer term to meet demographic and other changes;
- assets which currently could be classified as unneeded and which could be disposed of;
- what the Council considers to be an affordable asset base; and
- the difference between this affordable base and the anticipated medium-term base, with appropriate plans developed to bridge this gap in the longer term.

Audit dimensions (continued)
Financial sustainability (continued)

Workforce strategy and plan

The Council's Workforce Strategy 2016-20 describes the Council's vision for supporting and developing its staff. However, there is no Council-wide workforce planning in place, with this completed at individual Directorate level.

We note that workforce planning is a stream within the Business Transformation Programme (as referred to on page 26). As with the wider programme, this is not at a sufficiently advanced stage to allow conclusions to be drawn on its effectiveness.

Given that employee costs account for approximately 60% of net Council expenditure, the Council needs to create a Council-wide Workforce Plan. The Council have identified they have an ageing workforce and in particular the Council has difficulty with recruitment in social care and they need to develop a plan to address this issue.

Further, we recommend further thought is given to succession planning and is considered for the Council as a whole within the Workforce Plan.

The Council has not been immune to the UK wide issue with regards to difficulty attracting high calibre staff into local government, and this is further exacerbated by the geographical isolation of the islands. There is limited detail on how the Council intends to combat this, with the development of a Council-wide workforce plan being pivotal to this.

The Council has confirmed that a facilitated session on workforce planning is to be held with the senior management team (executive managers and team leaders). This was meant to happen early July, however we note this was delayed and is now due to take place in the middle of September. Given the importance of this stream to the wider Business Transformation Programme, we strongly encourage the Council to focus on the development of a Workforce Plan in 2018/19.

Members

This Council is made up of 22 elected Members and following the local election in May 2017, there are 21 independent Members and 1 SNP Member.

Subsequent to the local elections, the Council carried out an induction programme for all the elected Council Members. The induction included overviews of the Council and Partnership Plans and all of the Council's other key strategies, challenges facing the Council and the support they will receive in their role as Council Members.

Members also have a development plan for each year. This includes core training, one to one meetings, improvement service workshops and bespoke training where a need is identified.

The Corporate Management Team reviews financial performance on a monthly basis, with Committee reporting on a quarterly basis to the Policy & Resources Committee and the full Council. Further information is available on the Councillors' intranet site and Officers are available to discuss any aspects of the report with Councillors. The level of scrutiny and debate is increasing as Members' knowledge and understanding grows.

Audit dimensions (continued)
Financial management

Audit dimension

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

Areas considered

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

Deloitte response

We have reviewed the budget and monitoring reporting to the Council during the year and the year-end position to assess whether financial management and budget setting is effective.

We have evaluated the key financial systems and internal control as part of our financial statements audit work and considered the work of internal audit.

We have considered the capacity and skills within the senior management of the finance team.

We have reviewed the Council's arrangements for the prevention and detection of fraud and irregularities, including their participation in the NFI exercise.

Deloitte view

We are satisfied the Council has strong budget setting and financial monitoring arrangements which are robust enough to sufficiently manage financial activity and capture and address any challenges to the achievement of financial targets. However, we note there is limited reporting in the year of performance against savings targets in the year and recommend that improvements be made in this regard.

We note that there is a large gap between the preparation of monitoring reports and their presentation to Committee, which reduces the relevance of scrutiny and limits the time for improvements to be made. The Council accepts that currently, the Committee cycle drives business, rather than vice versa, and that this needs to change.

We are satisfied that the Finance Team has sufficient capacity and skills to carry out its responsibilities. However, the Council needs to ensure appropriate change management processes are in place given the change in Executive Manager – Finance in early September 2018 to minimise any disruption to Council activities.

We have also reviewed internal audit reports issued in the year and note our broad agreement with their findings and conclusions.

From our testing throughout the audit we are satisfied that the Council has an adequate system of internal controls in place, subject to the small number of issues highlighted on page 15.

Following recommendations made in our report in 2016/17, we are satisfied that the Council places appropriate emphasis and provides sufficient resource for the timely completion of the NFI process.

We are satisfied the Council has appropriate arrangements in place for the prevention and detection of fraud and corruption.

Audit dimensions (continued)
Financial management

Budgetary control systems

The Council has effective financial planning and management arrangements in place. Senior management and Councillors regularly review progress. The Corporate Management Team and the Policy & Resources Committee review financial performance monthly and quarterly respectively.

We have seen a move in other bodies to reporting on a more risk-based approach, with higher risk areas being reported more regularly and lower risk areas less frequently. This can help with the management workload and allows Members to receive more up-to-date reports on areas more critical for decision making and action.

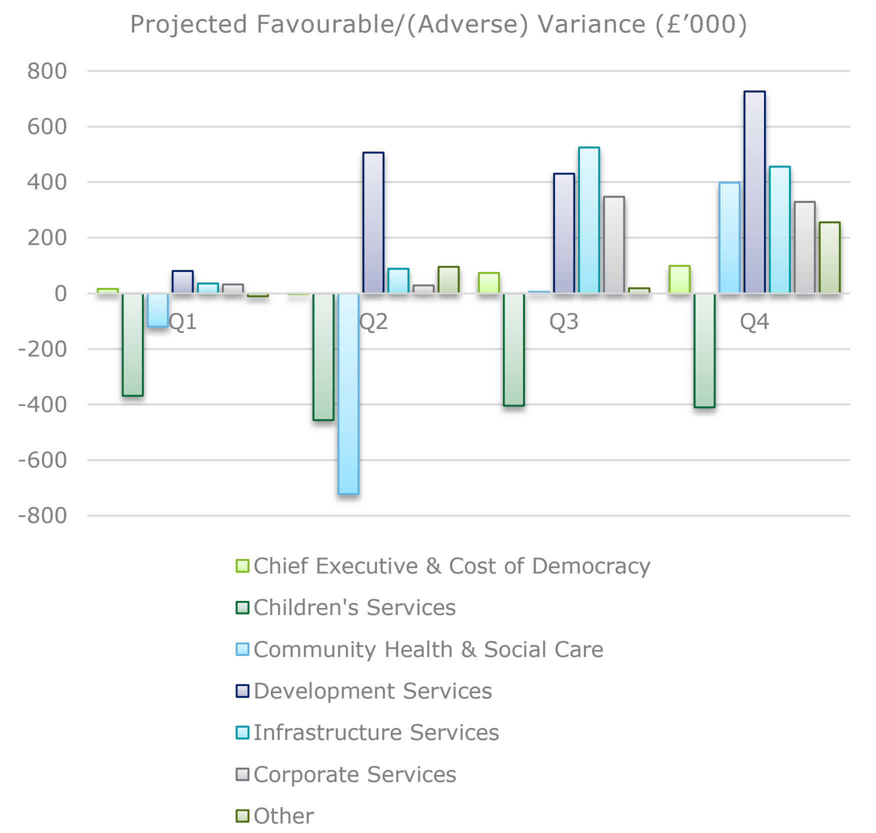
The Finance Team is led by the Executive Manager – Finance and Team Leader – Accountancy, both of whom are experienced in local government finance roles. We have not identified any issues with the financial skills, capacity and capability of the Finance Team.

We are aware that there will be a change in the Executive Manager – Finance position from September 2018. The Council needs to have appropriate change management processes in place to ensure this does not impact negatively on how the Council delivers its responsibilities.

Financial performance – General Fund

The Comprehensive Income and Expenditure Statement (CIES) reported a deficit of £25.49m on the provision of services in 2017/18. Adjusting this balance to remove the accounting entries required by the Code of Practice for Local Authority Accounting, the Council's usable reserves increased by £5.74m – driven primarily by increases in earmarked reserves (as discussed on page 25).

The variances to budget reported throughout the year are summarised across by Directorate:



The key reasons for the variances were:

- Increased cost of providing residential care for looked after children;
- Lower than initially anticipated capital costs due to delays; and
- Lower than anticipated staff costs due to ongoing vacancies.

We recommend that the Council documents why revisions to the budget were unforeseeable and thus not captured in the original budget. This will allow a clearer understanding of whether variances are due to Council actions or areas outwith Council control.

Audit dimensions (continued)
Financial management (continued)

Financial performance –Housing Revenue Account

The Housing Revenue Account reported a deficit of £0.14m on the provision of services in 2017/18. Adjusting this balance to remove the accounting entries required by the Code of Practice for Local Authority Accounting, the Council's HRA fund increased by £1.88m. This compared to budget as summarised in the table below:

	Budget (£m)	Actual (£m)	Variance (£m)
Expenditure	£7.30	£7.91	£0.61
Income	£6.82	£7.77	£0.95
Transfer to / (Use of) HRA	(£0.48)	£1.88	£2.36

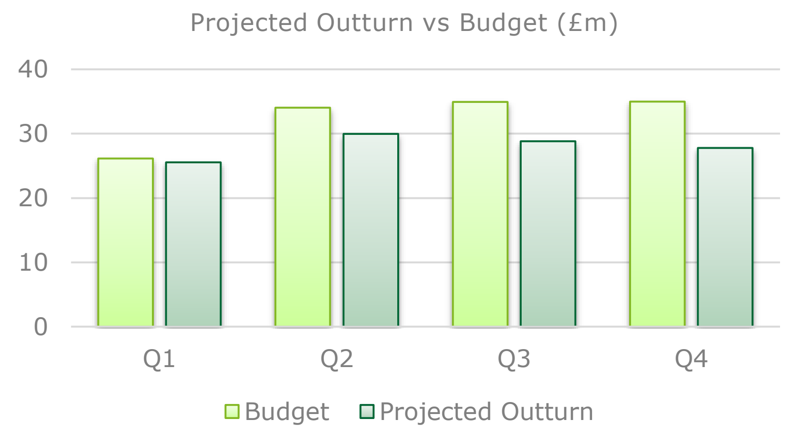
The main driver of the variances in the year was due to capital receipts being used to fund capital expenditure, rather than these being funded from current revenue.

Capital expenditure

The key areas of capital expenditure incurred in delivering the Asset Investment Plan in 2017/18 by the Council were roads, schools, infrastructure and housing which totalled £27.76m, compared to £20.89m in 2016/17. Funding for this spend came from a number of sources:

- Capital receipts - £2.08m;
- Government Grants and contributions - £7.64m;
- Sums sets aside from revenue - £1.53m;
- Borrowings - £10.16m; and
- Reserves - £6.35m.

The movement in budget and forecast allocation in the year is illustrated below:



In all main categories of capital spend, the Council underspent against its budget. However, it needs to be recognised that this underspend is an in year underspend only, caused by a slippage in commencement dates and other delays in capital programmes. Given that this follows a similar underspend in 2016/17, the Council needs to consider if this is a wider issue with capacity to deliver the Asset Investment Plan.

Financial management (continued)

Systems of internal financial control

As discussed further on page 15, we have evaluated the Council's key financial systems and internal control to determine whether they are adequate to prevent misstatements in the annual accounts. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.

No material weaknesses have been identified from our audit work performed. However, there are two areas (see page 15) where we have identified areas for improvement.

Fraud and irregularity

We have reviewed the Council's arrangements for the prevention and detection of fraud and irregularities. Overall we found the Council's arrangements to be operating effectively.

In accordance with Audit Scotland planning guidance, we are required to monitor the Council's participation and progress in the National Fraud Initiative (NFI) during 2016/17 and 2017/18. An NFI audit questionnaire was completed and submitted to Audit Scotland on 28 February 2018, which concluded that the Council was fully engaged in the exercise.

We are pleased to note that recommendations made in our 2016/17 audit report on NFI participation have been actioned by the Council in the current year, as discussed on page 61.

Internal Audit

While the internal audit function is responsible for providing internal audit services to the Council, the IJB, the internal audits are relied upon by ZetTrans and the Orkney & Shetland Valuation Joint Board ('VJB') as they use Council staff and systems.

In both 2016/17 and 2017/18, we have noted that a number of items on the initial internal audit Annual Plan have been carried forward to the following year (8% in 2016/17, 10% in 2017/18). We also note from review of the internal audit 2017/18 Annual Report that the resources available for internal audit have been reduced in the previous few years and that this has impacted on the Audit Plan for 2018/19.

Given the importance of the internal audit function, the Council needs to consider if the Audit Plan for 2018/19 is appropriately robust on its own merits (as opposed to considering if it is robust enough given budgetary constraints) and whether sufficient resourcing is available to deliver a comprehensive programme of high quality internal audits.

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

From our review of the internal audit reports issued during 2017/18, we have noted a number of recommendations, including issues identified from internal audit around lack of segregation of duties and inconsistent application of controls. These findings are in line with our findings on internal controls.

We note that no frauds have been identified as a result of these issues.

Audit dimensions (continued)
Governance and transparency

Audit dimension

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

Areas considered

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

Deloitte response

We have reviewed the financial and performance reporting to the council during the year as well as minutes of Committee meetings to assess the effectiveness of the governance arrangements. Our attending at Audit Committees has also informed our work in this area.

We have also reviewed the governance arrangements in relation to the IJB.

Deloitte view

The Council has robust governance arrangements in place. However, there is room for improvement in the reporting calendar, rationalisation of the Committee structure and the presentation of performance monitoring reports to Committees.

We are pleased to note the development of a new Shetland Partnership Plan in the current year. However, it is imperative that delivery plans are developed to ensure that the aims of this plan are achieved, with these plans including clear targets and milestones to enable appropriate scrutiny. We further recommend that the Council align its strategic priorities with those of the Partnership Plan when preparing an updated Council Plan.

We have found that the integration of health and social care has continued to be an area of concern in the current year, with a number of areas for improvement highlighted both within this report and within the separate audit report to the Shetland Islands Integration Joint Board, which we encourage the Council to follow up (this has already been reported to Shetland NHS in our 2017/18 audit report). There is a lack of integration in budget setting, a significant funding gap which has resulted in no budget being approved for 2018/19 and a number of resignations of Board members, with these receiving substantial coverage in the press. Each of these presents an issue for the integration of health and social care in Shetland and the Council needs to work closely with its partners in the NHS and the IJB to deliver the required changes to address these challenges.

From our review of the internal audit plan for 2017/18 and internal audit reports, we are satisfied that there are appropriate systems of internal control in place and no significant weaknesses have been identified. Appropriate disclosure has been made in the annual governance statement of issues identified from the work of internal audit and any actions being taken.

Audit dimensions (continued)

Governance and transparency (continued)

Leadership and vision

The Council has strong leadership and, with its partners, has a clear vision for what it wants to achieve for the people of Shetland. Councillors and staff support the vision.

The Community Plan for 2018-28 sets out both national and local priorities and specifies four key priority areas for the life of the plan. Measures of success for each priority are set out in the plan. These are predominantly aspirational and the actions and detailed/proxy measures used to assess progress are set out in individual delivery plans.

We recommend the creation of comprehensive delivery plans as soon as possible to assist in the achievement of the targets set out in the Plan. We further recommend that these plans contain measurable milestones, to allow analysis/comparison at year-end of performance.

A recommendation was made in the prior year regarding aligning the visions of the various plans across Shetland. Although this has been partially taken on board by having a clear 'vision' in the Partnership Plan, it is confusing to have several competing strategic priorities (as the Council priorities are distinct from the Partnership Plan) when there is no clear link between them or which takes priority if there is competition between them. The Council should ensure that the strategic priorities are aligned when developing an updated Council Plan so that each Plan progresses the other, rather than competes with it.

Governance arrangements

Following the local government elections in May 2017, the Council appointed elected members to the Council's decision making structure, including Leader and Deputy Leader. The Council comprises predominantly of independent Members.

From our observations from attendance at Audit Committee meetings, we note that they are generally well attended and a good level of scrutiny and debate is evident. Council meetings are held in public and all papers and minutes are available through the Council's website. The Council is open and transparent about the way it conducts is business and how decisions are made.

The Council has a large number of Committees, with some Members on a significant amount of these. The Council should consider rationalising its Committee structure to ensure that it is sufficient to provide effective governance and scrutiny in the current climate. The Council should consider if the responsibilities of any Committees can be merged to reduce the number of Committees whilst maintaining the overall responsibilities, given that this will reduce the administrative time in preparing papers for and attending differing Committees without the loss of any scrutiny. Additional Committees require additional Member and management time and detract from time which can be spent elsewhere.

The Shetland Partnership Plan's **vision** is:

"Shetland is a place where everyone is able to thrive; live well in strong, resilient communities; and where people and communities are able to help plan and deliver solutions to future challenges."

The Shetland Partnership Plan has agreed four **strategic priorities** to help make this happen:

- **Participation**
- **People**
- **Place**
- **Money**

Audit dimensions (continued)

Governance and transparency (continued)

Governance arrangements (continued)

Although performance reports are generally sufficiently detailed, they could give more qualitative descriptions, which highlight/draw out what the challenges are. It would also enable greater scrutiny to benchmark against other Councils. Management accept that data is reported but does not reflect on where the challenges are. Management further accepts that the risk element of the report should link back to the data.

We have noted from discussions that due to time pressures, preparation of reports does not always receive the level of attention it should. Rationalising the Committee structure (as recommended on page 59) and the reporting calendar (per page 58) would be expected to help alleviate this problem.

The Council is currently in the process of rewriting the performance management strategy to make it more accessible (e.g., infographics). The Council notes that there are no issues with availability of data, but with use of it.

Finally, we have noted from our work that members of the Audit Committee have not formally reviewed their effectiveness or training in the year. The Audit Committee should carry out an annual effectiveness self-review in order to identify areas for improvement and to ensure that the training needs of Members are appropriately met. We have noted in other clients that non-Committee members (e.g., Council Members) attend one Committee meeting in the first couple of years of their appointment so that they can see how the Committee operates and satisfy themselves as to its performance (and thus better challenge the Audit Committee report to the full Council). This would also benefit scrutiny at full Council of internal and external audit issues.

Following the public pound

The statutory requirements to comply with the Following the Public Pound Code, in conjunction with the wider statutory duty to ensure Best Value, means that Councils should have appropriate arrangements to approve, monitor and hold third parties accountable for public funding provided to them. We are satisfied that through the use of Council systems and services and joint Committees, the Council has sufficient oversight of money provided to the Shetland Islands Integration Joint Board, Zetland Transport Partnership and Orkney & Shetland Valuation Joint Board.

Audit dimensions (continued)

Governance and transparency (continued)

Health and social care integration

The Council and the NHS have a well established partnership, strengthened by the Shetland Islands Integration Joint Board (IJB) which was established in June 2015. The IJB worked quickly to agree its plans, which reflect both national and local commitments.

For **2017/18**, the IJB approved an unbalanced budget of £44.22m (2016/17: £43.45m), with an unresolved funding gap of £2.53m. The final position for 2017/18, was an underspend against budget of £0.24m due to an underspend in the Scottish Government Additionality Funding. However, this underspend occurred only after a 'one-off' payment from the NHS to bridge the funding gap.

The **2018/19** budget was noted by the IJB but as yet it is not approved due to the inability to deliver a balanced budget.

	2017/18 budget (£m)	2017/18 revised budget (£m)	2017/18 actual (£m)	2018/19 budget (£m)
Council managed budget	£20.49	£22.15	£21.71	£24.13
NHS managed budget	£24.37	£22.07	£24.91	£22.27
IJB Total	£44.86	£44.22	£46.62	£46.40

As is the case across Scotland, the Council (along with the IJB and NHS Shetland) should continue to work to resolve funding issues around shifting the balance of care between hospitals and communities. At present, the IJB budget is still monitored against the Council and NHS Shetland managed budgets, rather than a genuine pooled budget for the IJB as a whole.

The partnership recognises that increasing demand, less money and the need to make savings means that it needs to think and work differently. Despite this, the IJB currently has no independent medium or long-term financial plan in place, relying on the separate NHS and Council plans instead.

Although the IJB is aware of the need to make savings and has identified a funding gap of £2.28m in 2018/19, there are no plans currently in place on how to deliver the required savings. We do note, however, that there is currently a 'scenario planning' programme underway which is looking at alternative models for the delivery of health and social care services in Shetland. The IJB estimates that it needs to achieve £9.96m of savings from this exercise over the coming five years.

The high turnover of Board members, along with the press comments for resignation, initially gave cause for concern with regards to governance arrangements but we are satisfied that these do not indicate any underlying issues and that membership will be consistent going forward.

We are aware that the process of creating the IJB caused tension between the Council and NHS. Given this, with the lessons learned in the previous number of years, the Council (in conjunction with the NHS) should consider reviewing the Integration Scheme to ensure it is fit for purpose.

Separately, given the pattern of Members going to the press when there are areas of concern or dispute, the Council needs to consider whether its internal mechanisms for identifying issues at an early stage and implementing appropriate remedies are sufficient. The involvement of the press does not solve the dispute and brings the Council and the IJB into disrepute.

Audit dimensions (continued)

Governance and transparency (continued)

Community engagement

The **Community Empowerment (Scotland) Act 2015** gives people more influence over how their Council and its partners plan services. It provides more formal ways for people to get involved. For example, people can ask to take part in decisions about Council services, which is called a Participation Request. The Act also makes it easier for communities to take ownership of land and buildings in a process known as asset transfers. This allows them to have a say in how the Council should spend money locally.

Shetland Islands Council understands the importance of community engagement and empowerment, however, limited focus was placed on this in 2017/18. Management have noted that this was due to it being an election year.

From our work, we noted that the Council primarily involves the community once a decision has been taken, for consultation and approval, rather than at the decision making stage.

Given the findings in the Partnership Plan - that 41% of residents want to be more involved in decision making, while only 27% feel they can currently influence local decisions - there is scope for improvement in this area. This is a new way of delivering local government and will require a change in mindset from Members and management to allow the community to drive decision, rather than the Council.

The pace of implementation of the requirements of the Act could be improved. Although the reasons for a 'slow' implementation are understood and admirable (attempting to 'get the process right'), this does not negate the fact that the Council could currently do more with regards to Community Empowerment.

With regards to participatory budgeting and the 1% Scottish Government target by 2020, Shetland is not currently but 'can' be on track. Management note that there are currently capacity issues in making this a high priority. However, this is a known challenge and is discussed at CMT meetings.

We note that in order to achieve the 1% target, a lot of emphasis is placed on bus tenders. There is a Council desire to improve engagement with the community, with Members considered to be on board with this. However, there is an acceptance that a cultural shift is required, so that this is treated as a method for the sharing of ideas rather than pitching for money.

Audit dimensions (continued)
Value for money

Audit dimension

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

Areas considered

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

Deloitte response

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

We have additionally considered the Council's arrangements for demonstrating value for money in the use of resources and the linkage between money spent, outputs and outcomes delivered.

Deloitte view

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

We are satisfied that following a number of changes to the unaudited annual accounts, Council performance is appropriately discussed within the Management Commentary in the Annual Accounts and management have introduced plans to address areas where progress has not been satisfactory.

Performance information is readily available to Shetland Islands residents via the Council website. However, there are areas for improvement in the presentation of this information, with the Council performance report reading like a list of Council achievements rather than a review of performance given the lack of linkage to the Council Plan or Local Outcome Improvement Plan and the use of graphs and infographics to highlight areas of good performance only, with little attention paid to areas of poor performance.

The Council performs well in the Local Government Benchmarking Framework ('LGBF'), although the differential between the percentage of indicators in the top and bottom quartile has decreased from 14% to 9% in the current year. Further, we note that areas where the Council performs poorly are 'topical' areas such as social care, environmental measures and gender balance. The areas of good and poor performance remain relatively consistent year on year, suggesting a focus on areas where the Council already performs well rather than on areas requiring improvement. This focus needs to be reconsidered.

Finally, we consider that more work could be done to evidence the link between spend and outcomes delivered at both a Council and Partnership level.

Audit dimensions (continued)
Value for money (continued)

Performance Management

The Council gathers performance information to monitor, track and improve service delivery to the community. The Shetland Partnership Plan and the Council Annual Performance Report are the main strategic tools which are used to plan for and report on the Council's performance. The Council monitors performance using the following measures:

- Local indicators detailed in Directorate and Service Plans;
- Local government benchmarking framework;
- Statutory indicators set by Audit Scotland;
- Shetland Partnership Plan indicators.

Although the Council has made an attempt to understand the nature and needs of residents in the Shetland Partnership Plan (2018-28), there is no clear link between actions taken by the Council and outcomes for local residents in the monitoring reports. The Council uses the 'Annual Performance Report' to report on actions taken in the year to progress the Partnership Plan, although there is a lack of any clear link between these actions, the goals set out in the Plan and the actual outcomes arising from these actions. As a result of this, although there is an attempt at applying demand management in the Plan itself, it is difficult to determine if this is being applied across the Council.

Performance information is readily available to Shetland residents and the use of infographics allows this information to be presented in a way that is visually interesting. However, given the lack of linkage between the performance reports and the plans against which this performance is meant to be measured, the Annual Performance Report reads like a list of Council achievements rather than a genuine analysis of performance.

The Annual Performance Report should be clearly linked to the Council's strategic priorities, with appropriate analysis given - especially in areas of poor performance (impact this has on achievability of the objective and remedial work taken.)

Although the inclusion of infographics and graphs is useful for accessibility, we noted from review of the 2016/17 Annual Performance Report that 7 graphs from the LGBF were included, and all 7 showed areas where the Council was outperforming the national average. Further, areas where there was perceived 'good' performance were accompanied by enlarged text and images, whereas areas of 'poor' performance were buried in the general text. The public will generally skim these documents - presenting the report in this way is misleading, and is not a balanced review of performance in the year.

Statutory performance indicators

The Accounts Commission places great emphasis on Councils' responsibility for public performance reporting. The Commission does not prescribe how Councils should report this information but expects them to provide the public with fair, balanced and engaging performance information.

For 2017/18, two SPIs were prescribed:

- SPI 1: Covering a range of information relating to service performance and local outcomes; and
- SPI 2: Relates to reporting of performance information as required by the Local Government Benchmarking Framework.

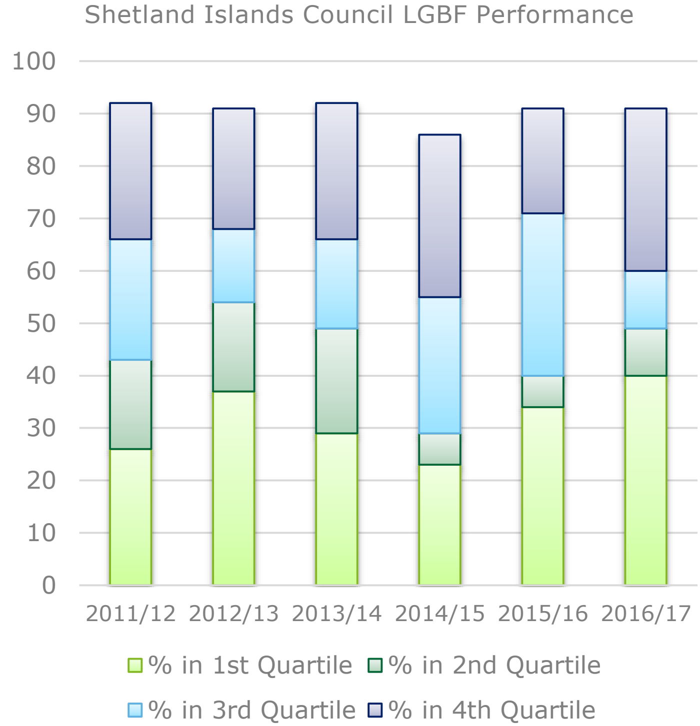
Overall, we concluded that the Council's arrangement for publication are satisfactory, subject to the improvements recommended above.

Audit dimensions (continued)

Value for money (continued)

Performance Data

We have drawn on the Local Government Benchmarking Framework (LGBF) to make a high level assessment of the Council's performance, relative to all Scottish councils, in 2016/17 (the latest data available). The LGBF includes a number of indicators organised under common service areas. Performance is summarised in the below table.*



* Note that the Council did not submit data for 100% of the indicators in the LGBF, hence why the amount in each quartile do not sum to 100%.

The Council's performance has become increasingly polarised in terms of the LGBF since 2011/12. In 2011/12, the Council sat in the top and bottom quartiles for 26% of indicators. In 2016/17, the Council was in the top quartile for 40% of indicators - up from 34% in 2015/16 - and in the bottom quartile for 31% of indicators - up from 20% in 2015/16. The areas of good and poor performance have remained relatively consistent year on year, demonstrating that where the Council does well, it appears to continue to invest and make decisions which improve the performance of that area, with areas of weaker performance being comparatively neglected.

The Accounts Commission accepts that Council's cannot excel in all areas in the current economic environment and that performance below the national average is acceptable if based on well considered, deliberate policy decisions. The Council should be aware of this when considering changes to improve performance in the areas in which it is historically poor performing.

Our review noted that areas of political/topical interest where the Council performs poorly are:
1. Recycling (only 8% of household waste recycled). Deloitte are aware that steps are being taken to improve this, with 'wheelie' bins being rolled out currently.

2. Satisfaction with adult social care and support (this is despite the fact that the Council spends 3.6 times the Scottish average on providing residential care to older people) is below the national average. This needs to be viewed in conjunction with the discussion on the integration of health and social care, as discussed on page 38.

3. Gender balance in senior posts (25% being female in Shetland, well below the Scottish average of 52% and a gender pay gap of 8.2% (compared to national average of 4.1%). We are aware that this is a known issue and management are taking steps to close this gap. This would be aided by the development of a Council-wide Workforce Plan, as discussed on page 30.

4. The Council spends £8,927 per child per week on residential care for 'looked after' children, well in excess of the Scottish average of £3,404. This compares with £399 per week on foster/family placements (Scottish average of £313). In Shetland, only 84% of 'looked after' children are in foster/family placements, compared to a Scottish average of 90% and the school attendance rate of 'looked after' children is substantially below the Scottish average. Management accept that this is not affordable and are currently progressing plans to reduce the use of residential care.

Audit dimensions (continued)

Sharing best practice

In our 2016/17 report, we provided the Council with some case study data where Deloitte has been involved in cost reduction work with a number of public sector bodies in England. We recommended that the Council reviews these case studies and considers them as opportunities for improvement going forward as potential areas for cost reduction.

During 2017/18, we have had some further discussion with the Chief Executive of Shetland Islands Council and the Chief Operating Officer for the Shetland Health and Social Care Partnership, to share areas of best practice around transformation and integration from our work in England.

From our experience, public sector bodies that have successfully delivered and sustained transformational change have tended to focus on the following six key requirements. The overarching aspect throughout a transformation programme is having strong leadership that believes in and can drive transformational change.

Strategic Driven	A "Place" leader	Digital data analytics and insights	Efficiency, productivity and income generation	Outcome focused partnership working	Relation with the Citizen
Plans and strategies need to be completely transparent and reflect **personal accountability** of those involved.	**Leadership** must drive transformation with partners and the rest of the workforce. Leadership development is key to effective change.	Bodies should rely on their **digital capacity** to drive productivity and efficiency.	New standardised processes need to reflect the agreed design, be **efficient**, effective and scalable.	Resources need to be targeted to **key priorities and outcomes** at a partnership level.	Shifting focus from servicing people's needs towards **empowering** their strengths to enable them to meet their own needs.
A key challenges is achieving buy-in from the workforce. Personal accountability is effective in ensuring this buy-in.	Difficult decisions may need to be made if leadership do not buy-in to the transformation agenda.	There is a wealth of data available to public sector bodies to help identify and achieve greater efficiency.	Essential for systems to be integrated as much as possible to achieve most benefit.	Transformation plans should be clear as to the expected impact on priority outcomes.	Processes need to be structured and systematic to be effective.

Audit dimensions (continued)

Sharing best practice (continued)

Below are some real life examples of work done in other public sector bodies to demonstrate how some of these six key requirements outlined on page 43 can be applied in practice.

Relation with Citizen

Outcome focused partnership working

A health body had a patient that required an extensive care package costing approximately £3,000 per week. This was a "needs-based" package and despite the level of care provided, the patient still felt isolated and alone. As part of a transformation to service delivery, the patient's package changed from a needs-based approach to focus on their strengths.

The patient became more active through engagement with their interests (specifically, the health body helped them join a local model-aeroplane building club), and this small but significant change to service delivery approach saw the cost of the patient's care package reduce from approx. £3,000 a week to approx. £20 a week. The patient was able to largely care for himself with appropriate support in the community. Whilst this is an extreme example, this is what real transformation to service delivery represents.

A Health and Social Care Partnership transformed its care at home service by introducing a "Front Door" approach. A single team of social workers, occupational therapists and support assistants based across two locations is now in place to talk to people who may need to use services. The council refers to this as changes to 'front door' services. Previously, individual teams provided separate care, with a referral process between teams. The new model of care encourages local people to develop the confidence and skills to care for themselves, using personal strengths, assets and wider community resources.

This approach is more personalised and helps reduce the demand for social care and acute hospital admissions. Individuals now have only one worker to deal with, and staff from different services can liaise with each other more easily. This reduces inappropriate referrals and, in some cases, removes the need for a referral, for example, if information and advice is all that someone needs.

Relation with Citizen

Outcome focused partnership working

Efficiency, productivity

Audit dimensions (continued)

Sharing best practice (continued)

Relationship with Citizen

A Council in England committed to a series of pledges and in return need residents and businesses to play their part too (The Deal). So far through working together, the Council has saved £115m, with evidence based outcome improvements.

The Deals are wide ranging, offering partnership work and support in a number of areas. As an example, the **Deal for Health and Wellness**, includes the following:

Our Part

- Ensure there are a wide range of facilities within local communities including parks, open spaces, leisure, safe cycling routes, good quality housing
- Ensure easy, timely access to good quality GP services, seven days a week, to screen, diagnose and treat and prevent disease as early as possible
- Support families to ensure their children have the best start in life

Your Part

- Keep active at whatever stage of life
- Register with a GP and go for regular check-ups – taking charge of your own health and wellbeing
- Quit smoking. Drink and eat sensibly and encourage your children to do the same

Digital data analytics and insights

A Health and Social Care Partnership invested in its digital capacity to collect and process data so it can better predict chronic health issues occurring amongst patients. This investment has allowed the partnership to reduce its acute care costs as less expensive and more effective health care can be provided upfront to address potential chronic health risks predicted by the data.

A police force, in partnership with its local health body, used data to reduce acquisitive crime rates. Data identified a pattern of acquisitive crime peaking on the weekends, and the police force determined that this was largely driven by the fact that methadone prescriptions in the area were issued every Friday. therefore led a programme to stagger the prescriptions throughout the week, leading the acquisitive crime rates levelling out and becoming more manageable.

Wider scope audit work (continued)

Specific risks

In accordance with our Audit Plan, we have considered the specific risks identified by Audit Scotland as part of our audit as follows:

Risk identified	Response
EU Withdrawal	The UK is expected to leave the European Union (EU) on 29 March 2019, followed by a transition period to the end of 2020. There are still a lot of uncertainties surrounding the terms of the withdrawal agreement but the outcome will inevitably have significant implications for devolved governments in Scotland and for Scottish public sector bodies. Given the scale of the potential implications and possible timescales for implementing changes, it is critical that public sector bodies are working to understand, assess and prepare for the impact on their organisation. This is likely to include consideration of three areas: **Workforce**: the extent to which potential changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour. **Funding**: the extent to which potential changes to funding flows, including amounts anticipated under existing EU funding programmes, are likely to affect the finances of the organisation and the activity that such funding supports. **Regulation**: the extent to which potential changes to regulation across a broad range of areas currently overseen at an EU level are likely to affect the activity of the organisation. Within the Council, the Development Committee specifically are considering the impact of the EU withdrawal in conjunction with a new sounding board set up to consider this area. There are approximately 1,000 EU nationals employed in Shetland, with approximately £20m of EU funding received in the community per annum. We note that the Highlands & Islands leadership group published a report recently on the impact of Brexit. The Council is considering the applicability of each risk to Shetland. Further, the Council is currently trying to identify areas of potential benefit rather than purely viewing EU withdrawal as a threat. Given the above, we are satisfied that adequate consideration is being given by the Council to EU withdrawal preparations, although the Council must ensure it increasingly focuses on the impact of withdrawal as the likely outcomes become clearer in 2018/19.
New financial powers	The Scottish Parliament's new financial and social security powers and responsibilities from the 2012 and 2016 Scotland Acts are fundamentally changing the Scottish public financials. The Scottish Government will publish its medium-term financial strategy in 2018 in response to recommendations in the Budget Process Review Group final report, and has made a number of other commitments to improve financial management to help Parliamentary scrutiny of decisions. As a result of this, there is an expectation that public bodies will be seen before subject committees of the Parliament more often. Councils should therefore use this as an opportunity to make comment within their annual reports beyond the compliance requirements to clearly articulate their achievements against outcomes and future plans.

Wider scope audit work (continued)
Specific risks (continued)

Risk identified	Response
Ending public sector pay cap	As discussed on page 25, the 2018/19 budget includes pay awards which have been aligned to the thresholds set out by the Cabinet Secretary in the Stage 1 debate on 31 January 2018. The impact of the ending of the public sector pay cap has been further built into the Medium-Term Financial Plan, with this expected to result in an additional £2m in costs to the Council per annum.
Cyber security risk	In light of recent cyber incidents, the Scottish Government has produced new guidance for public bodies. This builds on Scotland's cyber resilience strategy (Safe, Secure and Prosperous), provides more concrete actions for bodies to take and develops a monitoring framework for the Scottish Government. The Council are undertaking all the required steps to achieve certification in line with Scottish Government requirements, with cyber risk built into Council working. The Council are now doing Cyber Essentials Plus certification along with the annual PSN CoCo certification. Further, the Council recently carried out an IT Health Check. Results are outstanding, but once received, the Council will put in place a plan to address any remediation work necessary, and finalise their Cyber Essentials Plus application. The Council expect to achieve this with little difficulty. The Council have taken the Scottish Government Cyber Response Plan and amended it for their specific circumstances, with this forming part of the Council’s Emergency Response plan, and the Emergency Planner will hold an exercise later in the year in this area. The Council has a dedicated team dealing with cyber risk and is carrying out all the expected steps to ensure it is cyber resilient.
Openness and transparency	From our audit work, we are satisfied that the Council is appropriately open and transparent in its operations and decision making. All reports presented to Committees and minutes of meetings are available on the Council website. However, we do note that there are a large number of Committees and the Council accepts that review and rationalisation may be appropriate, as outlined on pages 58 and 59.

Technical update

Technical Update

New standards for 2018/19 accounting code

IFRS 9, Financial instruments and IFRS 15, Revenue from contracts with customers, have been adopted for the 2018/19 accounting code. Transitional reporting requirements have been adopted such that the preceding year is not restated. In order to support local authorities, CIPFA, under the guidance of LAAP, has issued separate guidance for local authority practitioners. We would encourage the council to consider these to ensure that it is fully prepared for implementation in 2018/19. We have summarised the key implications of the new standards below.

IFRS 9, Financial Instruments

- It is likely that many collective investment vehicles would be classified to fair value through profit or loss (FVPL) from 1 April 2018, so that the fair value gains and losses will be chargeable to the Surplus or Deficit on the Provision of Services as they arise.
- There has been some debate around whether collective investment vehicles qualify for the presentation election under IFRS 9 to be reclassified to fair value through other comprehensive income (FVOCI). In order to qualify for this presentation the investment would need to meet the definition of an equity instrument. This would not be the case if instrument is 'puttable' (i.e. the holder has the right to demand repurchase or repayment of the principal).
- One of the other main features of IFRS 9 is the change in the impairment loss model for financial assets from one based on incurred losses to one based on expected (credit) losses. The new forward looking approach is likely to result in an increase in the allowances required as at 1 April 2018. As allowances are based on the risk of default and the approach to investments in local authorities is to opt for security and high quality financial instruments, CIPFA has indicated that for many financial assets the impact should be modest. Particular attention will need to be paid to material balances or loans to third parties against which there has been no default but there are significant possibilities that there may be in the future.

IFRS 15, Revenue from Contracts with Customers

- IFRS 15 will require local authorities to recognise revenue in such a way that it represents the transfer of promised goods or services to the service recipient (customer) in an amount that reflects the consideration to which the authority expects to be entitled in exchange for those goods or services. CIPFA is of the view that generally this should not have a substantial effect for local authorities with relatively predictable income streams but it may have an impact on authorities where the consideration is variable and/or when income is recognised over time.
- CIPFA would also note that the disclosure framework under IFRS 15 is substantially increased. It is intended to allow an understanding of the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers and includes the disaggregation of revenue, information on performance objectives, the significant judgements made and contract balances. CIPFA would encourage local authority accounts preparers to focus on the materiality of the income that is recognised to ensure that the key messages in local authority financial statements are not obscured.

Potential impact on the Council

We do not anticipate that IFRS 15 will have a significant impact on the Council. However, given the level of investments held by the Council, IFRS 9 will have a substantial impact, as outlined in our planning paper in February 2018. This could result in investment gains and losses being recognised through the CIES unless a specific designation is made otherwise, to continue the current practice of disclosing these as other comprehensive income and expenditure. There is also a need to consider the revised three stage impairment model, which includes lease receivables, and the associated additional disclosure requirements. As these are changes for the 2018/19 Code, the Council needs to consider now the steps it is going to take to comply with the new requirements and the time and resources required to comply. We will focus closely in this area in our 2018/19 audit.

Technical Update

IFRS 16 Leases

The effective date of IFRS 16 Leases is 1 January 2019. Therefore (subject to CIPFA/ LASAAC decision) the standard is anticipated to be adopted in the 2019/20 Code.

IFRS 16 removes the existing classifications of operating and finance leases under IAS 17 *Leases* for lessees.

It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value. A lessee will recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing the lessee's obligation to make lease payments for the asset.

The consultation papers and the Exposure Draft have been drafted by CIPFA/LASAAC with the assistance of its sub group. However, both CIPFA and CIPFA/LASAAC are considering new ways of assessing how the standard will impact on local authorities.

CIPFA/LASAAC will issue the consultation as soon as possible, and notification of the issue of the consultation will be via Treasurers Societies, the Networks and CIPFA social media or via the CIPFA/LASAAC pages of the CIPFA website. This consideration will also include the assessment of the practical effects of implementation. The consultation papers, for example, include a readiness assessment questionnaire to assist CIPFA/LASAAC with an understanding of the impact (and could also be usefully used by local authorities to assess the issues that need to be considered).

Potential impact on the Council

The Council has substantial operating leases as lessee, totalling £15.6m as at 31 March 2018. These are currently disclosed in the notes to the annual accounts but not included on the balance sheet. From 2019/20, the Council will be required to recognise a 'right-of'-use' asset and corresponding lease liability. The former will be valued at the same as the lease liability plus any incidental costs to the lease, whereas the latter will be valued at the present value of future lease payments. The leases will need to be assessed for depreciation and impairment as currently undertaken for the Council's other assets.

This will have a substantial impact on the assets and liabilities held by the Council as all operating leases going forward will essentially be treated as finance leases. Due to the number of operating leases and the work involved in calculating the value of the asset and corresponding liability, we recommend that the Council carry out preparatory work in 2018/19 to ensure it is in a position to comply with the new requirements from the beginning of 2019/20. We are pleased to note that the Council has carried out some work and prepared a briefing note for staff on the new standard, key points, transitional arrangements and planned 'next steps'.


Appendices

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

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

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

What we don’t report

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

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

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

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

The scope of our work

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

We described the scope of our work in our audit plan and the supplementary “Briefing on audit matters” circulated separately.

This report has been prepared for the Audit Committee and Council, as a body, and we therefore accept responsibility to you alone for its contents.

We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

for and on behalf of Deloitte LLP

Glasgow

4 September 2018

Audit adjustments
Corrected misstatements

We have identified the following misstatements from our audit work, all of which have been corrected by management but we nonetheless bring to your attention. The net impact of these misstatements on the deficit for the period is £nil.

		Debit/ (credit) in CIES £m	Debit/ (credit) in net assets £m	Debit/ (credit) reserves £m	If applicable, control deficiency identified
Corrected misstatements					
Valuation of Property Assets	[1]		(0.19)	0.19	Yes – page 15
IJB & ZetTrans Debtors and Creditors	[2]		(0.36)	0.36	Yes – page 15
Total			**(0.55)**	**0.55**	

[1] This error has arisen due to the Council's approach to valuation of specialised assets not being consistent with valuation guidance, which direct the Council to reflect 'least cost to replace' considerations, focusing on commercial rather than residential land values. Including residential land values in the calculation of 'least cost to replace' overstates the value of the assets to the Council by £0.19m, as the Council would not be in a position to bid for such sites. This adjustment also removes the corresponding increase in the revaluation reserve.

[2] This error arose as the Council was accounting for all income and expenditure with the IJB and ZetTrans as debtors and creditors at the year end. An adjustment has been raised to ensure that the debtors and creditors recorded by the Council reflect the amounts actually outstanding with the IJB and ZetTrans at the year end.

The adjustment posted relating to the IJB reduces the level of debtors and creditors held by the Council by £22.07m and £21.71m respectively. This results in the Council recording a net creditor of £0.18m owing to the IJB, due to the Scottish Government 'Additionality Funding' it is holding on their behalf. The net impact of this on net assets is a reduction of £0.36m. The adjustment also removes a corresponding amount that the Council had held in its Community Care Fund reserves relating to this Additionality Funding, as these are not Council reserves.

The adjustment posted relating to ZetTrans reduces the level of debtors and creditors held by the Council by £1.90m both ways. There is no impact on net assets as the Council was previously treating ZetTrans as a net debtor and this is appropriate as ZetTrans owe the Council £0.19m.

Action plan

Recommendations for improvement

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Valuation of property assets	The Council should ensure that the post of Valuer, independent of the Team Leader of Estates and Assets, is filled for 2018/19 and that sufficient segregation of duties exist between the person carrying out the valuation of property assets and the person carrying out the technical review of that work. (Refer to page 15 for details)	Management have confirmed that the post has been filled for 2018/19.	Executive Manager – Capital Programmes	31 December 2018	High
Financial Sustainability: Workforce planning	The Council should develop a Council-wide workforce plan. This should include details on succession planning, recruitment and retentions. (Refer to page 30 for details)	The Council has confirmed that a facilitated session on workforce planning is to be held with the senior management team in September 2018.	Executive Manager – HR	31 December 2019	High
Financial Sustainability: Savings target	Additional work needs to be done to determine the feasibility of the Council savings target of 3.4% across the board and how these savings will be delivered. Business Transformation and Service Redesign projects need to include clear targets and milestones against which to measure performance. In addition, progress on these projects and against savings targets in general should be clearly reported to Members as part of the quarterly monitoring reports. (Refer to page 26 for details)	Management has confirmed the Business Transformation and Service Redesign programmes will continue to be reported regularly to monitor and measure performance. Members had been asked where focus and priorities should be in the medium term and management will continue to work with members to deliver these projects.	Executive Manager – Finance	31 March 2019	High

Action plan

Recommendations for improvement (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Financial Sustainability: Transformation programme	The Council needs to consider how it delivers services as a whole through a single, unified transformation programme which includes a medium-term plan for addressing the funding gap, rather than taking an ad-hoc approach to transformation. This must involve a high level of community and Member engagement given the nature of services in Shetland. The Council is in the fortunate position of having a high level of reserves and should use the existence of this 'buffer' to take the necessary steps to change its service delivery model so that it is fit for the future given anticipated demographic and financial changes. The Council must further consider the infrastructure in place to deliver such a programme, including significant Member involvement, a PMO, its change management approach and access to relevant tools and templates to assess performance. (Refer to page 26 for details)	The Policy and Resources Committee receives updates on the Business Transformation and Service Redesign programmes quarterly. The programmes are linked and seen as inter-dependent rather than as one programme. The programmes and individual projects are managed using PRINCE2 methodologies. There are Sounding Boards for each programme with elected members as core members. The Corporate Management Team regularly reviews performance and savings targets. The Council is currently exploring ways of providing additional staffing resources to take forward projects using Spend to Save and Service Change budgets established for this purpose.	Director – Corporate Services	31 March 2019	High
Value for Money: Local government benchmarking	The Council should consider its priority areas compared with it's areas of poor performance in the LGBF and compare what is being carried out locally with what is being done at other Councils which sit at the higher end of the scale. The Council has far greater resources available to it than other Councils nationally, and should have the ability to carry out the necessary changes to improve performance in the areas which are historically poor performing. (Refer to page 42 for details)	LGBF data is reported to the Council and functional Committees. One of the priority areas in the Service Redesign Programme is the consideration of "outliers" where the Council's LGBF data is at odds with similar Council's data this includes fully understanding the data and whether the service outcomes being delivered explain the difference in Shetland's data.	Chief Executive	31 March 2019	High

Action plan

Recommendations for improvement (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Financial Sustainability: Long-term financial planning	In line with best practice, the Long-Term Financial Plan should include additional detail on how the Council can continue to provide services and deliver outcomes in line with its current and anticipated objectives, given anticipated longer-term demographic and technological changes. This should include a long-term capital plan (with this clearly linked to the Business Transformation Programme). The Council should also consider at the next revision of the LTFP whether community engagement would result in better information for Members on the longer-term aspirations and expectations of the community (in line with best practice), as we have noted that there was no community engagement in the development of the current LTFP. (Refer to page 28 and 29 for details)	The current LTFP covers a 35-year period to 2050. Work on the next iteration of the LTFP is expected to commence over the next 12-18 months and community engagement will be considered as part of this process.	Executive Manager - Finance	31 August 2019	High
Governance & Transparency: Health and social care integration	There is a need to improve integration of the IJB budget, rather than viewing it as two separate budgets from the Council and NHS. Steps also need to be taken to close the funding gap at the IJB. Given the lessons learned in the previous number of years, the Council (in conjunction with the NHS) should consider reviewing the Integration Scheme to ensure it is fit for purpose. Separately, the Council also needs to consider whether its internal mechanisms for identifying disputes at an early stage and implementing appropriate remedies are sufficient. We have also found that there is scope for the governance arrangements between the Council and IJB to be improved to ensure that the respective roles and responsibilities are clear. (Refer to page 38 for details)	Work has commenced on a self-evaluation of the IJB's governance framework and production of a Code of Corporate Governance. This evaluation will consider the recommendations made, including the need for a review of the Integration Scheme and its supporting governance and reporting arrangements.	Executive Manager – Governance & Law	31 March 2019	High

Action plan

Recommendations for improvement (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Financial Management: Budget setting	The Council should adopt a priority-based approach to budget setting, whereby resources are focused on the Council's priority areas. Applying a 4.5% savings target across the board (a 'salami slice' approach) is difficult to put into practice and not achievable in the long term, is vague in how savings will actually be achieved and does not protect priority areas. The Council should carry out self-evaluation on completion of projects, to confirm whether the project achieved its stated aims, delivered value for money, and how it performed against budget (in terms of cost and time). As highlighted in 'Best Value' audits conducted at other councils, the Council needs to demonstrate how its actions actually make a difference to the lives of residents - the Council should ensure such a section is included on any post-completion evaluation of projects. (Refer to page 29 and 32 for details)	Management recognise the difficulty with the 'salami slice' approach and promotes that a more selective approach in line with Council priorities is the way forward. Evaluation on completion of projects is an integral part of the Building Better Business Cases methodology being applied to the Service Redesign programme.	Executive Manager – Finance	31 March 2019	High
Value for Money: Performance reporting	The Annual Performance Report should be clearly linked to the Council's strategic priorities and the Partnership Plan, with appropriate analysis given - especially in areas of poor performance (including the impact this has on achievability of the objective and remedial work taken). The Council also needs to reconsider how the report is presented in future years to ensure that the message presented to the public is fair and balanced. (Refer to page 41 for details)	A recent Council Customer First survey asked the public for views on how the Council provides performance information. Executive Services will ensure that feedback from that exercise, together with the recommendations in this Action Plan, is taken into account in producing the next annual public performance report.	Executive Manager – Executive Services	31 March 2019	High

Action plan

Recommendations for improvement (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Financial Management: Reporting calendar	The Council should reconsider its reporting calendar for reporting to Committee and Council, narrowing the gap between the time the monitoring reports are prepared and when they are presented to Members. We also recommend that the Council consider reporting on a more risk-based approach, with higher risk areas being reported more regularly and lower risk areas less frequently. (Refer to page 32 for details)	Work is due to commence on the reporting calendar for 2019/20. This will take account of the recommendations made in relation to performance and financial reporting timescales, alongside the needs of other business and reporting requirements and timescales.	Executive Manager – Governance & Law	31 March 2019	Medium
Governance & Transparency: Partnership planning	As the Council is currently refreshing the Council Plan, we recommend that it is made clear within the Council Plan how the strategic priorities and plans of the Council align with and help achieve the priorities in the Partnership Plan. Further, it is important that comprehensive delivery plans are developed in the near future to ensure that the aims of the Partnership Plan are achieved. These delivery plans need to include measurable milestones to allow monitoring of performance. (Refer to page 36 for details)	The Shetland Partnership is commencing the development of delivery plans. The Partnership is also developing the governance structure to ensure the plans are monitored against the milestones for changing individual and community outcomes. The Council's Corporate Plan halfway review is being reported to the Council in September. Directorate Performance reports now refer to both the Corporate Plan performance and the Directorate's links to the partnership plan. This will be made clearer in the revised Directorate plans developed as part of the budget preparation process between September 2018- February 2019.	Chief Executive	31 March 2019	Medium

Action plan
Recommendations for improvement (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Governance & Transparency: Committee framework	The Council should consider rationalising its Committee structure to ensure that there are enough Committees to provide effective governance and scrutiny, but no more than that as additional Committees require additional Member and management time and detract from time which can be spent elsewhere. As part of this rationalisation, the Council should consider if the responsibilities of any Committees can be merged to reduce the number of Committees whilst maintaining the overall responsibilities, given that this will reduce the administrative time in preparing papers for and attending differing Committees without the loss of any scrutiny. (Refer to page 36 for details)	Work has commenced on a self-evaluation of the Council's governance framework. This evaluation will consider the recommendations made, recognising the need to reduce Member and management time at meetings, but will balance this with the overall need to ensure the decision-making framework supports sound and effective corporate governance.	Executive Manager – Governance & Law	31 March 2019	Medium
Governance & Transparency: Performance monitoring	Performance monitoring reports should give more qualitative descriptions, which highlight and draw out what the challenges are. Further, although performance reports are generally sufficiently detailed, they should include comparative information by benchmarking to other Councils. (Refer to page 37 for details)	Benchmarking data is already reported as part of Performance reports- APSE reports, LGBF, audit reports. Performance Management is a key strand in the Business Transformation Programme and this issues will be picked up by targeted work during the next 6 months.	Chief Executive	31 March 2019	Medium

Action plan

Recommendations for improvement (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
Value for Money: Participatory budgeting	The Council is not currently on track to meet the 1% target for 2020 set by the Scottish Government. More emphasis needs to be placed on this area in 2018/19 to identify areas where participatory budgeting can be improved in order to achieve, or exceed, the national target by 2020. (Refer to page 39 for details)	Management note that there is a Council desire to improve engagement with the community, with Members considered to be on board, however there are currently capacity issues in making this the highest priority. As and when services are reviewed, the relevance of community consultation will be considered.	Executive Manager – Finance	31 March 2019	Medium
Governance & Transparency: Community engagement	Given the findings in the Partnership Plan - that 41% of residents want to be more involved in decision making, while only 27% feel they can currently influence local decisions - there is scope for improvement in community engagement. This is a new way of delivering local government and will require a change in mindset from Members and management to allow the community to drive decisions, rather than the Council. (Refer to page 39 for details)	Participation is a key strand in in the Partnership Plan and the Corporate Plan which are focused on Community Empowerment. A number of initiatives have been developed to enhance participation, including the "Voices for Equity" mentoring scheme and promotion of Community Council roles through a film and publicity programme. The Council supports Participatory Budgeting. Opportunities for community engagement are built into the Service redesign projects. The Council continues to explore the appropriate balance between participatory and representative democracy in its decision making processes.	Chief Executive	31 March 2019	Medium

Action plan

Follow-up of 2016/17 recommendations

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Strategic Priorities	While the Council has multiple sets of outcomes, priorities and aims to deliver its vision, we recommend that these be reconsidered to ensure better alignment with outcomes.	Management agreed with this recommendation.	Chief Executive	March 2018	High	*Partially implemented:* The outcomes, priorities, aims and vision in the Partnership Plan and the Council Plan are not entirely aligned and there is no 'bridging' document which shows how the Council will align with the Partnership Plan whilst still delivering on its own individual vision. The updated Council Plan should clearly link with the Partnership Plan priorities. **Updated management response:** The halfway review of the Corporate Plan is being reported to Council in September 2018. The Directorate Plans being prepared between September 2018 and February 2019 will show how Directorates' activities are delivering on the Partnership Plan outcomes as well as the actions in the Council's Corporate Plan. The delivery plans that are prepared by the Partnership will assist in ensuring that it is clear how the Council prioritises activity that impact on Partnership plan outcomes. **Updated target date:** March 2019
National Fraud Initiative	The Council should ensure that appropriate resources are put in place to address the NFI matches on a timely basis.	Additional resources are planned to be allocated to the completion of the NFI going forward.	Executive Manager – Finance	March 2018	Medium	*Fully implemented:* All matches investigated and the NFI exercise now completed. Further, a new anti fraud policy has been implemented and the NFI & Fraud Annual Report completed.

Action plan
Follow-up of 2016/17 recommendations (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
PPE Valuations	A number of recommendations have been made in review of the valuation exercise, undertaken by our property specialists. These points should be considered when preparing the valuation report in the coming year.	The valuers have noted all the points raised by Deloitte and have agreed that these points will be considered in valuations going forward.	Executive Manager – Capital Programmes	March 2018	Medium	*Partially implemented:* The majority of recommendations made in 2016/17 were taken on board and applied in the 2017/18 valuations. However, not all recommendations were actioned - this is likely due to the change in key personnel in the year. **Updated management response:** Management confirmed that they aim to address all recommendations in the year they are raised, and that they will follow up and implement all recommendations made with regards to the valuation process in 2018/19. **Updated target date:** 31 December 2018
Fishing Quota Valuation	The Council should request additional information regarding any assumptions used (e.g. if it references prices offered - these should be attached in an appendix to the valuation with evidence).	Management have agreed to obtain additional documentation to back up the valuation as appropriate.	Executive Manager – Finance	March 2018	Medium	*Fully implemented:* The Council have included in the scope of the work of the valuer a list of items as highlighted by Deloitte that should be provided (competence, work carried out, back up for valuation, etc.). Deloitte confirmed this was appropriate and that the Council is to perform a sense-check when the valuation is received. The valuation received was sufficiently precise and appropriately supported, with the Council checking this proactively and requesting Deloitte feedback before accepting the valuation.

Action plan

Follow-up of 2016/17 recommendations (continued)

Area	Recommendation	Management Response	Responsible person	Target Date	Priority	2017/18 Update
Journal Entry Listing	As part of year end reporting, the full journal entry listing should be reconciled to the trial balance used to generate the financial statements.	Management has taken this on board and the finance team will produce a reconciliation in future periods.	Executive Manager – Finance	March 2018	Medium	*Fully implemented:* A fully reconciled journal listing and trial balance were provided when the auditors arrived on site.
Leases	All lease agreements should be signed by both parties, with all key terms clearly defined within.	Management accepts these points, noting that it is their intention and practice that these issues should not arise in the first instance and that going forward they will ensure these issues do not recur.	Executive Manager – Capital Programmes	March 2018	Medium	*Partially implemented:* No issues were noted in internal checks with leases following these points. However, no retrospective review of leases has been carried out. **Updated management response:** There has been no retrospective review of existing leases, however on renewal or extension all agreements will be signed by both parties. **Updated target date:** Not applicable – leases to be checked on renewal or extension, rather than retrospectively.

Fraud responsibilities and representations

Responsibilities explained

Responsibilities:

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

Required representations:

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

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

Audit work performed:

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

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

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

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

Concerns:

No concerns have been identified regarding fraud.

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 that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.
Fees	The audit fee for 2017/18 is £211,741 as detailed in our Audit Plan. No fees for non-audit services have been charged by Deloitte in the period.
Non-audit services	In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the company's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence. We are not aware of any relationships which are required to be disclosed.

Events and publications

Our publications and insights to support the Council

Publications

The State of the State 2017-18
Citizens, government and business

This year's report finds the UK Government amid the complex challenge of leaving the EU. Inevitably, this early phase of EU exit is taking place under intense media scrutiny and passionate political debate. But while EU exit issues may dominate headlines, the public services face more local challenges as they address rising demand, budget restraint and renewed levels of concern about social inequality.

The State of the State 2017-18 explores government through three lenses – the citizen lens, the public sector lens and the business lens.

Download a copy of our publication here:
https://www2.deloitte.com/uk/en/pages/public-sector/articles/state-of-the-state.html

Sharing our informed perspective

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

Recent publications relevant to the local authorities are shared opposite:

Perspectives: Do you have a digital mindset?
Accelerating health and care integration

Digital technology is helping to transform the way citizens interact with service providers across all other service industries. The time is now ripe for changing the relationship between health and social care commissioners and providers and service users.

Read the full blog here:
https://www2.deloitte.com/uk/en/pages/public-sector/articles/do-you-have-a-digital-mindset.html

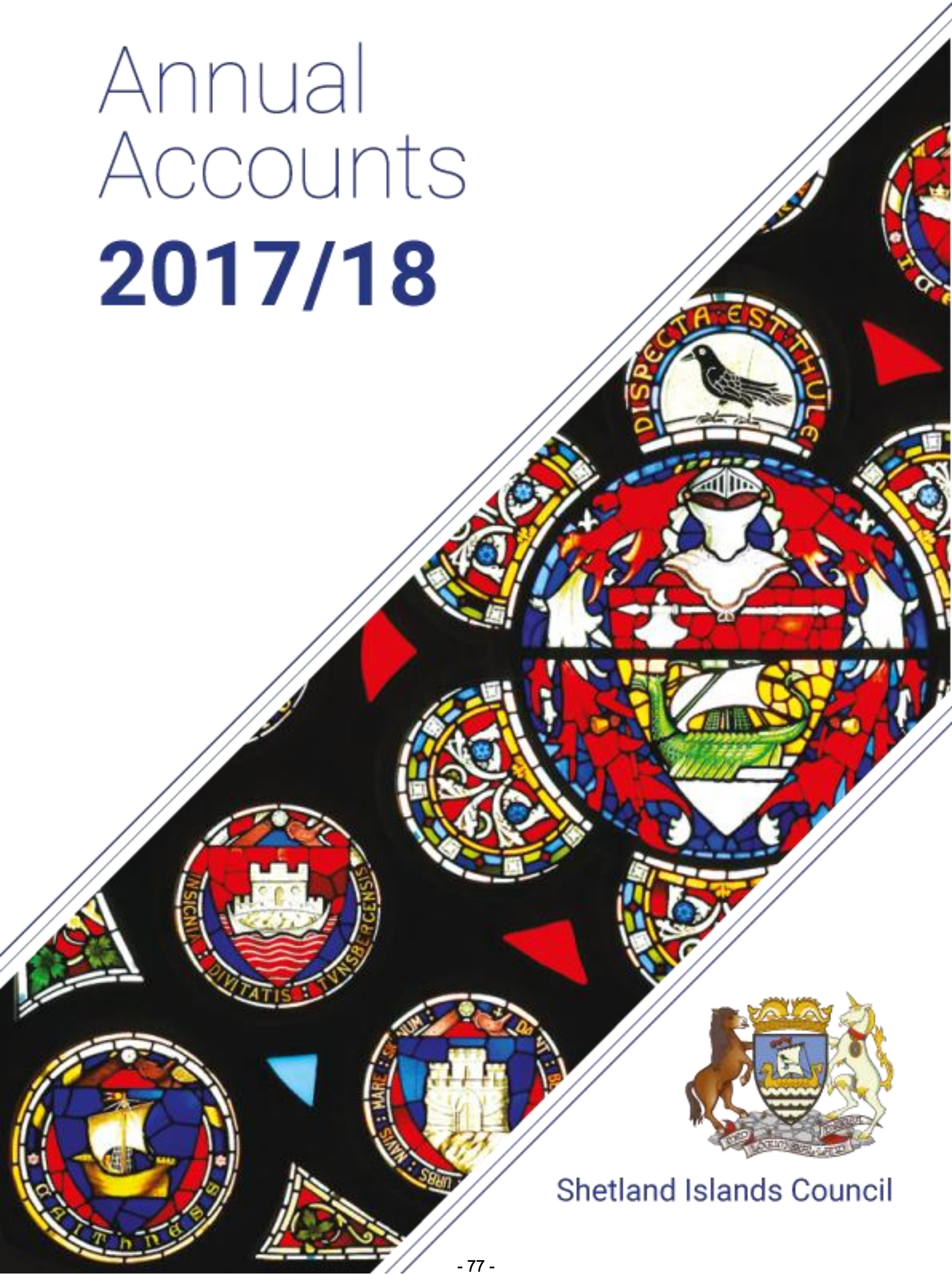
Article: Public sector transformation
Five lessons from the private sector

An analysis of private sector global companies, including high-tech start-ups, manufacturers, banks, retailers and insurance firms, reveal five valuable lessons for the public sector.

Read the full article here:
https://www2.deloitte.com/uk/en/pages/public-sector/articles/public-sector-transformation.html

Deloitte.

Annual Accounts 2017/18



Shetland Islands Council

Contents

Management Commentary

Introduction

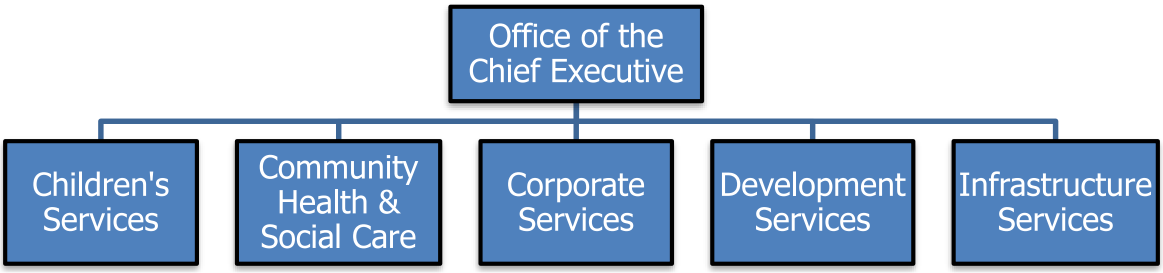
The Annual Accounts present the financial statements of Shetland Islands Council for the year ended 31 March 2018.

The purpose of the Management Commentary is to present an overview of the Council's financial performance during the year 2017/18 and to help readers understand its financial position at 31 March 2018. In addition, it outlines the main risks and uncertainties facing the Council for the financial year 2017/18 and beyond.

Background

Shetland Islands Council is one of 32 local authorities in Scotland.

It is governed by 22 elected members (21 independent and 1 SNP) serving a population of approximately 23,000 people. The Council is organised to provide and deliver its services to the public, such as schools, public transport, economic development, social care, environmental health, housing, ports and harbours and roads, as follows:



Full details on the services provided can be found on the Council's website: www.shetland.gov.uk

Strategy and Performance Management

Corporate Plan

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

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

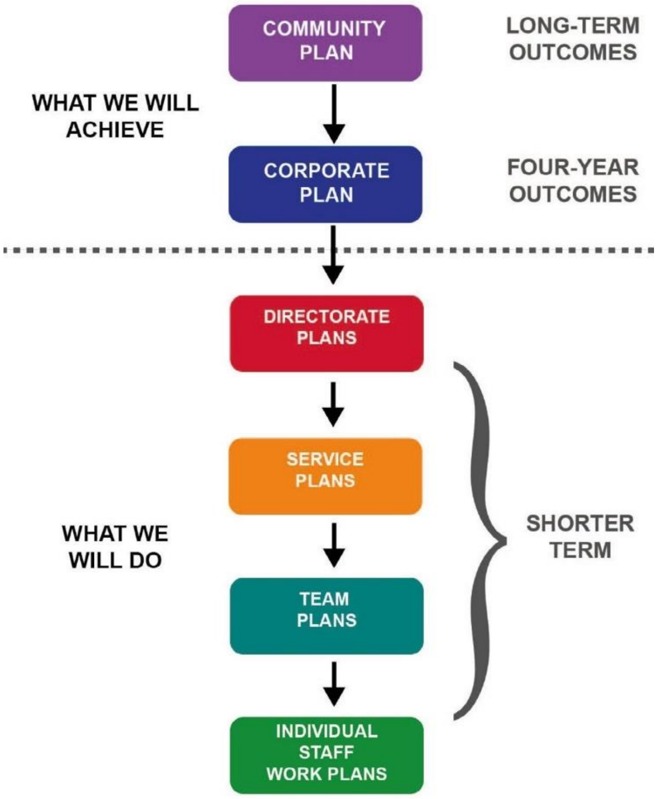
The plan is monitored through the quarterly reporting cycle of service performance reports and a half-way progress update is due to be reported to Council in autumn 2018. It can be found at: http://www.shetland.gov.uk/documents/OurPlan2016-20final.pdf.

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

- Complete and move into the new Anderson High School and Halls of Residence – pupils and teachers moved in during October 2017;
- Increase the supply of affordable housing in Shetland – the Scottish Government have committed £14.3m for affordable housing in Shetland over the next three years and the current Strategic Housing Investment Plan, delivered in conjunction with Hjaltland Housing Association, plans for 316 dwellings over the next five years;
- Improve high-speed broadband and mobile connections throughout Shetland – 'Broadband and Connectivity' is one of the key strands in the Council's Business Transformation Programme, currently being progressed;
- Provide quality transport services within Shetland, and push for improvements in services to and from Shetland – in partnership with ZetTrans, the Shetland Transport Strategy is currently being refreshed;
- Support older people across Shetland so that they can get the services they need to help them live as independently as possible – the Council, through the Integration Joint Board, introduced a number of new initiatives during

2017/18, including a Falls Prevention Strategy and extension to the work of the Intermediate Care Team.

The Corporate Plan describes how, as a strategy, it fits in with other local plans. Its objectives stem from the priorities enshrined in the community plan, as described in the following diagram:



The outcomes of the Corporate Plan then cascade to the Council's directorate plans and on through the organisation to individual work plans.

Community Planning

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

Community Planning in Shetland aims to create communities that are:

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

The Community Plan is linked to the Local Outcomes Improvement Plan (LOIP), which sets out the activities and priorities of the Shetland Partnership to deliver the Community Plan.

The Community Planning Partnership is responsible for preparing a LOIP under the Community Empowerment (Scotland) Act 2015, which aims to empower community bodies through ownership or control of land and buildings and by giving them more say in decisions about public services.

A new LOIP, called Shetland's Partnership Plan 2018-2028, was approved by the Council on 27 June 2018. It is built on an evidence-based understanding of local needs, circumstances and opportunities.

Shetland's Partnership Plan 2018-2028 proposes a shared vision that:

"Shetland is a place where everyone is able to thrive; living well in strong, resilient communities; and where people and communities are able to help plan and deliver solutions to future challenges"

Shetland's Partnership Plan is the principal strategic planning document for delivery of public services in Shetland.

Within the Council, it will be supported by delivery plans that will be monitored by the relevant committees.

Shetland's Partnership Plan 2018-2028 outlines four shared priorities, as follows:

The Partnership will undertake evaluation of its own performance annually as well as on delivery of the Plan. Reporting on this performance will be transparent and publicly available.

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

Performance

The principal source of council performance information is the Local Government Benchmarking Framework website (http://www.improvementservice.org.uk/benchmarking/explore-the-data.html); it provides a range of indicators that show how Shetland Islands Council is performing over time and against other local authorities.

In addition, the Council has its own performance web page, called Our Performance Matters, that can be accessed here:
http://www.shetland.gov.uk/about_performance/default.asp. The following table gives a sample of the types of information available, but there is much more data to explore online, as detailed above.

2016/17 Data	Shetland Islands Council	Scottish Average
Cost per primary school pupil	£7,779	£4,788
Cost per secondary pupil	£10,792	£6,806
Cost per home of Council Tax collection	£13.96	£8.98
Council Tax collection rate	97.1%	95.8%
Cost per premise on refuse collection	£48.00	£64.50

Key Risks

The Council maintains a Corporate Risk register and reports progress on a quarterly basis to the Policy & Resources Committee. The latest report was presented on 28 August 2018 and can be found here:
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=22956

This report highlights two risks considered to be high in both likelihood and probability. These are extracted as follows:

Risk 1: Infrastructure Maintenance

The Council invested heavily in infrastructure at the time when the oil industry was taking off. This infrastructure was funded from income generated from the oil industry. That infrastructure is now ageing and will need to be replaced, however, the financial situation is now tighter which will mean that it will be challenging to finance this.

Actions to mitigate risk

The current Asset Investment Plan focuses on the maintenance of existing assets in order to prolong their useful economic lives. This should mitigate against the risk of immediate failure. In order to address the longer term replacement of assets, a Borrowing Policy was approved by Council on 11 December 2013.
Other measures in place include: MTFP, budget monitoring and scrutiny, clear and robust roles and responsibilities for managers and financial procedures and regulations.

Responsible officer

Director – Corporate Services

Risk 2: Pension Fund

The SIC Pension Fund is not currently 100% funded. At 31 March 2017 triennial evaluation the Fund was 90% funded. The Fund, as well as the Council has a number of Scheduled and Admitted Bodies that have liabilities to fund over the long term.
Admitted bodies failing or being unable to meet their contributions places risk from these arrangements on the Council, as the largest contributor to the Pension Fund.

Actions to mitigate risk

Bodies seeking admission to the Pension Fund they now have to be supported in doing so by the Council (as a Schedule 1 Body) and also provide a guarantee / bond to meet any liabilities should they default in the future. This mitigates the risk to the Fund in relation to new employers.

Responsible officer

Executive Manager - Finance

Council Highlights 2017/18

New Chief Executive

Maggie Sandison, who has served as Director of Infrastructure Services since October 2013, was appointed in February 2018 as the new Chief Executive of Shetland Islands Council. Her appointment follows the retirement of Mark Boden, who held the post for over five years.

Community Choices Project

A well-used coastal footpath in Lerwick known as the Sletts opened to the public in December after the completion of improvement works that were initiated as a result of this project being the first-choice voted for by the public in the Shetland Community Choices project in 2017.

Town Centre Works

A new 20mph zone, traffic calming and zebra crossings have been introduced in Lerwick town centre with a view to reducing accidents and improving the town centre experience for pedestrians.

New High School and Halls of Residence

In October 2017 the new Anderson High School and Halls of Residence opened to pupils, with final construction costs amounting to £55.75m.

The Scottish Government has committed to funding construction costs of £42m over the next 25 years.

Knab Site Masterplan

In July 2017, Edinburgh-based 7N Architects were appointed by the Council to produce a masterplan for the redevelopment of the site of the previous Anderson High School in Lerwick. This will include public consultation and is expected to incorporate mixed use and residential development.

Values and Behaviours

During 2017, the Council launched its staff Values and Behaviours Framework, which has the following message at its core: “Excellent service is at the heart of everything we do. We provide excellent service by taking personal responsibility and working well together."

New tug for Sullom Voe port

In November 2017 the Council completed its purchase of a new £7.6m tug to the port of Sullom Voe as a replacement for the *Tirrick*, which was sold to Greek buyers.

A second new tug, replacing the *Shalder*, is currently in operation under a ‘bare boat’ charter arrangement, with an option to purchase later in 2018.

Primary Financial Statements

The annual accounts summarise the Council's transactions for the year, its year-end position at 31 March 2018 and its cashflows. The annual accounts are prepared in accordance with the International Accounting Standards Board (IASB) Framework for the Preparation and Presentation of Financial Statements (the IASB Framework) as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom.

A description of the purpose of primary statements has been included immediately prior to the four single entity statements: the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement, Balance Sheet and Cash Flow Statement.

These four statements are accompanied by notes to the accounts which set out the accounting policies adopted by the Council and provide more detailed analysis of the figures disclosed on the face of the primary financial statements.

The primary financial statements and notes to the accounts, including the accounting policies, form the relevant annual accounts for the purpose of the audit report.

Financial Performance in 2017/18

The Comprehensive Income and Expenditure Statement (CIES) on page 30 presents the full economic cost of providing Council services in 2017/18. This differs from the budgeted outturn position that was reported to the Policy & Resources Committee of the Council on 22 May 2018 and is available on the Council's website. The reasons for this difference are two-fold:

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

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

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

The Deficit on Provision of Services of £25.5m, disclosed on the CIES, has been reconciled to the outturn used for management decision-making of £7.0m in the Expenditure and Funding Analysis on page 38.

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

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

The table that follows shows that the draw on reserves, excluding accounting adjustments, was £8.6m for 2017/18. This is significantly lower than the planned draw on reserves of £17.2m. A breakdown of the variances can be seen in this table and in is explained further detail in the following sections.

As a result of an overall budget underspend and by applying the Council's carry-forward scheme, a sum of £6.7m has been committed for use in 2018/19. Of this, £3.7m will support the 2018/19 revenue budget and £3.0m will support asset investment, or capital, activities.

The actual Total Revenue Draw figure below of £6.973m reconciles to the deficit shown in Note 1: Expenditure and Funding Analysis on page 38.

The narrative following the table explains the financial performance of each of the funds during the year.

Budget v Expenditure draw from / (contribution to) Reserves 2017/18	Revised Budget £m	Actual £m	Budget v Actual variance Under / (Over) £m	Carry forwards £m	Revised variance Under / (Over) £m
General Fund	22.853	19.345	3.508	1.696	1.812
Revenue Spend to Save	0.250	0.000	0.250	0.377	(0.127)
Housing Revenue Account	0.484	(1.048)	1.532	0.157	1.375
Harbour Account	(9.376)	(11.324)	1.948	1.440	0.508
Total Revenue Draw	**14.211**	**6.973**	**7.238**	**3.670**	**3.568**
Capital Spend to Save	0.620	0.292	0.328	0.268	0.060
Asset Investment Plan	2.334	1.332	1.002	2.734	(1.732)
Total	**17.165**	**8.597**	**8.568**	**6.672**	**1.896**

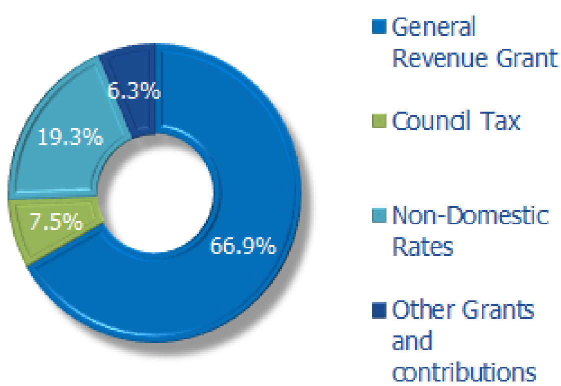
General Fund

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

The General Fund expenditure for 2017/18 was £109.1m, which amounts to 96.7% of the Council's annual budget, resulting in a net underspend of £3.8m. This underspend can be attributed to a drive across services to reduce expenditure and increase income, as well as a number of one-off savings in year, mainly due to the number of staff vacancies within the Council.

In 2017/18 the Council's General Fund received the majority of its funding from the Scottish Government, which is made up of General Revenue Grant and National Non-Domestic Rates (NDR).

The total external funding breakdown is shown below:



The collection of Council Tax represents 7.5% of the Council's overall funding and an in-year collection rate of 97.1% was achieved during 2017/18.

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

The resources deployed by the Council through its General Fund were used in the delivery and commissioning of services to the population of Shetland. As mentioned above, there have been some notable high-level achievements that have developed and improved these services during 2017/18.

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

Harbour Account

The Zetland County Council Act 1974 empowers the Council to transfer surpluses arising on the Harbour Account to the Harbour Reserve Fund. The Harbour Account budgeted for a £9.4m contribution to the Reserve Fund in 2017/18.

The actual contribution was £11.3m, the increase being due to additional income from fish landings, delays in capital programme meaning less revenue contributions required and higher than expected throughput income from the Shetland Gas Plant.

Housing Revenue Account

The Housing Revenue Account (HRA) is a separate account within the Council. The HRA budgeted for a £0.5m contribution from its reserve in 2017/18 which was exceeded by £1.5m, giving a total contribution to the HRA of £1.0m in the year. The increase is mainly due to increased capital receipts which reduced the requirement to fund capital from rental income.

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

A five-year business plan for the HRA was approved in 2016/17, underpinned by a 30-year financial model to ensure affordability and sustainability over the long term.

At 31 March 2018 the HRA was responsible for 1,662 properties, a decrease of 22 since 31 March 2017. There has been a consistent reduction in housing properties due to a high level of housing sales through the tenants 'Right to Buy' scheme. The right to request a council house purchase under the scheme ended on 31 July 2016, however there are still a number of purchases being finalised.

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

Asset Investment Plan

In 2017/18 Shetland Islands Council incurred capital expenditure of £27.8m against a budget of £35.0m representing an underspend of £7.2m in the year.

The main reason for this underspend is a revision to the timing of construction in relation to the Halls of Residence, Scalloway Fish Market, Recycling Sorting Shed and Lerwick Library, as well as delays in ferry replacement and life extension works.

£7.2m will be carried forward to future years to enable work to be completed.

More information about capital expenditure and funding can be found in Note 34: Capital Expenditure and Capital Financing on page 71.

The Balance Sheet

The Balance Sheet sets out the total net worth of Shetland Islands Council and is a snapshot of the position as at 31 March 2018. When comparing this to the position at 31 March 2017, there has been an overall increase in the net worth of the Council of £73.0m. This figure matches the total figure in the Comprehensive Income and Expenditure Statement, which captures all transactions during the financial year that led to the movement in the Council's net worth.

Material Transactions

Long-Term Investments

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

The Medium-Term Investment Strategy is supported by an Annual Investment and Treasury Strategy report, which includes more detail on capital and treasury activities, including key treasury indicators. It can be found at http://www.shetland.gov.uk/about_finances/

As at 31 March 2018 the Council had £345.4m invested with three external Fund Managers, an increase of £11.6m from the previous year. This increase is mainly attributable to excellent equity growth throughout the year and the Fund Managers' management of the investments. During the year the Council withdrew £10.0m from investments to meet its cashflow requirements. This is in line with the approved strategy, which sets a maximum 5.2% withdrawal of investments funds per annum.

The Fund Management Annual Investment Report 2017/18 was presented to Council on 23 May 2018 and this summarised the performance of the Council's investments during the year. The report indicates that the Council's investments experienced positive returns of 6.6% during the year. The target was 7.3%, however this is viewed over a 20-year planning timeframe, to take account of market volatility.

A new investment strategy for 2018/19 onwards was approved by the Council on 22 August 2018.

External Borrowing

External borrowing is regulated by the Borrowing Policy, part of the Council's Annual Investment and Treasury Strategy, which aims to secure best value in the financing of capital expenditure.

The Council's Capital Financing Requirement (CFR) is £93.0m as at 31 March 2018, of which £41.2m relates to external borrowing. It represents the capital expenditure to be funded from borrowing. Whilst the CFR is a guide to the Council's underlying need to borrow, the Executive Manager – Finance can manage the Council's actual borrowing position by either borrowing to finance the CFR, choosing to utilise some temporary cashflow funds instead of borrowing (under-borrowing), or borrowing for future increases in the CFR (borrowing up to two years in advance of need).

As at 31 March 2018, external borrowing was £41.2m (£31.1m at 31 March 2017) and this is reflected on the Council's Balance Sheet on page 32.

Debt financing costs currently represent 2.1% of the Council's net revenue stream (2% 2016/17) from General Revenue Grant (including NDR), Council Tax, housing rents and harbour income. This provides an indication on the affordability of the Council's debt in terms of how much income can be directed to provide front-line service delivery rather than funding capital expenditure costs. Ongoing revenue implications of investment decisions will be managed within existing budgetary levels and the estimated cost of debt for 2018/19 is 1.8% of the net revenue stream.

Pension

The Council is the administering authority for the Shetland Islands Council Local Government Pension Scheme, which has a statutory requirement to prepare a separate annual report and accounts. The 2017/18 report can be accessed on the Council's website at: http://www.shetland.gov.uk/about_finances/.

The impact of the Local Government Pension Scheme and Teachers' Superannuation Scheme on the Council's accounts has been disclosed in Notes 26 and 27 to the accounts.

The pension liabilities continue to outstrip pension assets and as such the net pension liability for the Council is £165.2m as at 31 March 2018 (£229.7m at 31 March 2017). This figure represents the amount that actuaries estimate that Shetland Islands Council will have to pay out in future years for all pension entitlements earned by current and previous staff up and until 31 March 2018.

During 2017/18, the net pension liability has decreased by £64.5m as a result of updated assumptions. The effects on the net pension liability of changes in individual assumptions can be measured. For instance, a 0.5% decrease in the discount rate assumption would result in an increase in the pension liability of £58.3m. The assumptions interact in complex ways, however, and are established for particular reasons.

The Council continues to monitor and measure its pension liability and make changes to cash contributions as part of the regular assessment made by an independent actuary. A scheduled triennial valuation of the Pension Fund as at 31 March 2017 was undertaken during 2017/18 and the results were presented to the Pension Fund Committee in February 2018. It showed that the Pension Fund is valued at £450m and is 90% funded, with a deficit of £52m. Further detail can be found in the 2017/18 Annual Report and Accounts.

Health and Social Care Integration

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

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

In 2017/18, the Council contributed £20.6m to the IJB and received income from it of £21.7m, a result of some social care funding being channelled through the NHS Shetland financial settlement.

The annual accounts of the IJB can be found on the Council's website at: http://www.shetland.gov.uk/about_finances/.

The Council's Reserves

The Council holds the following balances in reserves:

Reserves	As at 1 April 2017 £m	As at 31 March 2018 £m
General Fund	54.292	60.318
Housing Revenue Account	15.614	17.335
Harbour Reserve Funds	63.518	63.221
Capital Funds	66.498	66.330
Other Usable Funds	44.378	42.593
Total Usable Reserves	**244.300**	**249.797**

The overall level of usable reserves was £249.8m at 31 March 2018, an increase of £5.5m from the previous year. The movement on reserves differs from the outturn position reported. The reserves position is required to reflect a number of accounting adjustments for matters such as asset transfers, provisions and capital grants, which are not reflected in the reports to management during the year. The Movement in Reserves Statement (page 31) and associated notes provide further detail.

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

Reserves are split between discretionary and earmarked reserves to recognise these decisions taken and also the availability of funds should any unplanned or unexpected liabilities or expenditure arise. The impact of various reserve movements and earmarking of funds is that the uncommitted General Fund reserve has decreased by £1.4m to £22.9m as at 31 March 2018 from the previous year (see page 45). The uncommitted balance represents 19.9% of the Council's annual budgeted net expenditure and is considered sufficient to manage financial risks in the short term.

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

The value of the Council's long-term investments, which are quite separate from its usable reserves, represent the money that has been invested by the Council for long-term return. The increase in value is measured in terms of income generated by those investments and a change in their value reflected by unrealised gains, plus any injection of new money by the Council during the year. More information is outlined in the 'Long-Term Investments' section on page 6.

Usable reserves on the other hand reflect a level of resources that the Council has available to carry out its future business; these reserves can be applied to the provision of services.

Group Accounts

The Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 (the Code) requires the Council to prepare group accounts where the Council has material interests in subsidiaries, associates and / or jointly controlled entities.

The Council has interests in Orkney and Shetland Valuation Joint Board (OSVJB), Zetland Transport Partnership (ZetTrans) and the Integration Joint Board (IJB).

The interest in OSVJB is deemed to be not material and is therefore not consolidated in group accounts. The results of the remaining two bodies have a net nil impact on both the Comprehensive Income and Expenditure Statement and the Balance Sheet; therefore, no Group Accounts are presented for 2017/18 as there is no financial impact and no qualitative benefit to readers. More detail can be found in Note 38: Group Interests on page 73.

The accounts of the OSVJB, ZetTrans and IJB can be found on the Council's website at: http://www.shetland.gov.uk/about_finances/.

2018/19 Budget and Medium-Term Financial Outlook

2018/19 Budget

The Council's 2018/19 budget is a tactical financial plan that complements the strategic Medium-Term Financial Plan (MTFP), to ensure that the Council delivers its strategic financial objectives and achieves its target outcomes.

It was prepared in line with budget targets set out in the Council's MTFP 2016/17-2021/22.

Comparative figures for the 2017/18 settlement are shown in the following table. The increase in revenue funding for Shetland is significantly higher than the Scottish average as a result of an additional funding for internal ferry operations that affected only Shetland and Orkney Islands Councils. Capital funding, however, has reduced by 7.8% for 2018/19; a significantly different outcome for Shetland than the average change.

Note that 2017/18 figures have been redetermined by the Scottish Government (Circular 4/2018).

	2018/19	2017/18	Movement	
Scotland	**£bn**	**£bn**	**£bn**	**%**
Revenue	9.780	9.686	0.094	1.0%
Capital	0.876	0.786	0.090	11.5%
Total	**10.656**	**10.472**	**0.184**	**1.8%**
Shetland	**£m**	**£m**	**£m**	**%**
Revenue	86.061	81.964	4.097	5.0%
Capital	6.643	7.208	(0.565)	-7.8%
Total	**92.704**	**89.172**	**3.532**	**4.0%**

Within the finance settlement from the Scottish Government there are certain conditions that local authorities must meet, which bring further financial pressures. These conditions are:

- Overall teacher: pupil ratios to be maintained and all probationer placements secured;
- £52m revenue and £150m capital funding to deliver the programme for the expansion of Early Years provision;
- A further £66m funding for social care, to be used for specific purposes; and
- Council Tax increases capped at 3%.

Following the announcement of the financial settlement for 2018/19 the Corporate Management Team considered the detail and agreed a revised budget strategy that was discussed with Councillors in seminars held in November 2017. A report on the settlement was also prepared and the Council considered this ahead of the formal budget-setting meeting.

The revised budget strategy took into account additional funding that was announced by the Scottish Government in January 2018 in support of inter-island ferries, which benefits Shetland to the value of £5.0m. The 2018/19 budget was formally approved by the Council on 14 February 2018.

Medium-Term Financial Outlook

The Medium-Term Financial Plan is the Council's strategic finance document which focuses on the next five years. It is anticipated that there will be significant cash reductions in the general revenue grant from the Scottish Government over the forthcoming years and therefore an increasingly unaffordable cost of service delivery is inevitable.

At the same time, the Council must manage increasing demand for services from school roll changes and areas such as community care, where the IJB will direct service development and adapt to these demands.

The latest MTFP was approved by the Council on 8 March 2017; it covers a five-year period to March 2022 and will be refreshed in autumn 2018. The MTFP is based on the following key principles:

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

Outlook - Projects and Initiatives

New Council Leadership

Cecil Smith stepped down as Council leader in March 2018 and a new leader was appointed by the Council in May. Steven Coutts had been serving as Deputy Leader since the local elections in May 2017 and is an independent member for Shetland West.

The Council also appointed a replacement Deputy Leader in May 2018: Emma MacDonald, who was elected as a member for Shetland North in the local elections in May 2017.

Business Transformation Programme

The Council continues to develop its Business Transformation Programme, approved by the Council in February 2017. This seeks to provide the framework to review and transform the services provided to the population of Shetland and the ways those services are delivered.

The most recent update report was presented to the Policy & Resources Committee on 28 August 2018 and can be found here: http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=22952

It demonstrates that all workstreams are well underway and in particular, that the Customer Strategy and Charter were approved on 18 June 2018 and are now live.

The report also updates the programme to Phase 2, removing completed items and introducing additional areas of work.

There are now eight subject areas, known as 'workstreams', as follows:

- Customer First
- Commissioning / Procurement Framework
- Workforce Strategy
- Accommodation Rationalisation
- Broadband & Connectivity
- Digital First
- Information Management & Improvement
- Performance & Management Reporting

Eric Gray Resource Centre

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

Kerbside Recycling

A new kerbside collection service is being rolled out on a phased basis across Shetland in 2018. At just 7.9%, Shetland Islands Council had the lowest recycling rate in Scotland in 2016/17 and the new scheme aims to address this. The first phase of the scheme launched in March 2018 collecting plastics and paper. The rollout will be complete by October 2018.

College Integration

A review of tertiary education in Shetland has moved forward to focus on addressing the unsustainable model currently in place and complex governance arrangements, with the aim of achieving growth in the sector and secure the benefits that the tertiary education, research and training sector delivers for the future.

A strategic outline business case was presented to the Council for consideration on 23 May 2018; it can be found here:

http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=22485

The decision resulted in approval to prepare a full business case on a merger of tertiary education, research and training services. This work will be reported to the Council in the Autumn.

Inter-Island Transport Study

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

This work has been the foundation for engaging with Transport Scotland and the Scottish Government in relation to fair funding for these services.

Shetland Islands Council was awarded £5.0m revenue funding in its 2018/19 financial settlement to support the delivery of inter-island ferries, however this has so far been committed only for one year.

With the support of Scottish Government Ministers, a multi-agency Inter-Island Working Group has been working to resolve the funding of inter-island transport on a permanent basis. The Council will continue to lobby for revenue funding and capital investment for its ferry replacement programme, with analysis of priority routes expected to be carried out during 2018/19.

Making Places

The Council has been awarded national funding as part of the Making Places Initiative to develop design workshops that will encourage the community of Scalloway to take part in shaping their environment.

Consultants GL Hearn were appointed to lead workshops in May 2018.

Executive Manager - Finance

The unaudited annual accounts were signed by the then Executive Manager – Finance and Section 95 officer, Jonathan Belford, who took up a new post at Aberdeen City Council on 1 September 2018. Jamie Manson has been appointed as the new Executive Manager – Finance and will start on 24 September 2018. In the interim Hazel Tait, Acting s95 Officer, has been given delegated authority to sign the annual accounts.

Conclusion

In summary, the Council has had a financially successful year in 2017/18 and is moving forward with a number of exciting projects designed to improve its efficiency and effectiveness and to secure improved outcomes for the people of Shetland.

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

....	....	....
Maggie Sandison Chief Executive 19 September 2018	Steven Coutts Leader of the Council 19 September 2018	Hazel Tait CPFA Acting Section 95 Officer 19 September 2018

Annual Governance Statement

Scope of Responsibility

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

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

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

The Governance Framework

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

The system of internal control is a significant part of the governance framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurance of effectiveness.

The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of Council's policies, aims and objectives, to evaluate the likelihood and potential impact of those risks being realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place for the year ended 31 March 2018 and up to the date of approval of the annual accounts.

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

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

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

Review of Effectiveness

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

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

- Each **director** has reviewed the arrangements in their portfolio and certified their effectiveness to the Executive Manager – Finance. These assurances include internal financial controls and provide the opportunity to highlight any weaknesses or areas of concern. For 2017/18, no areas of weakness or concern were raised.

- The Council's **financial management** arrangements comply with the requirements of the CIPFA Statement on the Role of the Chief Financial Officer in Local Government (2010).
- The Council's **committee structure** supports the organisational and management structure of the Council, incorporating a culture of accountability that has been developed throughout.
- The Council's **Constitution** promotes good decision-making and adherence to the Building Better Business Cases methodology, supporting evidence-based options appraisal for the commissioning and procurement of services.
- The **Audit Committee** remains responsible for ensuring the effectiveness of the internal audit function and considering all reports prepared by the external auditor. Its remit ensures that the work of the Council, from both a control and performance perspective, is checked and scrutinised.
- A significant **induction and training programme** for new and returning councillors is delivered after each local election, including the May 2017 election.
- A professional, independent and objective **internal audit** service is one of the key elements of good governance. The Council's internal audit function operates in accordance with the Public Sector Internal Audit Standards (PSIAS).
- The internal audit service followed their **Audit Plan** during the year and their work revealed a range of findings. Management are undertaking work to implement agreed recommendations. This is described in the Internal Audit Annual Report.
- The Council's **external auditor** is Deloitte LLP. They regularly report to the Audit Committee and their reports cover the annual accounts audit and wider scope requirements set out within the Code of Audit Practice.

We have been advised on the implications of the result of the review of the effectiveness of the governance framework by the Corporate Management Team and the Audit Committee and that arrangements continue to be regarded as fit for purpose in accordance with the governance framework.

The areas already addressed and those to be specifically addressed with new actions planned are outlined below.

Significant Governance Issues

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

The following issues and related action plans were highlighted in Internal Audit's Annual Report for 2017/18 as specific areas of concern:

- fire and other risk assessments either not being in place or out of date and inadequate health and safety monitoring;
- contractual and procurement issues identified in procurement reviews;
- operational grants processing and monitoring issues.

A mid-year progress report is presented to Audit Committee outlining any follow-up work carried out in relation to the issues highlighted in the annual reports. Reports can be viewed on the Council's website as follows:

- Annual Report – June 2018: http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=22649
- Progress Report - February 2018: http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=21962
- Annual Report - June 2017: http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=21055

Internal audit concluded that, aside from the areas still noted above, satisfactory progress had been made in addressing control weaknesses.

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

Conclusion

Overall, we consider that the governance and internal control environment operating in 2017/18 provides reasonable and objective assurance that any significant risks impacting on the achievement of our principal objectives will be identified, and actions taken to avoid or mitigate their impact.

....	....
Steven Coutts	Maggie Sandison
Leader of the Council	Chief Executive
19 September 2018	19 September 2018

Remuneration Report

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

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

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

Remuneration Arrangements of Senior Councillors

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

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

The salary that is to be paid to the Convener of the Council is set out in the amended Regulations SSI 2008/415, which came into effect on 10 February 2009 (later amended by the 2013 and 2015 Regulations). For 2017/18 the level of remuneration (including expenses) for the former Leaders was £3.6k (G Robinson) (£28.9k in 2016/17) and £35.1k (C Smith) and £36.4k for the Convener (£21.4k in 2016/17).

The Regulations also set out the remuneration that may be paid to senior councillors and the total number of senior councillors a council may have. The maximum yearly amount that may be paid to a senior councillor is 75% of the total yearly amount payable to the leader of a council. The total yearly amount payable by the Council for remuneration of all of its senior councillors shall not exceed £171k in 2017/18 (£171k in 2016/17).

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

The senior councillor positions are:

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

Excluding the Convener and the Leader, the total remuneration paid to these Councillors in 2017/18 was £171k (£171k in 2016/17).

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

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

Local government elections were held in May 2017, resulting in changes to senior councillor posts.

Remuneration of Conveners and Vice-Conveners for Joint Boards

In addition to the senior councillors of the Council, the Regulations also set out the remuneration payable to councillors with the responsibility of a Convener or a Vice-Convener of a Joint Board, such as the Orkney and Shetland Valuation Joint Board.

The Regulations require the remuneration to be paid by the Council of which the Convener or Vice-Convener (as the case may be) is a member.

The Council is also required to pay any pension contributions arising from the Convener or Vice-Convener being a member of the Local Government Pension Scheme.

The Convener of the Orkney and Shetland Valuation Joint Board from May 2017 has been a senior councillor of Orkney Islands Council, who are reimbursed by the Joint Board for additional remuneration paid in respect of this role.

Remuneration of Senior Employees

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

The salary of senior employees is set by reference to national arrangements and agreements. The Scottish Joint Negotiating Committee (SJNC) for Local Authority Services sets the salaries for the Chief Executives of Scottish Local Authorities. Circular CO/149 sets the amount of salary for the Chief Executive of Shetland Islands Council for 2017/18.

The salaries of the directors are based on a fixed percentage of the Chief Executive's salary, namely 80% of the value of the Chief Executive's salary.

Executive managers fall into two bandings, the second reflecting the additional level of statutory responsibility held by the Monitoring Officer, the Section 95 Officer and the Chief Social Work Officer.

The current senior management structure is:

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

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

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

Allowances

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

General Disclosure by Pay Band

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

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

Bands that do not appear in the table had nil employees in both 2017/18 and 2016/17.

Total at 31 March 2017	Remuneration Bands	Children's Services	Infra-structure Services	Community Health & Social Care	Development Services	Corporate & Executive Services	Total at 31 March 2018
	Number of Employees						
58	£50,000 - £54,999	23	33	0	1	1	58
30	£55,000 - £59,999	8	13	2	2	2	27
16	£60,000 - £64,999	7	7	1	2	2	19
9	£65,000 - £69,999	2	6	0	0	1	9
7	£70,000 - £74,999	0	11	0	0	0	11
4	£75,000 - £79,999	1	2	0	0	2	5
1	£80,000 - £84,999	0	0	0	0	0	0
5	£85,000 - £89,999	1	0	0	1	3	5
1	£90,000 - £94,999	0	1	0	0	0	1
1	£100,000 - £104,999	0	0	0	0	0	0
1	£105,000 - £109,999	0	0	0	0	0	0
3	£110,000 - £114,999	0	0	0	0	0	0
1	£115,000 - £119,999	0	1	0	0	0	1
0	£135,000 - £139,999	0	2	0	0	0	2
1	£140,000 - £144,999	0	1	0	0	0	1
0	£145,000 - £149,999	0	1	0	0	0	1
138	**Total**	**42**	**78**	**3**	**6**	**11**	**140**

Of the 42 staff (42 in 2016/17) in Children's Services noted above, 20 were head teachers or senior teaching staff (29 in 2016/17).

Of the 78 staff (74 in 2016/17) in Infrastructure Services noted above, 67 worked in Ports and Harbours Operations or Ferry Operations (67 in 2016/17).

Summary of Remuneration paid to Councillors

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

	2017/18 £000	2016/17 £000
Salaries	368	372
Expenses	59	84
Allowances	30	34
Total	**457**	**490**

The annual return of Councillors' salaries and expenses for 2017/18 is available for any member of the public to view at the Finance Service, Montfield, 28 Burgh Road, Lerwick during normal working hours or on the Council's website at http://www.shetland.gov.uk/

Summary of Remuneration paid to Employees

The Council paid the following salaries, expenses and additional allowances in respect of all staff:

	2017/18 £000	2016/17 £000
Salaries	69,786	68,299
Overtime	3,207	2,968
Expenses	1,794	1,850
Allowances	626	622
Total	**75,413**	**73,739**

Note that the Distant Islands Allowance, which is paid to all staff based in Shetland, is included within Salaries.

Exit Packages

The Regulations require the Remuneration Report to provide information on the number of exit packages awarded in bandings of £20k up to £100k, and thereafter in bandings of £50k, along with the total cost of the exit packages within each band.

The Regulations also require disclosure of the number of compulsory redundancies and other agreed departures. The cost of exit packages must pay back within three years, with ongoing salary savings realised thereafter.
The total cost for 2017/18 of £138k (£222k in 2016/17) in the table includes £40k (£32k in 2016/17) for termination benefits agreed, accrued for and charged to the Comprehensive Income and Expenditure Statement (CIES) in the current year, comprising redundancy payments and pension strain costs.

In addition, the table includes £98k (£190k in 2016/17) for the capitalised cost of compensatory added years, agreed in 2017/18, that will be charged to the CIES in future years.

Exit package cost band (including special payments)	(a) Number of compulsory redundancies		(b) Number of other departures agreed		(a+b) Total number of exit packages by cost band		Total cost of exit packages in each band	
	2017/18	2016/17	2017/18	2016/17	2017/18	2016/17	2017/18 £000	2016/17 £000
£0 - £19,999	0	1	5	6	**5**	**7**	**32**	**18**
£20,000 - £39,999	0	0	0	2	**0**	**2**	**0**	**68**
£40,000 - £59,999	0	0	1	0	**1**	**0**	**45**	**0**
£60,000 - £79,999	0	0	1	0	**1**	**0**	**61**	**0**
£80,000 - £99,999	0	0	0	0	**0**	**0**	**0**	**0**
£100,000 - £149,999	0	0	0	1	**0**	**1**	**0**	**136**
Total	**0**	**1**	**7**	**9**	**7**	**10**	**138**	**222**

The table above details the number and cost of exit packages awarded in 2017/18 and 2016/17. Included in the cost of the exit packages are:

- Any termination payment, such as a redundancy payment;
- Strain on the Fund cost (the amount payable by the Council to the Pension Fund because the employee has retired before the assumed retirement age);
- Any enhanced payments, such as compensatory added years; and
- A capitalised value of the recurring compensatory added years payment. This is paid annually by the Council once an employee has left and is therefore a notional cost at 31 March 2018.

Disclosure of Remuneration for Senior Councillors

There was an election on 4 May 2017, which changed the senior post holders during the year. Prior year figures are shown only once per affected councillor.

Councillor Name	Designation	2017/18 Salary, Fees and Allowances £	2017/18 Taxable Expenses £	2017/18 Total Remuneration £	2016/17 Total Remuneration £
Until 3 May 2017					
G Robinson	Leader of the Council	2,546	70	**2,616**	**28,920**
F Robertson	Chair - Planning Committee	1,678	169	**1,847**	**19,290**
C Smith	Chair - Integration Joint Board	1,769	0	**1,769**	see below
G Smith	Chair - Licensing Committee	1,678	0	**1,678**	see below
M Stout	Chair - Environment & Transport Committee	1,769	121	**1,890**	**19,696**
V Wishart	Chair - Education & Families Committee	1,769	0	**1,769**	**19,568**
From 8 May 2017					
I Scott	Chair - Licensing Committee	16,657	120	**16,777**	**0**
C Smith (a)	Leader of the Council	24,302	125	**24,427**	**19,718**
G Smith	Chair - Education & Families Committee	17,539	98	**17,637**	**18,555**
T Smith (b)	Chair - Planning Committee	16,798	0	**16,798**	**16,893**
R Thomson	Chair - Environment & Transport Committee	17,539	133	**17,672**	**0**
Full year (excluding 4-7 May)					
M Bell	Convener	20,797	177	**20,974**	**21,356**
P Campbell	Chair - Shetland College Board	18,335	138	**18,473**	**18,771**
A Cooper	Chair - Development Committee	19,308	177	**19,485**	**19,816**
A Duncan	Chair - Audit Committee	19,216	125	**19,341**	**18,705**
A Manson	Chair - Harbour Board	18,335	98	**18,433**	**18,555**

Notes:

a) C Smith stepped down as Leader of the Council on 8 March 2018 and the post was held on an interim basis by the Depute Leader, S Coutts, until he was formally appointed as Leader on 9 May 2018.

b) T Smith received an allowance from the Orkney and Shetland Valuation Joint Board as Vice Convener and therefore did not receive additional remuneration for holding the Chair of Planning Committee post. He was not a senior councillor in 2016/17.

c) Taxable expenses include telephone line rental / broadband costs.

d) The chair of the Integration Joint Board from 8 May 2017 was appointed to a person not employed by Shetland Islands Council.

e) Due to the Local Election, there was a gap between 3 and 8 May 2017 where no councillor remuneration was paid.

Remuneration of Senior Employees of the Council

Name of Senior Official	Designation	2017/18 Salary, Fees and Allowances £	2017/18 Taxable Expenses £	2017/18 Total Remuneration £	2016/17 Total Remuneration £
M Boden (c)	Chief Executive	87,694	37	**87,731**	**103,562**
M Sandison	Chief Executive	8,888	0	**8,888**	**0**
M Sandison (d)	Director - Infrastructure Services	79,797	0	**79,797**	**86,315**
H Budge	Director - Children's Services	87,206	0	**87,206**	**86,315**
C Ferguson	Director - Corporate Services	87,206	337	**87,543**	**86,770**
N Grant (e)	Director - Development Services	88,542	0	**88,542**	**86,315**
J Belford	Executive Manager - Finance (Section 95 Officer)	76,331	0	**76,331**	**75,548**
J Riise (f)	Executive Manager - Governance & Law (Monitoring Officer)	76,331	23	**76,354**	**75,548**
M Nicolson	Executive Manager - Children & Families (Chief Social Work Officer)	68,729	0	**68,729**	**67,163**

Notes:

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

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

c) M Boden retired from the post of Chief Executive during 2017/18. Remuneration is shown up to his retirement date of 31 January 2018. The full-time equivalent remuneration for the post of Chief Executive in 2017/18 was £104,648.

d) M Sandison held the post of Director of Infrastructure Services until her appointment as Chief Executive, which commenced on 19 March 2018. The full-time equivalent remuneration for the post of Director of Infrastructure Services in 2017/18 was £87,229. The post remained vacant until 18 May 2018.

e) From 1 February 2018 to 28 February 2018, N Grant, Director of Development Services held the position of Interim Chief Executive; the remuneration above includes £1.3k in addition to his Director salary.

f) In addition to the above, the Executive Manager - Governance & Law received a payment of £3.2k for his Returning Officer duties in respect of the local and general elections in 2017 (£6.5k in 2016/17);

g) The post of Director of Community Health & Social Care is held by S Boker-Ingram, who is employed by NHS Shetland; 50% of the cost of this post is funded by the Council. In 2017/18 the Council paid £60k (£59k for 2016/17) to NHS Shetland in respect of this post and his remuneration is disclosed in the Remuneration Report of the Integration Joint Board.

Pension Benefits – Senior Councillors

The pension entitlements for senior councillors are shown in the table below, together with the contribution made by the Council to each senior councillor during the year.

There was an election on 4 May 2017, which changed the senior post holders during the year. Councillors can be members of the Pension Scheme until the eve of their 75th birthday and on the completion of their term can access the pension benefits that have accrued to them if they have attained / exceeded their normal pension age. Some senior councillors who were re-elected took advantage of these Scheme conditions.

Name of Councillor	Designation	In-Year Employer Pension		Accrued Pension Benefits			
				As at 31 March 2018		Difference from 31 March 2017	
		31 March 2018 £000	31 March 2017 £000	Pension £000	Lump Sum £000	Pension £000	Lump Sum £000
M Bell	Convener	4	4	2	0	0	0
G Robinson	Leader of the Council	1	6	6	2	2	0
C Smith (a)	Leader of the Council	5	4	4	20	(1)	18
P Campbell	Chair - Shetland College Board	4	4	3	0	1	0
A Cooper	Chair - Development Committee	4	4	0	0	(4)	(2)
A Duncan	Chair - Audit Committee	4	4	0	0	(4)	(1)
A Manson	Chair - Harbour Board	4	4	2	0	0	0
I Scott	Chair - Licensing Committee	3	n/a	0	0	n/a	n/a
G Smith	Chair - Education & Families Committee	4	4	2	0	0	0
T Smith	Chair - Planning Committee	4	3	0	0	0	0
M Stout	Chair - Environment & Transport Committee	0	4	2	0	0	0

Notes:

a) C Smith stepped down as Leader of the Council on 8 March 2018 and the post was held on an interim basis by the Depute Leader, S Coutts, until he was formally appointed as Leader on 9 May 2018.

b) The table excludes F Robertson, Chair of the Planning Committee until 3 May 2017, V Wishart, Chair of the Education & Families Committee until 3 May 2017 and R Thomson, Chair of the Environment & Transport Committee from 8 May 2017, as they are not members of the Local Government Pension Scheme.

Pension Benefits - Senior Employees

Name of Senior Official	Designation	In-Year Employer		Accrued Pension Benefits			
				As at 31 March 2018		Difference from 31 March 2017	
		31 March 2018 £000	31 March 2017 £000	Pension £000	Lump Sum £000	Pension £000	Lump Sum £000
M Boden (a)	Chief Executive	18	20	8	0	0	0
M Sandison (b)	Chief Executive Director - Infrastructure Services	18	17	30	46	3	2
H Budge	Director - Children's Services	15	15	28	84	1	4
C Ferguson	Director - Corporate Services	18	17	46	96	2	1
N Grant	Director - Development Services	18	17	21	21	2	1
J Belford	Executive Manager - Finance	16	15	29	51	2	1
M Nicolson	Executive Manager - Children & Families	14	13	23	36	2	1
J Riise (c)	Executive Manager - Governance & Law	17	16	36	67	2	1

Notes:

a) M Boden figures for 2017/18 are reported up to the retirement date of 31 January 2018.

b) M Sandison held the post of Director of Infrastructure Services until her appointment as Chief Executive, which commenced on 19 March 2018.

c) The Executive Manager - Governance & Law also has pension benefits arising from Returning Officer (RO) duties in respect of Local Government, Scottish and European Parliamentary elections. A single disclosure of the pension benefits is detailed above and includes RO accrued pension benefits of £1.8k and £2.7k lump sum at 31 March 2018. In 2016/17, the comparative figures were £1.6k and £2.5k respectively;

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

Pension Benefits

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

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

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

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

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

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

Tiered contribution rates on whole time pay are as follows:	2017/18 %
On earnings up to and including £20,700	5.50
On earnings above £20,700 and up to £25,300	7.25
On earnings above £25,300 and up to £34,700	8.50
On earnings above £34,700 and up to £46,300	9.50
On earnings above £46,300	12.00

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

There is no automatic entitlement to a lump sum. Members may opt to give up (commute) up to 25% of their pension for a lump sum, per the Finance Act 2004. From April 2015 pensions are built up at a rate of 1/49th of annual pensionable pay for that year. Prior to April 2015, the accrual rate guaranteed a pension based on 1/60th of final pensionable salary and years of pensionable service. (Prior to 2009 the accrual rate guaranteed a pension based on 1/80th and a lump sum based on 3/80th of final pensionable salary and years of pensionable service).

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

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

Trade Union Facility Time Report 2017/18

The Trade Union (Facility Time Publication Requirements) Regulations 2017 came into force on 1 April 2017. These regulations place a legislative requirement on relevant public sector employers to collate and publish, on an annual basis, a range of data on the amount and cost of facility time within their organisation.

It should be noted that the following information is unaudited at the time of publication.

Facility Time Publication Requirements 2017/18	Central Function Employees	Education Function Employees
Table 1 - What was the total number of your employees who were relevant union officials during the relevant period?		
Number of employees	25	8
Full-time equivalent employee number	23.2	5.9
Table 2 - How many of your employees who were relevant union officials employed during the relevant period spent a) 0%, b) 1%-50%, c) 51%-99% or d) 100% of their working hours on facility time?		
Percentage of time	**Number of employees**	**Number of employees**
0%	5	0
1-50%	20	8
51-99%	0	0
100%	0	0
Table 3 - Percentage of pay bill spent on facility time: Provide the figures requested in the first column of the table below to determine the percentage of your total pay bill spent on paying employees who were relevant union officials for facility time during the relevant period.		
	£000	**£000**
Total cost of facility time (A)	10	25
Total pay bill (B)	91,710	19,415
Percentage of the total pay bill spent on facility time (A ÷ B)	0.01%	0.13%
Table 4 - Paid trade union activities: As a percentage of total paid facility time hours, how many hours were spent by employees who were relevant union officials during the relevant period on paid trade union activities?		
	%	**%**
Total hours spent on paid trade union activities by relevant union officials during the relevant period ÷ Total paid facility time hours x 100	18.69%	0%

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Steven Coutts
Leader of the Council
19 September 2018

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Maggie Sandison
Chief Executive
19 September 2018

Statement of Responsibilities for the Annual Accounts

The Council's Responsibilities

The Council is required to:

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

I can confirm that these annual accounts were approved for signature by the Council on 19 September 2018.

Signed on behalf of Shetland Islands Council.

The Executive Manager - Finance's Responsibilities

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

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

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

The Executive Manager - Finance has also:

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

I certify that the annual accounts give a true and fair view of the financial position of the Council at the reporting date and the transactions of the Council for the year ended 31 March 2018.

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Steven Coutts
Leader of the Council
19 September 2018

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Hazel Tait CPFA
Acting Section 95 Officer
19 September 2018

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

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the annual accounts of Shetland Islands Council for the year ended 31 March 2018 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement, Balance Sheet, Cash Flow Statement, Housing Revenue Account, Council Tax Income Account, and the Non-domestic Rate Income Account and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 (the 2017/18 Code).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2017/18 Code of the state of affairs of the Shetland Islands Council as at 31 March 2018 and of its income and expenditure for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2017/18 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Basis for opinion

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

Conclusions relating to going concern basis of accounting

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Executive Manager – Finance has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about Shetland Islands Council's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Responsibilities of the Executive Manager – Finance and Shetland Islands Council for the financial statements

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

In preparing the financial statements, the Executive Manager – Finance is responsible for assessing the Shetland Islands Council's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless deemed inappropriate.

The Shetland Islands Council is responsible for overseeing the financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other information in the annual accounts

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

In connection with our audit of the financial statements, our responsibility is to read all the other information in the annual accounts and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Report on other requirements

Opinions on matters prescribed by the Accounts Commission

In our opinion, the audited part of the Remuneration Report has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014.

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

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

Matters on which we are required to report by exception

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

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

We have nothing to report in respect of these matters.

Use of our report

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

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

19 September 2018

Primary Financial Statements

Comprehensive Income and Expenditure Statement for year ended 31 March 2018

This statement shows the accounting cost in the year of providing services in accordance with generally accepted accounting practices, rather than the amount to be funded from taxation. Councils raise taxation to cover expenditure in accordance with regulations; this may be different from the accounting cost. The taxation position is shown in both the Movement in Reserves Statement on page 31 and in Note 1: Expenditure and Funding Analysis on page 38.

2016/17 Net Expenditure £000		Notes	2017/18 Gross Expenditure £000	2017/18 Gross Income £000	2017/18 Net Expenditure £000
2,155	Chief Executive and Cost of Democracy		6,181	(6,104)	77
47,837	Children's Services		62,835	(8,267)	54,568
20,745	Community Care Services		56,036	(30,695)	25,341
11,313	Corporate Services		19,071	(12,701)	6,370
14,805	Development Services		27,875	(10,486)	17,389
27,066	Infrastructure Services		48,938	(19,777)	29,161
(1,361)	Housing Revenue Account		5,828	(7,141)	(1,313)
(9,659)	Harbour Account		20,290	(28,759)	(8,469)
112,901	**Cost of Services**		**247,054**	**(123,930)**	**123,124**
0	Removal of internal recharges		(38,377)	38,377	0
112,901	**Net Cost of Services**		**208,677**	**(85,553)**	**123,124**
(572)	Other operating income and expenditure	7	3,357	0	3,357
(1,840)	Financing and investment income and expenditure	8	10,025	(13,644)	(3,619)
(96,055)	Taxation and non-specific grant income	9	0	(97,371)	(97,371)
14,434	**Deficit on Provision of Services**		**222,059**	**(196,568)**	**25,491**
	Items that will not be reclassified to the (surplus) or deficit on the provision of services			**Notes**	
(4,529)	Surplus on revaluation of non-current assets			10	(10,305)
(61,891)	Surplus on revaluation of available for sale financial assets			10	(57,555)
79,290	Remeasurement of the net defined benefit liability			10	(78,203)
12,870					**(146,063)**
	Items that may be reclassified to the (surplus) or deficit on the provision of services				
1,868	Amounts recycled from the AFSFI reserve upon derecognition			10	47,791
14,738	**Other Comprehensive Income and Expenditure**				**(98,272)**
29,172	**Total Comprehensive Income and Expenditure**				**(72,781)**

Movement in Reserves Statement

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

	General Fund £000	Housing Revenue Account £000	Capital Funds £000	Other Revenue/ Statutory Funds £000	Total Usable Reserves £000	Unusable Reserves £000	Total Reserves £000
Balance at 1 April 2017	**(54,292)**	**(15,614)**	**(66,498)**	**(107,896)**	**(244,300)**	**(234,494)**	**(478,794)**
Movement in reserves during the year:							
Total Comprehensive Income and Expenditure	25,351	140	0	0	**25,491**	(98,272)	**(72,781)**
Removal of IJB surplus (Note 2)	238	0	0	0	**238**	0	**238**
Adjustments between accounting basis & funding basis per regulations (Note 6)	(30,525)	(2,023)	1,322	0	**(31,226)**	31,226	**0**
Net (Increase)/Decrease before transfers	**(4,936)**	**(1,883)**	**1,322**	**0**	**(5,497)**	**(67,046)**	**(72,543)**
Net Transfers to/(from) Other Statutory Reserves	(1,090)	162	(1,154)	2,082	**0**	0	**0**
(Increase)/Decrease in year	**(6,026)**	**(1,721)**	**168**	**2,082**	**(5,497)**	**(67,046)**	**(72,543)**
Balance at 31 March 2018	**(60,318)**	**(17,335)**	**(66,330)**	**(105,814)**	**(249,797)**	**(301,540)**	**(551,337)**

Comparative movements in 2016/17 (restated)	General Fund £000	Housing Revenue Account £000	Capital Funds £000	Other Revenue/ Statutory Funds £000	Total Usable Reserves £000	Unusable Reserves £000	Total Reserves £000
Balance at 1 April 2016	**(40,232)**	**(13,143)**	**(84,178)**	**(104,676)**	**(242,229)**	**(265,862)**	**(508,091)**
Movement in reserves during the year:							
Total Comprehensive Income and Expenditure	16,385	(1,951)	0	0	**14,434**	14,738	**29,172**
Removal of IJB surplus (Note 2)	125	0	0	0	**125**	0	**125**
Adjustments between accounting basis & funding basis per regulations (Note 6)	(18,999)	(520)	1,569	0	**(17,950)**	17,950	**0**
Net (Increase)/Decrease before transfers	**(2,489)**	**(2,471)**	**1,569**	**0**	**(3,391)**	**32,688**	**29,297**
Net Transfers to/(from) Other Statutory Reserves	(11,571)	0	16,111	(3,220)	**1,320**	(1,320)	**0**
(Increase)/Decrease in year	**(14,060)**	**(2,471)**	**17,680**	**(3,220)**	**(2,071)**	**31,368**	**29,297**
Balance at 31 March 2017	**(54,292)**	**(15,614)**	**(66,498)**	**(107,896)**	**(244,300)**	**(234,494)**	**(478,794)**

Balance Sheet as at 31 March 2018

This shows the value as at the Balance Sheet date of the assets and liabilities held by the Council. The net assets of the Council (assets less liabilities) are matched by the reserves held by the Council.

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

As at 31 March 2017 (restated) £000		Notes	As at 31 March 2018 £000
371,052	Property, Plant and Equipment	12	423,052
4,854	Heritage Assets	14	4,853
25,114	Intangible Assets	15	27,160
333,784	Long-term Investments	17	345,392
4,393	Long-term Debtors	22	1,911
739,197	**Long-Term Assets**		**802,368**
1,355	Assets held for Sale	20	557
4,511	Inventories	24	4,704
16,293	Short-term Debtors	21	16,876
3,909	Cash and Cash equivalents	19	4,002
26,068	**Current Assets**		**26,139**
(18,002)	Short-term Creditors	23	(18,620)
(634)	Short-term Provisions	25	(1,378)
(24)	Grant Receipts in Advance - Revenue	10	(197)
(18,660)	**Current Liabilities**		**(20,195)**
(31,075)	Long-term Borrowing	17	(41,202)
(229,675)	Pension Liability	27	(165,171)
(1,230)	Long-term Provisions	25	(579)
0	Deferred Liabilities	17	(44,321)
(5,831)	Other Long-term Liabilities	17	(5,702)
(267,811)	**Long-Term Liabilities**		**(256,975)**
478,794	**Net Assets**		**551,337**
(244,300)	Usable Reserves	7	(249,797)
(234,494)	Unusable Reserves	11	(301,540)
(478,794)	**Total Reserves**		**(551,337)**

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Hazel Tait CPFA
Acting Section 95 Officer
19 September 2018

Cash Flow Statement for year ended 31 March 2018

This statement shows the changes in cash and cash equivalents of the Council during the financial year. It shows how the Council generates and uses cash and cash equivalents by classifying cashflows as operating, investing and financing activities.

The amount of net cashflows arising from operating activities is a key indicator of the extent to which the operations of the Council are funded by way of taxation and grant income, or from the recipients of services provided by the Council.

Investing activities represent the extent to which cash outflows have been made for resources which are intended to contribute to the Council's future service delivery.

Cashflows arising from financing activities are useful in predicting claims on future cashflows by providers of capital (i.e. borrowing) to the Council.

2016/17 £000		Notes	2017/18 £000
	Operating activities		
14,434	Net deficit on the provision of services		25,491
(35,382)	Adjustment to net surplus or deficit on the provision of services for non-cash movements	30	(52,886)
8,959	Adjustments for items included in the net surplus or deficit on the provision of services that are investing and financing activities	30	9,738
(11,989)	**Net cash flows from Operating Activities**		**(17,657)**
10,488	Investing activities	31	27,088
112	Financing activities	32	(9,524)
(1,389)	**Net increase in cash and cash equivalents**		**(93)**
2,520	Opening Cash and Cash Equivalents		3,909
1,389	Net movement of Cash and Cash Equivalents during the year		93
3,909	**Closing Cash & Cash Equivalents**		**4,002**

Housing Revenue Account

Introduction and Statutory Background

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

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

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

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

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

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

The HRA Income and Expenditure Statement

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

Housing Revenue Account Income and Expenditure Statement

2016/17 £000		2017/18 £000
	Expenditure	
2,055	Repairs and maintenance	2,368
670	Supervision and management	592
2,395	Depreciation and impairment of non-current assets	2,235
48	Movement in the allowance for bad debts	60
175	Other expenditure	206
5,343	**Total expenditure**	**5,461**
	Income	
(6,552)	Dwelling rents	(6,577)
(190)	Non-Dwelling rents	(221)
(25)	Other Income	(22)
(6,767)	**Total income**	**(6,820)**
(1,424)	**Net income of HRA services as included in the CIES**	**(1,359)**
63	HRA services' share of Corporate and Democratic Core	89
(1,361)	**Net Income of HRA Services**	**(1,270)**
	HRA share of operating income and expenditure included in the CIES	
(128)	Taxation and non-specific grant income	(114)
(766)	Gain on sale of HRA non-current assets	1,764
624	Interest payable and similar charges	497
(404)	Interest and investment income	(836)
84	Pension interest cost and expected return on pension assets	99
(590)	**Net HRA share of operating expenditure**	**1,410**
(1,951)	**(Surplus) / Deficit for the year on HRA services**	**140**

Movement on the Housing Revenue Account Statement

2016/17 £000		2017/18 £000
0	**Opening balance on the HRA**	(15,614)
(13,143)	Transfer from Housing Repairs & Renewals Account	0
(1,951)	(Surplus) / Deficit on the HRA Income and Expenditure Statement	140
(520)	Adjustment between accounting basis and funding basis under statute	(2,023)
(15,614)	**Increase in year on the HRA**	**(1,883)**
0	Transfers to reserves	162
(15,614)	**Closing balance on the HRA**	**(17,335)**

The adjustments between accounting basis and funding basis for the HRA are shown in disclosure Note 6: Adjustments between Accounting Basis and Funding Basis under Regulations on page 42 and transfers to or reserves are shown in Note 7: Transfers to / (from) Earmarked Reserves on page 45.

Further information on HRA activities can be found in Note 13: Notes to the Housing Revenue Account on page 54.

Council Tax Income Account

The Council Tax Income Account shows the gross income raised from council taxes levied and deductions made under statute. The resultant net income is transferred to the Council's Comprehensive Income and Expenditure Statement.

Council Tax Income Account

2016/17 £000		2017/18 £000
(10,435)	Gross Council Tax levied and contributions in lieu	(11,056)
623	Council Tax Reduction Scheme	625
1,208	Other discounts and reductions	1,299
35	Write-offs of uncollectable debts	51
27	Adjustment to previous years' Community Charge and Council Tax	39
(8,542)	**Transfer to General Fund**	**(9,042)**

Council Tax Base

The table below shows the Council Tax base used to set the 2017/18 charges. The amount of Council Tax payable depends on the valuation band of the dwelling. The following analysis sets out the number of chargeable dwellings in each valuation band, before and after adjustment for exemptions and discounts, with all figures also shown after conversion to band D equivalents.

2017/18	Number of dwellings	Number of exemptions	Disabled relief	Discounts	Council Tax Reduction	Total dwellings	Ratio to Band D	2017/18 Band D equivalents	**2016/17 Band D equivalents
Band A*			11	(1)	(3)	7	0.56	4	3
Band A	2,954	(124)	4	(453)	(299)	2,082	0.67	1,388	1,401
Band B	1,825	(63)	8	(230)	(173)	1,367	0.78	1,063	1,069
Band C	2,774	(71)	11	(301)	(216)	2,197	0.89	1,953	1,953
Band D	1,801	(33)	5	(133)	(41)	1,599	1.00	1,599	1,584
Band E	1,377	(15)	1	(65)	(12)	1,286	1.31	1,685	1,533
Band F	272	(2)	1	(7)	(1)	263	1.63	429	365
Band G	64	(2)	0	(4)	(1)	57	1.96	112	88
Band H	1	(1)	0	0	0	0	2.45	0	0
Sub-total								**8,232**	**7,996**
Less Bad Debt provision at 3%								(247)	(240)
Council Tax Base								**7,985**	**7,756**

** Relates to Band A properties subject to disabled relief ** The 2016/17 figure has been adjusted for Council Tax Reduction*

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

Council Tax Reduction Scheme:

This is a scheme that reduces the Council Tax liability of low income households in Scotland.

Exemptions:

Houses where all the residents are students, or under 18 years old, or are persons with a severe mental impairment will be exempt. Some classes of empty property, in many cases only for a limited period, will also be exempt.

Discounts:

If only one adult lives in a property, the bill may be cut by 25%. If the property is unoccupied and is no-one's sole or main residence, the bill may be cut by up to 50%. If the property is a second home or long-term empty, the discount will only be 10%.

Reliefs:

If a house has been structurally altered for a disabled person, the Council Tax bill may be set at the next band lower in value than that shown in the Valuation List (Band A* shown above). A reduction is also offered for properties in Band A.

Non-Domestic Rate Income Account

Statutory Background

The Non-Domestic Rate Account (Scotland) is a statement that reflects the statutory obligation for billing authorities to maintain a separate Non-Domestic Rate Account. The statement shows the gross income from the rates and deductions made under statute. The net income is paid to the Scottish Government as a contribution to the national non-domestic rate pool.

Non-Domestic Rate Income Account

2016/17 £000		2017/18 £000
27,279	Gross rates levied and contributions in lieu	29,875
(3,779)	Reliefs and other deductions	(4,569)
1	Write-offs of uncollectable debts	(16)
23,501	**Net non-domestic rate income**	**25,290**
(242)	Adjustment to previous years' national non-domestic rates	(409)
23,259	**Contribution to non-domestic rate pool**	**24,881**
(17,822)	Distribution from non-domestic rate pool	(23,240)
(17,822)	**Transfer to Comprehensive Income & Expenditure Statement**	**(23,240)**

Analysis of Rateable Value

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

The national non-domestic rate poundage set for 2017/18 is 46.6p (48.4p in 2016/17) with a large business supplement of 2.6p (2.6p in 2016/17) for all subjects with a rateable value above £51,000 (£35,000 in 2016/17).

The large business supplement contributes to the cost of the Small Business Bonus Scheme, which was introduced by the Scottish Government from 1 April 2008, replacing the Small Business Rate Relief Scheme and applies to properties with a rateable value of £18,000 or less.

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

Rateable values at 1 April 2017	Number of Subjects	Rateable Value £000
Commercial	561	8,589
Industrial	486	37,058
Other	1,009	15,149
Total	**2,056**	**60,796**

Note 1: Expenditure and Funding Analysis

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

2017/18	Net Expenditure chargeable to the General Fund and HRA £000	Adjustments between Funding and Accounting Basis £000	Present-ational Adjustments £000	Net Expenditure in the CIES £000
Chief Executive and Cost of Democracy	1,706	198	(1,827)	77
Children's Services	40,417	10,127	4,024	54,568
Community Care Services	19,229	3,021	3,091	25,341
Corporate Services	9,411	1,870	(4,911)	6,370
Development Services	13,997	2,309	1,083	17,389
Infrastructure Services	24,426	7,935	(3,200)	29,161
Housing Revenue Account	(1,048)	274	(539)	(1,313)
Harbour Account	(11,324)	3,127	(272)	(8,469)
Net Cost of Services	**96,814**	**28,861**	**(2,551)**	**123,124**
Other income and expenditure	(89,841)	3,686	(11,478)	(97,633)
(Surplus) or Deficit	**6,973**	**32,547**	**(14,029)**	**25,491**
Opening General Fund and HRA balance*		**70,031**		
Add (Surplus) / Deficit in the year		6,973		
Add other items not charged to the (Surplus) / Deficit		649		
Closing General Fund and HRA balance		**77,653**		

2016/17	Net Expenditure chargeable to the General Fund and HRA £000	Adjustments between Funding and Accounting Basis £000	Present-ational Adjustments £000	Net Expenditure in the CIES £000
Chief Executive and Cost of Democracy	1,754	642	(241)	2,155
Children's Services	39,954	5,775	2,108	47,837
Community Care Services	18,323	1,470	952	20,745
Corporate Services	10,562	5,988	(5,237)	11,313
Development Services	13,815	1,623	(633)	14,805
Infrastructure Services	19,725	5,652	1,689	27,066
Housing Revenue Account	(2,067)	648	58	(1,361)
Harbour Account	(12,118)	2,468	(9)	(9,659)
Net Cost of Services	**89,948**	**24,266**	**(1,313)**	**112,901**
Other income and expenditure	(87,300)	(4,746)	(6,421)	(98,467)
(Surplus) or Deficit	**2,648**	**19,520**	**(7,734)**	**14,434**
Opening General Fund and HRA balance*		**53,375**		
Add (Surplus) / Deficit in the year		2,648		
Add other items not charged to the (Surplus) / Deficit		13,883		
Closing General Fund and HRA balance		**69,906**		

**For a split between General Fund and HRA balances, see the Movement in Reserves Statement on page 31.*

The following table analyses the Adjustments between Funding and Accounting Basis figure outlined above:

2017/18	Adjustments for capital £000	Adjustment for pensions net change £000	Other adjustments £000	Total adjustments £000
Chief Executive and Cost of Democracy	56	142	0	198
Children's Services	9,188	1,103	(164)	10,127
Community Care Services	858	2,479	(316)	3,021
Corporate Services	1,044	925	(99)	1,870
Development Services	1,706	621	(18)	2,309
Infrastructure Services	6,365	1,613	(43)	7,935
Housing Revenue Account	148	147	(21)	274
Harbour Account	2,666	603	(142)	3,127
Net Cost of Services	**22,031**	**7,633**	**(803)**	**28,861**
Other income and expenditure	(4,309)	6,066	1,929	3,686
Total adjustments between accounting basis and funding basis	**17,722**	**13,699**	**1,126**	**32,547**

2016/17	Adjustments for capital £000	Adjustment for pensions net change £000	Other adjustments £000	Total adjustments £000
Chief Executive and Cost of Democracy	376	266	0	642
Children's Services	5,471	(102)	406	5,775
Community Care Services	410	928	132	1,470
Corporate Services	655	5,161	172	5,988
Development Services	1,429	148	46	1,623
Infrastructure Services	5,014	572	66	5,652
Housing Revenue Account	498	143	7	648
Harbour Account	2,275	140	53	2,468
Net Cost of Services	**16,128**	**7,256**	**882**	**24,266**
Other income and expenditure	(4,818)	0	72	(4,746)
Total adjustments between accounting basis and funding basis	**11,310**	**7,256**	**954**	**19,520**

Capital Adjustments

This column includes depreciation, impairment and revaluation gains and losses, income on disposal of assets and the amounts written off for those assets; statutory charges for capital financing and capital grants not chargeable under generally accepted accounting practices.

Pensions Adjustments

Employer pension contributions made by the Council are removed here and replaced with current service costs and past service costs according to IAS 19. Net interest on the defined benefit liability is charged to the CIES.

Other Adjustments

Other differences between amounts charged to the CIES and amounts to be recognised under statute include the amount by which finance costs charged to the CIES are different from finance costs chargeable in the year and the amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year.

Presentational Adjustments

Further adjusting differences between amounts charged to the CIES and amounts reported internally to management include year-end internal recharges. These are removed from Gross Expenditure and Gross Income in the CIES and net to nil overall; i.e. income to one service line is a cost to another. Some items of investment income and expenditure are not reported internally and therefore must also be presented here.

Note 2: Change in Accounting Policy

The Council reported debtor and creditor balances in its unaudited accounts relating to amounts owed from and owing to Zetland Transport Partnership and the Shetland Islands Integration Joint Board (IJB). In line with presentation in those bodies' accounts, the accounting policy has been changed so that only the net amount outstanding is shown in the balance sheet.

In addition, £0.363m has been removed from Usable Reserves (Community Care Fund) because this is cash held on behalf of the IJB which cannot be spent by the Council alone.

The impact on the primary statements is as follows:

Effect on Balance Sheet as at 31 March 2018	As Originally Stated £000	As Restated £000	Restatement £000
Short-term Debtors	40,848	16,876	(23,972)
Short-term Creditors	(42,229)	(18,620)	23,609
Usable Reserves	(250,160)	(249,797)	363

Effect on Balance Sheet as at 31 March 2017	As Originally Stated £000	As Restated £000	Restatement £000
Short-term Debtors	37,869	16,293	(21,576)
Short-term Creditors	(39,453)	(18,002)	21,451
Usable Reserves	(244,425)	(244,300)	125

Note 3: Accounting Standards Issued not Adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued, but not yet adopted. This applies to the adoption of the following new or amended standards within the 2018/19 Code:

- IFRS 9: Financial Instruments;
- IFRS 15: Revenue from Contracts with Customers, including amendments and clarifications;
- Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses; and
- Amendments to IAS 7 Statement of Cashflows: Disclosure Initiative.

The Code requires implementation in the accounts from 1 April 2018 and there is therefore no impact on the 2017/18 financial statements, neither will there be retrospective restatement of the 2017/18 year in next year's accounts upon implementation of the two new standards. Instead, opening balances at 1 April 2018 will be adjusted.

The new standards are expected to have negligible impact on the Council's financial statements, except for IFRS 9: Financial Instruments. Under this new accounting standard, the classification of 'Available for Sale' financial assets disappears and, due to the nature of investments held by the Council, any unrealised gains and losses may require to be accounted for as income through the CIES.

The value of the Council's accumulated unrealised gains in Available for Sale financial assets at 31 March 2018 was £108.5m (see Note 11: Unusable Reserves on page 48).

Note 4: Material Items of Income and Expenditure

The CIES includes an actuarial gain on the pension liability of £78.2m (see Note 11: Unusable Reserves).

Note 5: Assumptions and Major Estimation Uncertainty

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

The items in the Council's Balance Sheet at 31 March 2018 for which there is a significant risk of material adjustment in the forthcoming financial year are shown in the following table:

Item	Uncertainties	Effect if actual results differ from assumptions
Pension Liability	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the Council with expert advice about the assumptions to be applied.	The effects on the net pensions liability of changes in individual assumptions can be measured. For instance, a 0.5% decrease in the discount rate assumption would result in an increase in the pension liability of £58.3m; however, the assumptions interact in complex ways.
Fair Value Measurement	When the fair value of financial assets and liabilities cannot be measured based on quoted prices in active markets (ie Level 1 inputs), their fair value is measured using valuation techniques. Where possible, the inputs to these valuation techniques are based on observable data, but where this is not possible judgement is required in establishing fair values. These judgements typically include considerations such as uncertainty and risk. The Council holds Available-for-Sale financial assets (investments) and Financial Guarantees at fair value.	This will be different in each case, but changes in any assumptions used in all asset valuation could affect the values disclosed in the accounts.
Property, Plant and Equipment	Assets are depreciated over useful lives that are dependent on assumptions about the level of repairs and maintenance that will be incurred in relation to individual assets. Any reduction in anticipated spending on repairs and maintenance may reduce the useful lives assigned to assets.	If the useful life of an asset is reduced, depreciation accelerates and the carrying value of the asset falls. It is estimated that the annual depreciation charge for buildings would increase by £1.0m for every year that useful lives were reduced.
Arrears	At 31 March 2018, the Council had a balance on short-term sundry debtors of £5.8m. A review of significant balances suggested that an allowance for impairment of doubtful debts of £0.2m is appropriate in the current economic climate. Council Tax collection does not impose a significant impairment risk as historically, less than 0.5% of charges levied are ever written off.	If sundry debtor collection rates were to deteriorate, for example if the amount of doubtful debts doubled, an additional £0.2m would require to be set aside as an allowance. It is estimated that no more than £0.1m will eventually be written off from Council Tax charges of £9.0m levied during 2017/18.
Fishing Quota	Fishing quota held by the Council were valued at £26.3m by an independent broker at 31 March 2018. The price that quota attract is affected by the quantity of Fixed Quota Allocation Units (FQAs) in the market. It is highly probable that Brexit will have a long-term impact on the quantity of FQAs in the market, however the transitional period to 31 December 2020 provides some short-term assurance.	The effect will vary depending on market conditions at the time of valuation; it is not quantifiable at this time.

Note 6: Adjustments between Accounting Basis and Funding Basis under Regulations

This note details the adjustments that are made to the CIES, recognised by the Council in the year in accordance with proper accounting practice, to the resources that are specified by statutory provisions as being available to the Council to meet future capital and revenue expenditure.
The following sets out a description of the reserves that the adjustments are made against:

General Fund

The General Fund is the statutory fund into which all the receipts of the Council are required to be paid and out of which all liabilities of the Council are to be met, except to the extent that statutory rules might provide otherwise.

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

Housing Revenue Account

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

Capital Usable Reserves

This includes the Capital Receipts Reserve and Capital Grants Unapplied Account.

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

The Capital Grants Unapplied Account holds the grants and contributions received towards capital projects for which the Council has met the conditions that would otherwise require repayment of the monies, but which have yet to be applied to meet expenditure.

The balance is restricted by grant terms as to the capital expenditure against which it can be applied and/or the financial year in which it can take place.

2017/18	Usable Reserves General Fund £000	Housing Revenue Account £000	Capital Usable Reserves £000	Total Usable Reserves £000	Unusable Reserves £000
Adjustments primarily involving the Capital Adjustment Account:					
Reversal of items charged to the CIES:					
Charges for depreciation of non-current assets	(14,901)	(2,059)	0	**(16,960)**	16,960
Charges for impairment of non-current assets	(6,987)	(153)	0	**(7,140)**	7,140
Amortisation of intangible assets	(1,332)	(23)	0	**(1,355)**	1,355
Capital grants and contributions applied	7,537	114	8	**7,659**	(7,659)
Amounts of non-current assets written off on disposal or sale as part of the gain / loss on disposal to the CIES	(2,008)	(3,421)	0	**(5,429)**	5,429
Capital repayment in respect of finance leases	99	0	0	**99**	(99)
Insertion of items not charged to the CIES:				**0**	0
Statutory provision for the financing of capital investment (principal repayments)	968	827	0	**1,795**	(1,795)
Capital expenditure charged against the General Fund and HRA balances	268	1,260	0	**1,528**	(1,528)
Adjustments primarily involving the Capital Grants Unapplied Account:					
Capital grants and contributions unapplied credited to the CIES	10	0	(10)	**0**	0
Adjustments involving the Capital Fund:					
Use of Capital Fund to fund capital expenditure in the year	0	0	103	**103**	(103)
Adjustments primarily involving the Capital Receipts Reserve:					
Transfer of cash sale proceeds credited as part of the gain/loss on disposal to the CIES	422	1,657	0	**2,079**	(2,079)
Use of the Capital Receipts Reserve to finance new capital expenditure	0	0	1,221	**1,221**	(1,221)
Adjustments involving the Financial Instruments Adjustment Account:					
Transfer of former Shetland Development Trust balances to the Local Investment Fund	(1,929)	0	0	**(1,929)**	1,929
Adjustments primarily involving the Pensions Reserve:					
Reversal of items relating to retirement benefits charged to the CIES	(26,009)	(429)	0	**(26,438)**	26,438
Employer's pensions contributions and direct payments to pensioners payable in the year	12,556	183	0	**12,739**	(12,739)
Adjustment primarily involving the Employee Statutory Adjustment Account:					
Amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements	782	21	0	**803**	(803)
Total Adjustments	**(30,524)**	**(2,023)**	**1,322**	**(31,225)**	**31,225**

2016/17	Usable Reserves General Fund £000	Housing Revenue Account £000	Capital Usable Reserves £000	Total Usable Reserves £000	Unusable Reserves £000
Adjustments primarily involving the Capital Adjustment Account:					
Reversal of items charged to the CIES:					
Charges for depreciation and impairment of non-current assets	(15,993)	(2,107)	0	**(18,100)**	18,100
Revaluation losses on property, plant and equipment	(249)	(265)	0	**(514)**	514
Amortisation of intangible assets	(1,044)	(23)	0	**(1,067)**	1,067
Capital grants and contributions applied	4,652	128	45	**4,825**	(4,825)
Amounts of non-current assets written off on disposal or sale as part of the gain / loss on disposal to the CIES	(538)	(1,462)	0	**(2,000)**	2,000
Capital repayment in respect of finance leases	94	0	0	**94**	(94)
Insertion of items not charged to the CIES:					
Statutory provision for the financing of capital investment (principal repayments)	244	1,086	0	**1,330**	(1,330)
Capital expenditure charged against the General Fund and HRA balances	1,512	45	0	**1,557**	(1,557)
Adjustments primarily involving the Capital Grants Unapplied Account:					
Capital grants and contributions unapplied credited to the CIES	38	0	(38)	**0**	0
Application of grants to capital financing transferred to the Capital Adjustment Account	0	0	0	**0**	0
Adjustments primarily involving the Capital Receipts Reserve:					
Transfer of cash sale proceeds credited as part of the gain/loss on disposal to the CIES	344	2,228	0	**2,572**	(2,572)
Use of the Capital Receipts Reserve to finance new capital expenditure	0	0	1,562	**1,562**	(1,562)
Adjustments primarily involving the Financial Instruments Adjustment Account:					
Amount by which finance costs charged to the CIES are different from finance costs chargeable in the year in accordance with statutory requirements	(72)	0	0	**(72)**	72
Adjustments primarily involving the Pensions Reserve:					
Reversal of items relating to retirement benefits charged to the CIES	(18,830)	(316)	0	**(19,146)**	19,146
Employer's pensions contributions and direct payments to pensioners payable in the year	11,717	173	0	**11,890**	(11,890)
Adjustment primarily involving the Employee Statutory Adjustment Account:					
Amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements	(875)	(7)	0	**(882)**	882
Total Adjustments	**(19,000)**	**(520)**	**1,569**	**(17,951)**	**17,951**

Note 7: Transfers to / (from) Earmarked Reserves

This note sets out the amounts transferred to and from General Fund and Housing Revenue Account balances and other earmarked reserves to meet General Fund and Housing Revenue Account expenditure in 2017/18.

	Balance at 31 March 2017 (restated) £000	Transfers out £000	Transfers in £000	Balance at 31 March 2018 £000
General Fund Balance (unearmarked)	(24,284)	20,439	(19,033)	**(22,878)**
Equalisation Fund (unearmarked)	(16,067)	0	(861)	**(16,928)**
Revenue Spend to Save Fund	(2)	0	(2,009)	**(2,011)**
Council Tax Second Homes Receipts	(1,164)	0	(164)	**(1,328)**
Welfare Reform Fund	(208)	0	(11)	**(219)**
Hansel Funds	(161)	1	0	**(160)**
School Funds	(283)	48	0	**(235)**
Shetland College	(180)	180	0	**0**
Central Energy Efficiency Fund	(117)	41	0	**(76)**
Community Care Fund	(367)	403	(265)	**(229)**
Local Investment Fund	(11,459)	0	(4,795)	**(16,254)**
Total General Fund	**(54,292)**	**21,112**	**(27,138)**	**(60,318)**
Capital Fund	(66,498)	3,332	(3,164)	**(66,330)**
Repairs & Renewals Fund	(44,134)	5,805	(2,364)	**(40,693)**
Housing Revenue Account	(15,614)	162	(1,883)	**(17,335)**
Harbour Reserve Fund	(63,518)	11,715	(11,418)	**(63,221)**
Insurance Fund	(244)	0	(1,656)	**(1,900)**
Total Statutory Reserves	**(190,008)**	**21,014**	**(20,485)**	**(189,479)**
Total Usable Reserves	**(244,300)**	**42,126**	**(47,623)**	**(249,797)**

General Fund Reserves

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

General Fund Balance: established to defray General Fund expenditure.

Equalisation Fund: realised returns that exceed the long-term average rate of return that can be released in future years.

Revenue Spend to Save Fund: to fund savings initiatives upfront, to be repaid when a saving is realised.

Council Tax Second Homes Receipts: to fund affordable housing expenditure from receipts from second homes' Council Tax.

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

Hansel Funds: held for the benefit of residents in care establishments.

School Funds: to contribute to the good of the schools of Shetland or enhance educational or social activities for children.

Shetland College Reserve: previously held funds relating to Shetland College; now transferred to the General Fund Balance.

Central Energy Efficiency Fund: to fund the reduction in energy consumption and carbon emissions.

Community Care Fund: balances relating to the Integrated Joint Board.

Local Investment Fund: income from Shetland Development Trust for investment in local businesses and distributing any investment income to Shetland Charities.

Other Statutory Reserves

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

The **Repairs and Renewals Fund** was established under the provisions of the Local Government (Scotland) Act 1975 for the purpose of defraying expenditure in repairing, maintaining, replacing and renewing any buildings, works, plant, equipment or articles belonging to the Council. This now incorporates the former Quarry Repairs and Renewals Fund.

The **Insurance Fund** may be used to make good loss or damage suffered by the Council as a result of an occurrence against the risk of which the Council can insure. It can also be used in paying premiums on a policy of insurance against the risk.

The **Housing Revenue Account** carries forward the accumulated surplus or deficit generated by the HRA each year. The fund is set aside to defray certain expenditure on the HRA, such as the future maintenance of housing stock.

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

Note 8: Other Operating Income and Expenditure

2016/17 £000		2017/18 £000
(572)	(Gains)/losses on the disposal of non-current assets	3,357
(572)	**Total**	**3,357**

Note 9: Financing and Investment Income and Expenditure

2016/17 £000		2017/18 £000
2,343	Interest payable and similar charges	3,959
5,264	Pensions interest cost and expected return on pensions assets	6,066
(2,361)	Interest receivable and similar income	(2,312)
(2,749)	Other investment income	(3,401)
(3,739)	Realised gains in relation to available for sale	(7,854)
(598)	Income from transferred SDT financial instruments	(77)
(1,840)	**Total**	**(3,619)**

Note 10: Grant Income

The Council credited the following grants, contributions and donations to the CIES in 2017/18:

2016/17 £000		2017/18 £000
	Credited to Taxation and Non-Specific Grant Income	
(64,873)	Revenue Support Grant	(57,428)
(17,822)	Non-domestic Rates	(23,240)
(8,542)	Council Tax	(9,042)
(4,818)	Capital Grants and Contributions	(7,648)
0	Donated Assets	(13)
(96,055)	**Total**	**(97,371)**
	Credited to Services	
(3,072)	Housing Benefit funding	(3,134)
(1,653)	Further Education and Higher Education funding	(2,752)
0	Scottish Government PFI Support	(1,601)
(286)	EU grants	(527)
0	Household Recycling Charter grant	(515)
(350)	Skills Development Scotland funding	(360)
(352)	Criminal Justice grant	(336)
(134)	NHS grants	(336)
(2,051)	Sports Development and Facilities funding	(312)
(50)	Educational Attainment / Pupil equity funding	(187)
(199)	Active Schools funding	(186)
0	Expansion of Early Learning and Childcare funding	(184)
(146)	Energy grants	(157)
(10)	Training grants	(98)
(83)	Education Maintenance Allowance funding	(88)
(51)	Employability funding	(82)
(70)	Youth Music funding	(78)
(155)	Department of Work and Pensions funding	(71)
(38)	Electric Vehicle funding	(62)
0	Empowering Communities funding	(50)
0	Smarter Choices Smarter Places funding	(49)
(23)	Languages funding	(39)
(101)	Transport grants	(25)
(15)	Youth Legacy / Year of Young People	(19)
(32)	Community Development funding	(12)
(184)	Housing grants	(10)
0	Athlete Support Programme funding	(10)
(17)	Milk Subsidy	(8)
(20)	Self Directed Support funding	0
(39)	Other grants and contributions	(50)
(9,131)	**Total**	**(11,338)**

(24)	**Value of grants received in advance not recognised**	**(197)**

Note 11: Unusable Reserves

Reconciliation of Unusable Funds to the Balance Sheet

2016/17 £000		2017/18 £000
(89,850)	Revaluation Reserve	(96,359)
(98,700)	Available for Sale Financial Instruments Reserve	(108,464)
(1,929)	Financial Instruments Adjustment Account	0
229,675	Pensions Reserve	165,171
(276,871)	Capital Adjustment Account	(264,267)
3,181	Employee Statutory Adjustment Account	2,379
(234,494)	**Total Unusable Reserves**	**(301,540)**

Revaluation Reserve

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

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

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

2016/17 £000		2017/18 £000
(91,109)	**Opening balance**	**(89,850)**
(4,529)	Surplus on revaluation of non-current assets	(10,305)
	Amounts written off to the Capital Adjustment Account:	
4,731	Difference between fair value depreciation and historical cost depreciation	2,672
1,057	Assets sold or scrapped	1,124
(89,850)	**Closing balance**	**(96,359)**

Available for Sale Financial Instruments Reserve

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

2016/17 £000		2017/18 £000
(38,677)	**Opening balance**	**(98,700)**
(61,891)	Surplus on revaluation of available for sale financial assets	(57,555)
1,868	Removal of previously unrealised gains in relation to assets sold	47,791
(98,700)	**Closing balance**	**(108,464)**

Financial Instruments Adjustment Account

The Financial Instruments Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for income and expenses relating to certain financial instruments and for bearing losses or benefiting from gains per statutory provisions. The value of investment assets transferred from Shetland Development Trust in 2014/15 have been transferred to the Local Investment Fund.

2016/17 £000		2017/18 £000
(2,001)	**Opening balance**	**(1,929)**
72	Amount by which finance costs charged to the CIES are different from the finance costs chargeable in the year in accordance with statutory requirements	0
0	Amounts written out to Usable Reserves	1,929
(1,929)	**Closing balance**	**0**

Pensions Reserve

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

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

2016/17 £000		2017/18 £000
143,129	**Opening balance**	**229,675**
79,290	Actuarial (gains) and losses on pensions assets and liabilities	(78,203)
19,146	Reversal of items relating to retirement benefits debited or credited to the Deficit on the Provision of Services in the CIES	26,438
(11,890)	Employer's pensions contributions and direct payments to pensioners payable in the year	(12,739)
229,675	**Closing balance**	**165,171**

Employee Statutory Adjustment Account

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

2016/17 £000		2017/18 £000
2,299	**Opening balance**	**3,181**
(2,299)	Settlement or cancellation of accrual made at the end of the preceding year	(3,181)
3,181	Amounts accrued at the end of the current year	2,379
3,181	**Closing balance**	**2,379**

Capital Adjustment Account

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

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

2016/17 £000		2017/18 £000
(279,503)	**Opening balance**	**(276,871)**
	Reversal of items relating to capital expenditure debited or credited to the CIES:	
18,100	Charges for depreciation of non-current assets	16,960
514	Charges for impairment of non-current assets	7,140
1,067	Amortisation of intangible assets	1,355
(94)	Repayment of capital on finance leases	(99)
0	Repayment of capital on PFI contract	(514)
2,000	Amounts of Non-Current assets written off on disposal or sale as part of the gain/loss on disposal to the CIES	5,429
175	Prior year disposal of asset transferred to stock	0
(5,787)	Adjustment amounts written out of the Revaluation Reserve	(3,796)
	Capital financing applied in the year:	
(4,134)	Use of the Capital Receipts Reserve to finance new capital expenditure	(3,300)
(4,780)	Capital grants and contributions credited to the CIES that have been applied to capital financing	(7,651)
(1)	Application of grants to capital financing from the Capital Grants Unapplied Account	(8)
(1,330)	Statutory provision for the financing of capital investment charged against the General Fund and HRA balances	(1,281)
(1,557)	Capital expenditure charged against the General Fund and HRA balances	(1,528)
(1,541)	Capital Fund Reserve	(103)
(276,871)	**Closing balance**	**(264,267)**

Note 12: Property, Plant and Equipment

	Council Dwellings £000	Other Land & Buildings £000	Vehicles, Furniture, Plant & Equipment £000	Infra-structure Assets £000	Community Assets £000	Surplus Assets £000	Assets Under Construction £000	Total Property, Plant and Equipment £000	PFI Assets included in Total £000
Cost or Valuation									
Opening Balance at 1 April 2017	**62,159**	**144,262**	**47,703**	**167,438**	**6,919**	**255**	**15,099**	**443,835**	**0**
Additions	3,167	49,035	10,481	1,860	0	0	9,208	73,751	46,000
Revaluation increases/(decreases) recognised in the Revaluation Reserve	8	3,303	(415)	0	563	17	0	3,476	0
Revaluation increases/(decreases) recognised in the Surplus/Deficit on the Provision of Services	(153)	(7,041)	(15)	0	0	(2)	0	(7,211)	0
Derecognition – disposals	(641)	(64)	(626)	0	0	(71)	0	(1,402)	0
Derecognition – other	(2,277)	(745)	(433)	0	0	0	0	(3,455)	0
Assets reclassified (to) / from Assets Held for Sale	(78)	0	(350)	0	0	10	0	(418)	0
Other movements in cost or valuation	84	18,524	0	0	0	38	(18,646)	0	0
Closing Balance at 31 March 2018	**62,269**	**207,274**	**56,345**	**169,298**	**7,482**	**247**	**5,661**	**508,576**	**46,000**
Depreciation and Impairment									
Opening Balance at 1 April 2017	**0**	**(4,799)**	**(19,137)**	**(48,825)**	**0**	**(22)**	**0**	**(72,783)**	**0**
Depreciation charge	(1,987)	(6,381)	(4,451)	(4,205)	0	(5)	0	(17,029)	(630)
Depreciation written out to the Revaluation Reserve	2	2,800	690	0	0	1	0	3,493	0
Depreciation written out to the Surplus/ Deficit on the Provision of Services	0	61	10	0	0	0	0	71	0
Derecognition – disposals	20	24	596	0	0	0	0	640	0
Derecognition – other	1	82	0	0	0	0	0	83	0
Other movements in depreciation	(1)	3	0	0	0	(1)	0	1	0
Closing Balance at 31 March 2018	**(1,965)**	**(8,210)**	**(22,292)**	**(53,030)**	**0**	**(27)**	**0**	**(85,524)**	**(630)**
Net Book Value as at 31 March 2018	**60,304**	**199,064**	**34,053**	**116,268**	**7,482**	**220**	**5,661**	**423,052**	**45,370**
Net Book Value as at 31 March 2017	**62,159**	**139,463**	**28,566**	**118,613**	**6,919**	**233**	**15,099**	**371,052**	**0**

Movements in 2016/17	Council Dwellings £000	Other Land & Buildings £000	Vehicles, Furniture, Plant & Equipment £000	Infra-structure Assets £000	Community Assets £000	Surplus Assets £000	Assets Under Construction £000	Total Property, Plant and Equipment £000
Cost or Valuation								
Opening Balance at 1 April 2016	**65,771**	**148,948**	**47,040**	**163,813**	**6,920**	**251**	**8,901**	**441,644**
Additions	2,507	2,731	3,518	2,478	0	0	9,372	20,606
Revaluation increases/(decreases) recognised in the Revaluation Reserve	(4,494)	(4,065)	(707)	0	0	(62)	0	(9,328)
Revaluation increases/(decreases) recognised in the Surplus/Deficit on the Provision of Services	(302)	(5,751)	(140)	0	0	(39)	0	(6,232)
Derecognition – disposals	(787)	(469)	(274)	(67)	(1)	0	0	(1,598)
Assets reclassified (to)/ from Assets Held for Sale	(399)	(538)	(300)	0	0	(19)	0	(1,256)
Other movements in cost or valuation	(137)	3,406	(1,434)	1,214	0	124	(3,174)	(1)
Closing Balance at 31 March 2017	**62,159**	**144,262**	**47,703**	**167,438**	**6,919**	**255**	**15,099**	**443,835**
Accumulated Depreciation and Impairment								
Opening Balance at 1 April 2016	**0**	**(6,326)**	**(14,804)**	**(46,179)**	**(8)**	**(31)**	**0**	**(65,021)**
Depreciation charge	(2,040)	(7,362)	(4,715)	(3,967)	8	(9)	0	(18,085)
Depreciation written out to the Revaluation Reserve	1,962	3,892	770	0	0	7	0	6,631
Depreciation written out to the Surplus/Deficit on the Provision of Services	49	5,533	118	0	0	19	0	5,719
Derecognition – disposals	24	25	241	22	0	0	0	312
Other movements in depreciation or impairment	5	(561)	(747)	1,299	0	(8)	0	(12)
Closing Balance at 31 March 2017	**0**	**(4,799)**	**(19,137)**	**(48,825)**	**0**	**(22)**	**0**	**(72,783)**
Net Book Value								
As at 31 March 2017	**62,159**	**139,463**	**28,566**	**118,613**	**6,919**	**233**	**15,099**	**371,052**
As at 31 March 2016	**65,771**	**142,622**	**32,236**	**117,634**	**6,912**	**220**	**8,901**	**374,296**

Capital Commitments

At 31 March 2018 the Council had entered into a number of contracts for the construction or enhancement of Property, Plant and Equipment in future years, budgeted to cost £3.3m. Similar commitments at 31 March 2017 were £11.0m.

Major commitments at 31 March	£m
Eric Gray Replacement	1.110
New Halls of Residence	0.576
Housing Quality Standard	0.498
Heating Replacement Programme	0.483

Revaluations

The Council carries out a rolling programme that ensures that all Property, Plant and Equipment required to be measured at fair value is revalued at least every five years. All valuations in the year were carried out internally. Valuations of land and buildings were carried out in accordance with the methodologies and bases for estimation set out in the professional standards of the Royal Institution of Chartered Surveyors.

Surplus Assets were valued using fair value in accordance with the CIPFA Code of Practice. Valuations of vehicles, plant, furniture and equipment are based on current prices where there is an active second-hand market or latest list prices adjusted for the condition of the asset.

The significant assumptions applied in estimating the fair values are:

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

The following table shows useful lives have been used in the calculation of depreciation and also details of revaluation programmes. The basis of valuation is set out in Note 40: Accounting Policies on page 82.

Category of Asset	Useful Life	Valuer	Basis of Valuation	Date of last full valuation
Council Dwellings	30 years	Asset Services Manager	Existing Use Value for Social Housing	31 March 2014
Other Land and Buildings (including PFI Assets)	1-120 years	Asset Services Manager	Existing Use Value or Depreciated Replacement Cost (for specialised operational properties)	Valued on 5-year rolling programme
Vehicles, Furniture, Plant & Equipment	1-32 years	Operational Manager	Existing Use Value	31 March 2016
Infrastructure Assets	2-47 years	n/a	Depreciated Historical Cost	n/a
Community Assets	Indefinite life	n/a	Historical Cost	n/a
Surplus Assets	2-20 years	Asset Services Manager	Fair Value (estimated at highest and best use)	Valued on 5-year rolling programme
Assets Under Construction	n/a	n/a	Historical Cost	n/a

Note 13: Notes to the Housing Revenue Account

Number and Types of Dwellings

The following table shows the stock movements by apartment size:

2016/17 Number	Housing Stock	2017/18 Number
87	1 Apartment	78
407	2 Apartment	412
527	3 Apartment	521
626	4 Apartment	615
34	5 Apartment	33
1	6 Apartment	1
2	8 Apartment	2
1,684	**Total**	**1,662**

Amount of Rent Arrears

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

2016/17 £000		2017/18 £000
227	Total value of rent arrears	232

2016/17		2017/18
547	Number of properties in arrears	520
32.5%	Properties in arrears as share of total stock (%)	31.3%
£415	Average amount per property in arrears (£)	£446

Provision for Bad Debts

Council approval is required to write off bad debts with a value over £5,000. The movements on the HRA bad debt provision during 2017/18 are detailed in Note 21: Short-term Debtors on page 61.

Void Rents

The following table summarises the income lost due to voids in 2017/18. These amounts are included in the other expenditure line of the Housing Revenue Account Income and Expenditure Statement.

2016/17 £000		2017/18 £000
66	General needs void rents and charges	68
30	Sheltered housing void rents and charges	45
96	**Total**	**113**

Note 14: Heritage Assets

Net Value	Historic Buildings £000	Museum Collection £000	War Memorial £000	Total Assets £000
Opening Balance at 1 April 2017	**1,585**	**3,269**	**0**	**4,854**
Additions	0	13	0	**13**
Depreciation	(14)	0	0	**(14)**
Closing Balance at 31 March 2018	**1,571**	**3,282**	**0**	**4,853**

2016/17	Historic Buildings £000	Museum Collection £000	War Memorial £000	Total Assets £000
Opening Balance at 1 April 2016	**1,599**	**3,269**	**57**	**4,925**
Other movements	0	0	(56)	**(56)**
Depreciation	(14)	0	(1)	**(15)**
Closing Balance at 31 March 2017	**1,585**	**3,269**	**0**	**4,854**

Additions in the year comprised of the restoration of a lifeboat from the liner "Oceanic" as well as three paintings, as follows:

- 'Sea eagle at North Roe, Shetland' by George Lodge (1915)
- 'The Skerries, Shetland' by Albert Dunnington (1880); and
- Portrait of Charles Ogilvy and Margaret Fea (c1830)

There were no disposals, revaluations or impairments during 2017/18.

The War Memorial asset was written off in the previous year, as it is not a Council asset.

Historic Buildings

The two historic buildings classified as heritage assets are the Dunrossness Crofthouse Museum and the Bod of Gremista.

The Dunrossness Crofthouse Museum is a restored 19th century crofthouse with thatched roof, outbuildings and a watermill. The property is open for public viewing during the months of May to September.

The Bod of Gremista is a two storey rectangular house built around 1790 to provide family accommodation and a store for fishing and fish curing activities. The property houses the Shetland Textile Museum and is open to the public from May to September.

Museum Collection

The Council's museum collections are on display at the Shetland Museum and Archives, open to the public all year. They are managed and curated by the Shetland Amenity Trust and any additions to the collection are treated as donated assets to the Council.

Note 15: Intangible Assets

The intangible assets disclosed on the Balance Sheet include fishing quota, fishing licences and software.

A fishing quota is the right to fish species over a defined period, usually one year. Quota are held by Government and distributed to the fishing industry through Producer Organisations. The Fishing Quota was originally purchased by the Shetland Development Trust to enable long-term access to a strategically important resource. The quota was transferred to the Council on 31 December 2014 as part of the wind-up of the Shetland Development Trust. The market value at 31 March 2018 is £26.3m. This is amortised on a straight-line basis over a 20-year period.

Fishing licences provide authority for a registered fishing vessel to fish for sea fish, subject to limitations stated in the licence. The licences were transferred to the Council on 31 December 2014 as part of the wind-up of the Shetland Development Trust. There were no disposals in 2017/18 (£0.2m in 2016/17). The market value as at 31 March 2018 was £0.1m (£0.1m in 2016/17). This is amortised on a straight-line basis over a 10-year period.

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

The carrying amount of intangible assets is amortised on a straight-line basis. Amortisation of £1.4m was charged directly to the Net Cost of Services in the CIES for 2017/18 (£1.1m in 2016/17).

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

As at 31 March 2017 £000		As at 31 March 2018 £000
	Balance at 1 April:	
22,101	Gross carrying amounts	27,301
(3,058)	Accumulated amortisation	(2,187)
19,043	**Net carrying amount at start of year**	**25,114**
295	Purchases	14
(129)	Disposals	0
26	Disposal amortisation	0
5,034	Revaluation increases	2,180
1,912	Revaluation amortisation	1,207
(1,067)	Amortisation for the period	(1,355)
25,114	**Net carrying amount at end of year**	**27,160**
	Comprising:	
27,301	Gross carrying amounts	29,495
(2,187)	Accumulated amortisation	(2,335)
25,114	**Balance at 31 March**	**27,160**

NB: - Improved analysis has led to 2016/17 information being reclassified.

Note 16: Private Finance Initiatives and similar contracts

Anderson High School contract

On 6 October 2017, the Council entered into a 25-year contract for the construction, maintenance and operation of the Anderson High School in Lerwick. The contract specifies minimum standards for the services to be provided by the contractor, with deductions from the fee payable being made if facilities are unavailable or performance is below the minimum standards.

The contractor took on the obligation to construct the school and maintain it in a minimum acceptable condition and to procure and maintain the plant and equipment needed to operate the school.

The buildings and any plant and equipment installed in them at the end of the contract will be transferred to Shetland Islands Council for nil consideration. The Council only has rights to terminate the contract if it compensates the contractor in full for costs incurred and future profits that would have been generated over the remaining term of the contract.

Property, Plant and Equipment

The assets used to provide services at the school are recognised on the Council's Balance Sheet. Movements in their value over the year are detailed in Note 12: Property, Plant and Equipment.

Payments

The Council makes an agreed payment each year, which is adjusted each year by inflation and can be reduced if the contractor fails to meet availability and performance standards in any year, but which is otherwise fixed. Payments remaining to be made under the contract at 31 March 2018 (excluding any estimation of inflation and availability / performance deductions) are as follows:

	Payment for Services £000	Reimbursement of Capital £000	Interest £000	Contingent Rent	Total £000
Payable in 2018/19	248	1,165	2,296	51	**3,760**
Payable within 2 to 5 years	1,288	5,101	8,551	282	**15,222**
Payable within 6 to 10 years	2,864	7,174	9,110	331	**19,479**
Payable within 11 to 15 years	3,303	9,158	7,070	510	**20,041**
Payable within 16 to 20 years	6,021	10,406	4,516	(267)	**20,676**
Payable within 21 to 25 years	4,533	12,482	1,493	441	**18,949**
Total	**18,257**	**45,486**	**33,036**	**1,348**	**98,127**

Although the payments made to the contractor are described as unitary payments, they have been calculated to compensate the contractor for the fair value of the services they provide, the capital expenditure incurred and interest payable while the capital expenditure remains to be reimbursed.

The liability outstanding to be paid to the contractor for capital expenditure incurred is as follows:

	2017/18 £000	2016/17 £000
Opening balance	**0**	**0**
Addition - asset brought into use	46,000	0
Capital payments incurred in the year	(514)	0
Closing balance	**45,486**	**0**

Note 17: Financial Instruments

Categories of Financial Instruments

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

As at 31 March 2017			As at 31 March 2018	
Long-Term £000	Current £000		Long-Term £000	Current £000
		Investments:		
333,784	0	Available for sale financial assets	345,392	0
0	3,909	Cash and cash equivalents	0	4,002
		Debtors:		
4,316	581	Loans	1,867	438
0	15,712	Trade receivables	44	16,438
338,100	**20,202**	**Total Financial Assets**	**347,303**	**20,878**
		Borrowing:		
(31,075)	(18)	External borrowing: principal sums	(41,202)	(27)
0	(397)	External borrowing: accrued interest	0	(502)
0	0	Deferred Liabilities (PFI)	(44,321)	(1,165)
		Creditors:		
(5,831)	(99)	Finance lease liabilities	(5,702)	(105)
0	(17,488)	Trade payables	0	(16,821)
0	**(116)**	**Financial guarantees**	**0**	**(108)**
(36,906)	**(18,118)**	**Total Financial Liabilities**	**(91,225)**	**(18,728)**

Fair Values of Assets and Liabilities

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

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

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

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

As at 31 March 2017			As at 31 March 2018	
Carrying Amount £000	Fair Value £000		Carrying Amount £000	Fair Value £000
4,897	4,559	Loans and receivables	2,305	2,310
(37,420)	(43,549)	Financial liabilities at amortised cost	(93,024)	(106,059)

Available for Sale assets and assets and liabilities at fair value through profit or loss are carried in the Balance Sheet at their fair value. These fair values are considered to be Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Market conditions are such that similar assets are actively sold and the level of observable inputs are significant, leading to this classification. Short-term debtors and creditors are carried at cost as this is a fair approximation of their value.

Income, Expense, Gains and Losses

Year ending 31 March 2018	Financial Assets: Loans and Receivables £000	Financial Assets: Available for Sale £000	Financial Liabilities: Amortised Cost £000	Total £000
Interest expense	0	0	3,054	**3,054**
Fee expenses	0	1,014	0	**1,014**
Total expense in (Surplus)/Deficit on the Provision of Services	**0**	**1,014**	**3,054**	**4,068**
Interest & dividend income	(195)	(5,704)	0	**(5,899)**
Gains on de-recognition	0	(7,854)	0	**(7,854)**
Total income in (Surplus)/Deficit on the Provision of Services	**(195)**	**(13,558)**	**0**	**(13,753)**
Gains on revaluation	0	(57,555)	0	**(57,555)**
Amounts recycled	0	47,791	0	**47,791**
(Surplus)/Deficit arising on revaluation of financial assets in CIES	**0**	**(9,764)**	**0**	**(9,764)**
Net (Gain)/Loss for the year	**(195)**	**(22,308)**	**3,054**	**(19,449)**

Year ending 31 March 2017	Financial Assets: Loans and Receivables £000	Financial Assets: Available for Sale £000	Financial Liabilities: Amortised Cost £000	Total £000
Interest expense	0	0	1,303	**1,303**
Fee expenses	0	1,040	0	**1,040**
Total expense in (Surplus)/Deficit on the Provision of Services	**0**	**1,040**	**1,303**	**2,343**
Interest & dividend income	(306)	(5,402)	0	**(5,708)**
Gains on de-recognition	0	(3,739)	0	**(3,739)**
Total income in (Surplus)/Deficit on the Provision of Services	**(306)**	**(9,141)**	**0**	**(9,447)**
Gains on revaluation	0	(61,891)	0	**(61,891)**
Amounts recycled	0	1,868	0	**1,868**
(Surplus)/Deficit arising on revaluation of financial assets in CIES	**0**	**(60,023)**	**0**	**(60,023)**
Net (Gain)/Loss for the year	**(306)**	**(68,124)**	**1,303**	**(67,127)**

There were gains for available-for-sale financial assets on revaluation of £57.6m as at 31 March 2018 (£61.9m at 31 March 2017) and no other indicators of impairment have been identified.

Note 18: Nature and Extent of Risks arising from Financial Instruments

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

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

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

Credit Risk

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

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

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

The Annual Investment Strategy states that the Council cannot lend more than £3.0m of its surplus balances to any single organisation at any one time, apart from the Council's own bank. No deposits were placed with any financial institutions outwith the Council's own bank during the financial year 2017/18.

The Council has a policy of lending to local businesses to maximise the benefit to the Shetland economy. Lending assists in sustainable economic growth with good employment opportunities, making Shetland a good place to live and work. In pursuing this policy, the Shetland Investment Fund was established on 18 April 2016 to provide a sustainable lending service of up to £15.0m.

As at 31 March 2018, £2.0m of this balance was loaned to local businesses, leaving £13.0m available for future lending.

The majority of Shetland Investment Fund lending is secured against assets, minimising the risk of default.

As at 31 March 2017 £000	Shetland Investment Fund	As at 31 March 2018 £000
611	Less than 1 year	439
1,624	2-5 years	883
1,011	6-10 years	591
1,313	Over 10 years	54
4,559	**Total**	**1,967**

The following analysis summarises the Council's potential maximum exposure to credit risk at 31 March 2018, based on experience of default and uncollectability, adjusted to reflect current market conditions:

Estimated maximum exposure to default and uncollectability at 31 March 2018		Deposits with Banks	Shetland Investment Fund	Customers
Balance at 31 March 2018	(a)	5,579	1,967	185
Historical experience of default expressed as % of (a)	(b)	0%	0%	25%
Historical experience adjusted for market conditions	(c)	0%	0%	25%
Estimated maximum exposure	**(a) x (c)**	**0**	**0**	**46**
Estimated maximum exposure at 31 March 2017		**0**	**32**	**64**

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

The Council does not generally allow credit for customers, such that £2.7m of the £5.4m balance of sums owing at 31 March 2018 is past its due date for payment.

The past due, but not impaired, amount can be analysed by age as follows:

As at 31 March 2017 £000	Customers	As at 31 March 2018 £000
505	Less than 3 months	1,178
523	3-6 months	274
246	7-12 months	251
744	Over 12 months	950
2,018	**Total**	**2,653**

Liquidity Risk

The Council has external investments with Fund Managers amounting to £345.4m at 31 March 2018. The Council has ready access to these funds to ensure that cash is available as needed, so there is no significant risk that it will be unable to meet its commitments under financial instruments. Instead, the risk is that the Council will be bound to sell external investments at a time of unfavourable market conditions.

The Council has ready access to borrowings from the money markets and the Public Works Loan Board. At 31 March 2018 the Council had fixed rate borrowings amounting to £41.0m from the Public Works Loan Board. The balance of £0.2m external borrowing is 0% finance for energy efficiency improvement projects.

The maturity analysis of the sums borrowed is as follows:

As at 31 March 2017 £000	Borrowing	As at 31 March 2018 £000
0	Less than 10 years	11,229
23,093	10-20 years	18,000
7,000	20-30 years	7,000
1,000	Over 40 years	5,000
31,093	**Total**	**41,229**

Market Risk

Interest Rate Risk

The Council is exposed to risk in terms of its exposure to interest rate movements on its borrowings and investments.

The Council's investment strategy aims to manage interest rate risk within the Council's investments by having various investment portfolios managed by external Fund Managers.

The investment portfolios are also separated into different asset classes to minimise the overall exposure to interest rate movements. The entire investment portfolio is held in unitised funds which increases diversification.

As at 31 March 2018 the composition of these funds was diversified between the following asset classes:

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

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

The largest investment exposure is to the Global Equity Fund and a risk assessment of a general shift of +/-1% in the Fund would have resulted in a gain or loss in the region of £1.5m for 2017/18. This sensitivity was compiled using figures from Fund Managers' quarterly figures, consistent with Note 17: Financial Instruments.

At 31 March 2018, the Council had external fixed rate borrowing amounting to £41.2m and no variable rate borrowing. Borrowings are not valued at fair value, so nominal gains and losses on fixed rate borrowings would not impact on the Surplus or Deficit on the Provision of Services or Other Comprehensive Income and Expenditure.

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

Price Risk

The Council had £345.4m of investments as at 31 March 2018 in the form of equity, bonds, diversified growth fund, and cash held within unitised products. The Council is consequently exposed to losses arising from movement in the price of these investment categories.

The Council's investment strategy reduces its exposure to price movements by diversifying its investment portfolio through the use of external Fund Managers, asset classes, investment guidelines and benchmarks.

The Council's external investments are all classified as 'available for sale' meaning that all movements in price will impact on gains and losses recognised in the CIES. A general shift of 5% in the general price of shares (positive or negative) would have resulted in a £11.5m gain or loss being recognised in the CIES for 2017/18.

Foreign Exchange Risk

The Council has £179.5m invested in overseas equities held within unitised products which are denominated in foreign currencies. The exposure to risk of loss in adverse movements in exchange rates is greatly reduced through the use of currency hedging strategies to specifically negate any currency movement impact.

Note 19: Cash and Cash Equivalents

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

As at 31 March £000		As at 31 March £000
29	Cash held by the Council	54
3,880	Bank current accounts	3,948
3,909	**Total**	**4,002**

Note 20: Assets Held for Sale

2016/17 £000		2017/18 £000
654	**Balance at 1 April 2017**	**1,355**
	Assets newly classified as held for sale:	
1,256	Property, plant and equipment	428
	Assets declassified as held for sale:	
0	Property, plant and equipment	(10)
(555)	**Assets sold**	(1,216)
1,355	**Balance at 31 March 2018**	**557**

Note 21: Short-term Debtors

As at 31 March 2017 (restated)* £000		As at 31 March 2018 £000
2,766	Central Government Bodies	3,366
3,670	Other Local Authorities	2,403
379	NHS Bodies	590
1,227	Public Corporations and Trading Funds	1,176
8,251	Other Entities and Individuals	9,341
16,293	**Total**	**16,876**

* see Note 2: Change in Accounting Policy on page 40 for details.

Movements in impairment allowance

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

2016/17 £000	General Fund	2017/18 £000
(213)	**Opening balance**	**(147)**
66	Movement in year	34
(147)	**Closing balance**	**(113)**

2016/17 £000	HRA	2017/18 £000
(39)	**Opening balance**	**(53)**
(14)	Movement in year	(18)
(53)	**Closing balance**	**(71)**

Note 22: Long-term Debtors

As at 31 March 2017 £000		As at 31 March 2018 £000
343	Long-term loans (PFI)	343
3,973	Development loans	1,524
77	Other long-term debtors	44
4,393	**Total**	**1,911**

Note 23: Short-term Creditors

As at 31 March 2017 (restated)* £000		As at 31 March 2018 £000
(3,740)	Central Government Bodies	(4,708)
(964)	Other Local Authorities	(2,254)
(108)	NHS Bodies	(238)
(872)	Public Corporations and Trading Funds	(781)
(12,318)	Other Entities and Individuals	(10,639)
(18,002)	**Total**	**(18,620)**

* see Note 2: Change in Accounting Policy on page 40 for details.

Note 24: Inventories

Balance at 31 March 2017 £000		Purchases £000	Recognised as an expense in the year £000	Balances written off £000	Balance at 31 March 2018 £000
2,870	Ports & Harbours stocks	894	(785)	0	2,979
1,399	Infrastructure stocks	2,618	(2,526)	(1)	1,490
242	ICT equipment	186	(193)	0	235
4,511	**Total**	**3,698**	**(3,504)**	**(1)**	**4,704**

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

Note 25: Provisions

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

A provision is recognised for decommissioning costs that are expected to be incurred between 2018 and 2027. The short-term provision of £0.8m recognises the estimated payment due in 2018/19. The provision is calculated at today's prices based on the estimated remaining useful lives of the energy recovery plant and landfill site and current usage. £0.6m is expected to be required beyond 2018/19. Total estimated costs are adjusted in the year when events indicating a change become known.

A provision of £0.1m was recognised in 2014/15 in relation to a grant payment for works at Symbister Peerie Dock. The grant will only be paid out if certain conditions are met. The deadline for the drawdown of the grant has been extended to March 2020.

The Council participates in the Carbon Reduction Commitment Energy Efficiency Scheme where it is required to purchase and surrender allowances, currently retrospectively, on the basis of carbon emissions. As carbon dioxide is emitted (i.e.as energy is used), a liability is recognised and then discharged by surrendering allowances. A provision of £0.1m is recognised, calculated on the basis of the current market price of allowances needed to meet the Council's liability at 31 March 2018.

Shetland Islands Council is required to respond to legal claims raised against it. The potential liabilities that arise from this consist of an estimate of legal fees and an estimate of the settlement of any actions. The provision of £0.3m is based on information available at 31 March 2018.

A number of financial guarantees transferred to the Council as part of the wind-up of the Shetland Development Trust. The likelihood of these guarantees being called has been assessed and a provision of £0.1m has been recognised at 31 March 2018.

Long-term Provisions	Balance at 1 April 2017 £000	Amounts used in 2017/18 £000	Unused amounts reversed £000	Additional provisions made £000	Transfer from Short-term Provisions £000	Transfer to Short-term Provisions £000	Balance at 31 March 2018 £000
Decommissioning	(1,230)	0	9	(146)	0	788	**(579)**
Total	**(1,230)**	**0**	**9**	**(146)**	**0**	**788**	**(579)**

Short-term Provisions	Balance at 1 April 2017 £000	Amounts used in 2017/18 £000	Unused amounts reversed £000	Additional provisions made £000	Transfer to Long-term Provisions £000	Transfer from Long-term Provisions £000	Balance at 31 March 2018 £000
Decommissioning	0	2	0	0	0	(788)	**(786)**
Carbon Reduction Commitment	(127)	127	0	(119)	0	0	**(119)**
Symbister Peerie Dock	(75)	0	0	0	0	0	**(75)**
Outstanding Legal Actions	(317)	0	27	0	0	0	**(290)**
Financial Guarantees	(115)	0	7	0	0	0	**(108)**
Total	**(634)**	**129**	**34**	**(119)**	**0**	**(788)**	**(1,378)**

Note 26: Leases

The Council as a Lessee

Finance Leases

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

As at 31 March 2017 £000		As at 31 March 2018 £000
6,507	Property, plant and equipment	7,102
6,507		**7,102**

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

The present value of minimum lease payments is made up of the following amounts:

As at 31 March 2017 £000		As at 31 March 2018 £000
(75)	Current	(75)
(1,592)	Non-current	(1,516)
(2,508)	Finance costs payable in future years	(2,221)
(4,175)		**(3,812)**

The present value of minimum lease payments is payable over the following periods:

	Minimum Lease Payments		Finance Lease Liabilities	
	As at 31 March 2018 £000	As at 31 March 2017 £000	As at 31 March 2018 £000	As at 31 March 2017 £000
Not later than one year	(337)	(364)	(75)	(75)
Later than one year and not later than five years	(1,117)	(1,204)	(300)	(300)
Later than five years	(2,358)	(2,607)	(1,216)	(1,292)
	(3,812)	**(4,175)**	**(1,591)**	**(1,667)**

Operating Leases

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

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

As at 31 March 2017 £000		As at 31 March 2018 £000
2,209	Not later than one year	3,097
7,482	Later than one year and not later than five years	6,840
6,780	Later than five years	5,627
16,471	**Total**	**15,564**

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

As at 31 March 2017 £000		As at 31 March 2018 £000
2,512	Minimum lease payments	2,310
(1,011)	Sub-lease payments receivable	(1,033)
1,501	**Total**	**1,277**

The Council as a Lessor

Operating Leases

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

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

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

As at 31 March 2017 £000		As at 31 March 2018 £000
(980)	Not later than one year	(1,001)
(4,750)	Later than one year and not later than five years	(4,709)
(2,404)	Later than five years	(2,404)
(8,134)	**Total**	**(8,114)**

The total value of rental income, excluding sub-leases, recognised in 2017/18 was £1.4m (£1.7m in 2016/17).

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

As at 31 March 2017 £000		As at 31 March 2018 £000
(1,085)	Not later than one year	(904)
(4,273)	Later than one year and not later than five years	(4,197)
(12,723)	Later than five years	(12,127)
(18,081)	**Total**	**(17,228)**

Note 27: Defined Benefit Pension Schemes

Participation in Pension Schemes

As part of the terms and conditions of employment of its employees, the Council makes contributions towards the cost of post-employment benefits. Although these benefits will not actually be payable until employees retire, the Council has a commitment to make the payments and that needs to be disclosed at the time that employees earn their future entitlement.

The Council participates in the Local Government Pension Scheme, administered locally by Shetland Islands Council. It is a funded defined benefit scheme, meaning that the Council and employees pay contributions into a fund, calculated at a level intended to balance the pension liabilities with investment assets. From April 2015 the pensions accrual rate guarantees a pension based on $1/49^{th}$ of pensionable pay. Prior to April 2015 the pension accrual rate guaranteed a pension based on $1/60^{th}$ of final pensionable salary and years of pensionable service. Prior to 2009, the accrual rate guaranteed a pension based on $1/80^{th}$ and a lump sum based on $3/80^{th}$ of final pensionable salary and years of pensionable service.

There is no automatic entitlement to a lump sum in respect of post-2009 service. Members may however opt to give up (commute) up to 25% of their pension for a lump sum per the Finance Act 2004. The Scheme's Normal Retirement Age is now linked to the member's State Pension Age (the minimum age being 65). Pensions are increased annually in line with changes to the Pensions (Increases) Act 1971 and Section 59 of the Social Security Pensions Act 1975.

Arrangements for the award of discretionary post-retirement benefits upon early retirement is an unfunded defined benefit arrangement, under which liabilities are recognised when awards are made but there are no investment assets built up to meet these pensions liabilities, and cash has to be generated to meet actual pension payments as they eventually fall due.

Shetland Islands Council Pension Fund is operated under the regulatory framework for the Local Government Pension Scheme and the governance of the Scheme is the responsibility of the Pension Fund Committee and Pension Board. The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administrating authority for the Shetland Islands Council Pension Fund.

The Pension Fund Committee is made up of the councillors who currently sit on the Policy & Resources Committee.

The Pension Board comprises elected members of Shetland Islands Council along with employee and employer representatives and a pension / deferred member representative.

Policy is determined in accordance with the Pension Fund Regulations. Management of the Fund's investments is carried out by the Council which receives recommendations from the Pension Fund Committee and Pension Board. The Council selects and appoints a number of external investment managers/partners and monitors their investment performance.

Under the regulations, employers fall into three categories: scheme employers (also known as scheduled bodies), community admission bodies and transferee admission bodies. Admission agreements are generally assumed to be open-ended; however, either party can voluntarily terminate the admission agreement by giving an appropriate period of notice to the other parties. Any deficit arising from the cessation valuation will usually be levied on the departing admission body as a capital payment.

The principal risks to the Council of the Scheme are the longevity assumptions, statutory changes to the Scheme, structural changes or curtailments to the Scheme (i.e. large-scale withdrawals from the Scheme, including employers ceasing to participate in the Scheme), changes to inflation, bond yields, and the performance of the equity investments held by the Scheme.

These are mitigated to a certain extent by the statutory requirements to charge to the General Fund and Housing Revenue Account the amounts required by statute as described in the Note 40: Accounting Policies on page 74.

Transactions Relating to Post-Employment Benefits

The Council recognises the cost of retirement benefits in the reported cost of services when they are earned by employees, rather than when the benefits are eventually paid as pensions. The charge required to be made in the CIES, however, is based on the cash payable in the year, so the real cost of post-employment / retirement benefits is reversed out of the General Fund via the Movement in Reserves Statement.

The following transactions have been made in the CIES and the General Fund via the Movement in Reserves Statement during the year:

2016/17 £000	Local Government Pension Scheme	2017/18 £000
	Comprehensive Income and Expenditure Statement (CIES)	
	Cost of Services	
13,882	Current service cost	20,157
220	Past service cost (including curtailments)	215
	Financing and Investment Income and Expenditure:	
5,044	Net interest expense	6,066
19,146	**Total pension benefit charged to the Surplus/Deficit on the Provision of Services**	**26,438**
	Other pension benefit charged to the CIES	
(55,844)	Return on plan assets (excluding the amount included in the net interest expense)	13,741
0	Actuarial (gains) and losses arising from changes in demographic assumptions	1,200
133,459	Actuarial (gains) and losses arising on changes in financial assumptions	(43,830)
1,675	Actuarial (gains) and losses arising from other experience	(49,314)
98,436	**Total pension benefit charged to the CIES**	**(51,765)**
	Movement in Reserves Statement	
(19,146)	Reversal of net charges made to the Surplus or Deficit for the Provision of Services for pension benefits in accordance with the Code	(26,438)
11,890	Employer's contributions and direct payments to pensioners payable in the year	12,739

The amount included in the Balance Sheet arising from the Council's obligation in respect of the Pension Fund is as follows:

2016/17 £000		2017/18 £000
(635,789)	Present value of the defined benefit obligation	(570,338)
406,114	Fair value of assets in the Local Government Pension Scheme	405,167
(229,675)	**Net liability arising from Defined Benefit Obligation**	**(165,171)**
(196,052)	Local Government Pension Scheme	(133,233)
(15,936)	Unfunded liabilities for Pension Fund	(14,998)
(17,687)	Unfunded liabilities for Teachers	(16,940)
(229,675)	**Total**	**(165,171)**

Assets and Liabilities in relation to Post-Employment Benefits

Reconciliation of fair value of the Scheme assets:

2016/17 £000		2017/18 £000
336,121	**Opening balance**	**406,114**
11,797	Interest income	10,580
	Re-measurement gains and (losses):	
55,844	Return on assets excluding amounts included in net interest	(13,741)
11,890	Employer contributions	12,739
3,239	Contributions by scheme participants	3,310
(12,777)	Benefits paid	(13,835)
406,114	**Closing balance**	**405,167**

Reconciliation of present value of the Scheme liabilities (defined benefit obligation):

2016/17 £000		2017/18 £000
479,250	**Opening balance**	**635,789**
13,882	Current service cost	20,157
16,841	Interest cost	16,646
3,239	Contributions by scheme participants	3,310
	Remeasurement (gains) and losses:	
0	Actuarial (gains) and losses from changes in demographic assumptions	1,200
133,459	Actuarial (gains) and losses from changes in financial assumptions	(43,830)
1,675	Actuarial (gains) and losses from other experience	(49,314)
(12,777)	Benefits paid	(13,835)
220	Past service costs including curtailments	215
635,789	**Closing balance**	**570,338**

Analysis of Pension Fund Assets

Shetland Islands Council's share of the Pension Fund assets at 31 March 2018 comprised:

2016/17 £000	Quoted Prices not in Active Markets	2017/18 £000
1,643	**Cash and cash equivalents**	**2,021**
	Property:	
42,306	UK property	47,120
1,321	Overseas property	440
43,627	**Sub-total Property**	**47,560**
	Investment Funds and Unit Trusts:	
256,211	Equities	254,562
35,237	Bonds	34,563
69,396	Other	66,461
360,844	**Sub-total Investment Funds and Unit Trusts**	**355,586**
406,114	**Total Assets**	**405,167**

Basis for Estimating Assets and Liabilities

Liabilities have been assessed on an actuarial basis using the projected unit credit method which is an estimate of the pensions that will be payable in future years, dependent on assumptions about mortality rates, salary levels, etc. Hymans Robertson LLP, an independent firm of actuaries, has assessed both the Local Government Pension Scheme and Discretionary Benefits liabilities.

Estimates for the Shetland Islands Council's Pension Fund are based on the latest full valuation of the Scheme as at 31 March 2017, projected forward to 31 March 2018.

Shetland Islands Council does not have an asset and liability matching strategy.

The principal assumptions used by the actuary have been:

2016/17		2017/18
	Long-term expected rate of return on assets in the Scheme:	
3.5%	Investment Funds and Unit Trusts	2.6%
	Mortality Assumptions:	
	Longevity at 65 for current pensioners (in years):	
22.8	Men	22.1
23.8	Women	24.0
	Longevity at 65 for future pensioners (in years):	
24.9	Men	23.9
26.7	Women	26.1
3.4%	Rate of inflation	3.4%
4.4%	Rate of increase in salaries	3.0%
2.4%	Rate of increase in pensions	2.4%
2.6%	Rate for discounting scheme liabilities	2.7%
70.0%	Take-up of option to convert annual pension into retirement lump sum (Pre-April 2009)	50.0%
85.0%	Take-up of option to convert annual pension into retirement lump sum (Post-April 2009)	75.0%

The estimation of the defined benefit obligations is sensitive to the actuarial assumptions set out in the table above. The sensitivity analyses below have been determined based on reasonably possible changes of the assumptions occurring at the end of the financial year and assumes for each change that the assumption analysed changes, while all the other assumptions remain constant. The principal demographic assumption is the longevity assumption (i.e. member life expectancy).

For sensitivity purposes, it is estimated that a one-year increase in life expectancy would approximately increase the Employer's Defined Benefit Obligation by around 3-5%. In practice the actual cost of a one-year increase in life expectancy will depend on the structure of the revised assumption (i.e. if improvements to survival rates predominantly apply at younger or older ages). Please note the figures in the table below have been derived based on the membership profile of the employer as at the date of the most recent actuarial valuation. The estimations in the sensitivity analysis have followed the accounting policies for the Scheme, i.e. on an actuarial basis using the projected unit credit method.

Impact of changes in assumptions	2017/18	
	%	£000
0.5% decrease in real discount rate	10%	58,281
0.5% increase in the salary increase rate	2%	11,057
0.5% increase in the pension increase rate	8%	46,318

Impact on the Council's Cashflows

The objectives of the Scheme are to keep employers' contributions at as constant a rate as possible. The Fund has agreed a strategy with the Scheme's actuary to achieve a funding level of 100% in the longer term. The Scheme is a multi-employer defined benefit plan and employers' contributions have been determined so that employee and employer rates are standard across all participating local authorities.

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £450m, were sufficient to meet 90% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2017 valuation was £51m.

Each employer had contribution requirements set at the valuation, with the aim of achieving full funding within a time horizon and probability as per the Funding Strategy Statement (FSS). Asset-liability modelling has been carried out which demonstrates that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is at least a 66% chance that the Fund will return to full funding over 14 years.

The employers' common contribution rate was set at 20.8% for 2017/18. Rates for the next three years, set out in the latest triennial valuation as at 31 March 2017, are as follows:

Year	Employer contributions
2018/19	20.80%
2019/20	20.80%
2020/21	20.80%

The total contributions expected to be made by the Council to the Pension Fund in the year to 31 March 2019 is £11.2m.

The weighted average duration of the defined benefit obligation for Scheme members is 20.6 years for 2017/18.

Note 28: Pension Schemes Accounted for as Defined Contribution Schemes

Teachers employed by the Council are members of the Teachers' Pension Scheme, administered by the Scottish Public Pensions Agency (SPPA). The Scheme provides teachers with specified benefits upon their retirement and the Council contributes towards the costs by making contributions based on a percentage of members' pensionable salaries.

The Scheme is a multi-employer defined benefit scheme. The Scheme is unfunded and the SPPA uses a notional fund as the basis for calculating the employer's contribution rate paid by local authorities.

Valuations of the notional fund are undertaken every four years. The Scheme has in excess of 160 participating employers and consequently, the Council is not able to identify its share of the underlying financial position and performance of the Scheme with sufficient reliability for accounting purposes. For the purposes of these annual accounts it is therefore accounted for on the same basis as a defined contribution scheme.

As a proportion of the total contributions into the Teachers' Pension Scheme, the Council's own contributions equated to approximately 0.6% (0.7% for 2016/17).
In 2017/18, the Council paid £2.6m to the SPPA in respect of teachers' pension costs, representing 17.2% of pensionable pay (£2.6m and 17.2% for 2016/17). There were no contributions remaining payable at the year-end. The estimated contribution for 2018/19 is £2.5m.

The Council is responsible for the costs of any additional benefits awarded upon early retirement outside of the terms of the Teachers' Pension Scheme. In 2017/18 these amounted to £0.9m, representing 5.7% of teachers' pensionable pay (£0.9m and 5.2% for 2016/17). These costs are accounted for on a defined benefit basis. The Council is not liable to the Scheme for any other entities' obligation.

Note 29: External Audit Costs

The Council has incurred the following costs in respect of external audit services provided in accordance with the Code:

2016/17 £000		2017/18 £000
218	Fees payable with regard to external audit services carried out by the appointed auditor for the year	212
218	**Total**	**212**

Note 30: Cash Flow Statement – Operating Activities

Cashflows for operating activities include the following:

2016/17 £000		2017/18 £000
(1,718)	Interest received	(2,437)
2,266	Interest paid	4,068
(605)	Dividends received	(3,456)
(57)	**Total**	**(1,825)**

The Surplus or Deficit on the Provision of Services has been adjusted for these non-cash movements:

2016/17 £000		2017/18 £000
(18,614)	Depreciation, impairment and revaluations	(24,100)
(1,067)	Amortisation	(1,355)
52	Decrease in impairment for bad debts	16
(14,904)	Increase in creditors	(2,792)
14,620	Increase in debtors	2,711
(53)	Decrease in inventories	193
(7,256)	Movement in pension liability	(13,699)
(2,000)	Carrying amount of non-current assets sold or de-recognised	(5,429)
(6,160)	Other non-cash items charged to the net surplus or deficit on the provision of services	(8,431)
(35,382)	**Total**	**(52,886)**

The Surplus or Deficit on the Provision of Services has been adjusted for the following items that are investing and financing activities:

2016/17 £000		2017/18 £000
4,134	Proceeds from the sale of property, plant and equipment, investment property and intangible assets	2,079
4,825	Any other items for which the cash effects are investing or financing cash flows	7,659
8,959	**Total**	**9,738**

Note 31: Cash Flow Statement – Investing Activities

2016/17 £000		2017/18 £000
20,889	Purchase of property, plant and equipment, investment property and intangible assets	27,775
700	Purchase of short-term and long-term investments	11,608
(4,134)	Proceeds from the sale of property, plant and equipment, investment property and intangible assets	(2,079)
(2,142)	Proceeds from short-term and long-term investments	(2,557)
(4,825)	Other receipts from investing activities	(7,659)
10,488	**Total**	**27,088**

Note 32: Cash Flow Statement – Financing Activities

2016/17 £000		2017/18 £000
0	Cash receipts of short and long-term borrowing	(10,155)
94	Cash payments for the reduction of the outstanding liabilities relating to finance leases and on-balance sheet PFI contracts	613
18	Repayments of short and long-term borrowing	18
112	**Total**	**(9,524)**

Note 33: Related Parties

The Council is required to disclose material transactions with related parties, bodies or individuals that have the potential to control or influence the Council or to be controlled or influenced by the Council. Disclosure of these transactions allows readers to assess the extent to which the Council might have been constrained in its ability to operate independently, or might have secured the ability to limit another party's ability to bargain freely with the Council.

Central Government and Other Public Bodies

Central Government has effective control over the general operations of the Council; it is responsible for providing the statutory framework within which the Council operates, provides the majority of its funding in the form of grants and prescribes the terms of many of the transactions that the Council has with other parties (e.g. Council Tax, housing benefits). Details of all grants received from Central Government and other public bodies can be found on page 47.

Members

Elected Members of the Council have direct control over the Council's financial and operating policies. The Council holds a Register of Members' Interests, which is open to public inspection at the Office Headquarters, Montfield, 28 Burgh Road, Lerwick, during office hours. It is also available to view on the Council's website by inspecting each individual Member at https://www.shetland.gov.uk/coins/allMembers.asp?sort=0. The Register details the bodies where Members are represented or for which they have declared an interest. The Council made payments totalling £6.0m in 2017/18 (£6.1m in 2016/17) to these bodies.

Officers

At the end of the financial year all senior managers were required to disclose any involvement with related parties of the Council. No significant items were reported.

Local Government Pension Scheme

The Local Government Pension Scheme is administered locally by Shetland Islands Council for the benefit of employees. The Council has made payments to the Local Government Pension Scheme as detailed in Note 27: Defined Benefit Pension Schemes.

Group Entities

The Integration Joint Board (IJB) is responsible for the strategic planning of the functions delegated to it by the Council and the Shetland Health Board; it is a Joint Venture between the two bodies.

Zetland Transport Partnership is a Regional Transport Partnership set up to deliver transport services for Shetland. It is an associate of the Council and is deficit funded by them.

The Orkney and Shetland Valuation Joint Board provides the valuation service for Orkney and Shetland and is funded by both Councils.

For details of members' influence on these three bodies and the transactions between them and the Council, please refer to Note 38: Group Interests on page 73.

Note 34: Capital Expenditure and Capital Financing

The total amount of capital expenditure incurred in the year is shown in the following table, together with the resources that have been used to finance it.

Where capital expenditure is to be financed in future years by charges to revenue as assets are used by the Council, the expenditure results in an increase in the Capital Financing Requirement (CFR), a measure of the capital expenditure incurred historically by the Council that has yet to be financed.

2016/17 £000		2017/18 £000
26,474	**Opening Capital Financing Requirement**	**33,702**
	Capital investment:	
20,594	Property, plant and equipment	73,761
295	Intangible assets	14
2,026	Revenue Expenditure Funded from Capital	0
	Sources of finance:	
(4,134)	Capital receipts	(3,300)
(6,807)	Government grants and other contributions	(7,659)
(1,765)	Funding from reserves	(103)
	Sums set aside from revenue:	
(1,557)	Direct revenue contributions	(1,528)
(94)	Lease principal	(99)
0	PFI contract principal repayments	(514)
(1,330)	Loans fund principal	(1,281)
33,702	**Closing Capital Financing Requirement**	**92,993**
	Explanation of movements in year:	
7,546	Increase/(decrease) in underlying need to borrow	13,899
(94)	Assets acquired under finance leases	(99)
0	Assets acquired under PFI contracts	45,487
(224)	Assets acquired under Decommissioning Obligations	4
7,228	**Increase/(Decrease) in Capital Financing Requirement**	**59,291**

Note 35: Contingent Liabilities

Shetland Islands Council has one outstanding claim under the Equal Pay Act 1970 for past pay inequalities. It is not yet possible to provide any financial quantification at this stage, however, no material loss is anticipated.

There is a developing line of case law around the pay and grading structures that organisations currently have in place. The most significant issues for the Council are out of hours allowances and pay grade changes required in response to the implementation of the Living Wage. The Council is unable to fully quantify the financial liability until the position has been fully reviewed.

There are a number of current legal claims against the Council that are being contested. Any potential financial liability cannot be assessed until these cases are finalised.

Note 36: Trust Funds administered by the Council

The Council administers, as sole trustee, five trust funds related to specific services. These are varied in nature and relate principally to legacies left by individuals over many years. Funds are mainly held in deposit accounts with local banks. The funds do not represent assets of the Council and are not included in the Balance Sheet.

As at 31 March 2017 £000	Trust Balances	As at 31 March 2018 £000
(30)	Bare Trust	(30)
(667)	Zetland Educational Trust	(673)
(3)	Others	(3)
(700)	**Total**	**(706)**

The Bare Trust was set up following the cessation of the Shetland Development Trust on 28 February 2015. It holds a number of loans and equity investments which were not considered to be cost effective to transfer to the Council on the winding up of the Development Trust. All assets and income arising from the Bare Trust will be paid or delivered to Shetland Islands Council. The Council, as Trustee, has full management powers as if they were absolute owners and not trustees.

Assets held in the Bare Trust had an estimated market value at 31 March 2018 of £0.638m.

The Zetland Educational Trust, with an income of £0.022m and expenditure of £0.016m, pays bursaries to university students, aids apprentices and supports educational trips.
The other trusts are essentially dormant due to their low annual income.

Note 37: Events after the Balance Sheet Date

The annual accounts were authorised for issue on 19 September 2018. Events taking place after this date are not reflected in the financial statements or notes. Where events taking place before this date provided information about conditions existing at 31 March 2018, the figures in the financial statements and notes have been adjusted in all material respects to reflect the impact of this information.

Note 38: Group Interests

Introduction

The Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 requires the Council to prepare group accounts where the Council has interests in subsidiaries, associates and/or jointly controlled entities, subject to the consideration of materiality. The Council has assessed that it has no material group entities, therefore no Group Accounts have been prepared. This assessment is based on the following considerations.

Group Boundary

Shetland Islands Council has considered all entities in which it has an interest for consolidation into the group accounts. To determine whether an entity should be included in the Council's group accounts, the factors of control, significant influence and materiality are considered.

Subsidiaries

The Code defines a subsidiary as an entity that is controlled by another entity. The Council does not have any subsidiaries that meet this definition.

Joint Ventures

The Code defines joint venture as a joint arrangement whereby the parties that have joint control of the arrangements have rights to the net assets of the arrangements. The Shetland Health and Social Care Partnership (IJB) meets the definition of a joint venture.

Associates

The Code defines an associate as an entity for which the Council is an investor that has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the entity. The Council has identified two entities that meet the definition of an associate. These are:

- Orkney and Shetland Valuation Joint Board
- Zetland Transport Partnership (ZetTrans)

Materiality

Where the financial impact of omitting an entity from the group accounts would not cause a user of the accounts to form a different view on the accounts, the Council has opted not to include these entities within the group boundary.

Orkney and Shetland Valuation Joint Board (OSVJB)

The OSVJB provides the valuation service for Orkney and Shetland and is funded by both Councils. In 2017/18, the Council held five Board places out of ten and contributed 49.2% of the Board's operating costs (49.0% in 2016/17).

The Council's share of the year-end net liability is £1.0m as at 31 March 2018 (£1.0m at 31 March 2017), which is considered not material for consolidation in group accounts.

The following table details Shetland Islands Council's share of the OSVJB's financial results for the year:

2016/17 (restated) £000	Orkney and Shetland Valuation Joint Board	2017/18 £000
351	Gross Income	373
(335)	Gross Expenditure	(339)
16	**Net (Surplus) / Deficit**	**34**
22	Current Assets	24
(24)	Current Liabilities	(26)
(989)	Non-current Liabilities	(967)
991	Capital and Reserves	969
0	**Net Assets**	**0**

Zetland Transport Partnership (ZetTrans)

ZetTrans was formed in 2006/07 by the Regional Transport Partnerships (Establishment, Constitution and Membership) (Scotland) Order 2005, made under the Transport (Scotland) Act 2005.

The Council contributed 93.7% of the Partnership's operating costs in 2017/18 (93.5% in 2016/17) and holds four out of six seats on the Partnership.

The Council's share of the net liability is nil at 31 March 2018 (nil at 31 March 2017) and is therefore considered not material for consolidation in group accounts.

The table below details Shetland Islands Council's share of ZetTrans' financial results for the year:

2016/17 (restated) £000	Zetland Transport Partnership	2017/18 £000
(1,354)	Gross Income	(1,839)
1,354	Gross Expenditure	1,839
0	**Net (Surplus) / Deficit**	**0**
88	Current Assets	128
(88)	Current Liabilities	(128)
0	**Net Assets**	**0**

Integration Joint Board (IJB)

The Integration Joint Board (IJB) was formally constituted on 27 June 2015 and is responsible for the strategic planning of the functions delegated to it by the Council and the Shetland Health Board. It represents a Joint Venture between these two bodies.

The Council contributed 46.1% of the Board's operating costs in 2017/18 (42.8% in 2016/17). It has three out of six voting members on the board.

The Council's share of the net surplus of the Integration Joint Board was £0.12m as at 31 March 2018 (£0.06m at 31 March 2017), which is considered not material for consolidation in group accounts.

The following table details Shetland Islands Council's share of the IJB's financial results for the year:

2016/17 (restated) £000	Integration Joint Board	2017/18 £000
(22,709)	Gross Income	(23,665)
22,647	Gross Expenditure	23,545
(62)	**Net (Surplus) / Deficit**	**(120)**
63	Current Assets	182
0	Current Liabilities	0
63	**Net Assets**	**182**

Note 39: Critical Judgements in Applying Accounting Policies

In applying the accounting policies set out in Note 40, the Council has had to make certain judgments about complex transactions or those involving uncertainty about future events. The critical judgments made in the Annual Accounts are:

- There are a number of legal claims currently outstanding against the Council. Where a reliable estimate can be made, these have been included as provisions within the Council's Balance Sheet. Where it has not been possible to establish a reliable estimate, the claims have been accounted for as contingent liabilities.
- There is a high degree of uncertainty about future levels of funding for local government. The Council has determined, however, that this uncertainty is not yet sufficient to provide an indication that its assets may be impaired as a result of (for example) reduced maintenance.

Note 40: Accounting Policies

A General Principles

The accounts summarise the Council's transactions for the 2017/18 financial year and its position at the year-end of 31 March 2018. The Council is required to prepare an annual Statement of Accounts by the Local Authority Accounts (Scotland) Regulations 2014, which Section 12 of the Local Government in Scotland Act 2003 requires to be prepared in accordance with proper accounting practices.

These practices, under Section 21 of the 2003 Act, primarily comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18, supported by International Financial Reporting Standards (IFRS) and statutory guidance issued under Section 12 of the 2003 Act.

The accounting convention adopted in the accounts is principally historical cost, modified by the revaluation of certain categories of non-current assets and financial instruments, which are consequently measured at fair value. The accounts have been prepared on a going concern basis.

B Prior Period Adjustments, Changes in Accounting Policies and Estimates and Errors

Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Changes in accounting estimates are accounted for prospectively, i.e.in the current and future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are made only when required by proper accounting practices, or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Council's financial position or financial performance.

Where a change is made, it is applied retrospectively (unless stated otherwise) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

C Accruals of Income and Expenditure

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- revenue from the sale of goods is recognised when the Council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the Council;
- revenue from the provision of services is recognised when the Council can measure reliably the percentage of completion of the transaction, and it is probable that economic benefits or service potential associated with the transaction will flow to the Council;
- supplies are recorded as expenditure when they are consumed, but where there is a gap between the date supplies are received and their consumption they are carried as inventories on the Balance Sheet;
- expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather than when payments are made; and
- interest receivable on investments and payable on internal borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than the cashflows fixed or determined by the contract.
- Where income and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to the CIES for the income that might not be collected.

D Cash and Cash Equivalents

Cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash equivalents are highly liquid investments that mature in three months or less from the Balance Sheet date and that are readily convertible to known amounts of cash with insignificant risk of change in value. In the Cash Flow Statement, cash and cash equivalents are shown net of bank overdrafts that are repayable on demand.

E Charges to Revenue for Non-Current Assets

Services are debited with the following amounts to record the cost of holding non-current assets during the year:

- depreciation attributable to the assets used by the relevant service;
- revaluation and impairment losses on assets used by the service where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off; and

- amortisation of intangible assets attributable to the service.

The Council is not required to raise Council Tax to fund depreciation, revaluation or impairment losses, or amortisation. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement equal to the Statutory Repayment of Loans Fund Advances.

The General Fund is balanced by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two sums.

F Employee Benefits

Benefits payable during employment

Short-term employee benefits are those due to be fully settled within 12 months of the year-end, such as wages, salaries, paid annual leave, paid sick leave, bonuses and non-monetary benefits (e.g. cars) for current employees, are recognised as an expense for services in the year incurred.

An accrual is made for the cost of leave entitlements earned by employees, but not taken before the year-end, which employees can carry forward into the next financial year. The accrual is made at the wage and salary rates applicable in the following accounting year, being the period in which the employee takes the benefit.

The accrual is charged to Surplus or Deficit on the Provision of Services, but then reversed out through the Movement in Reserves Statement so that holiday benefits are charged to revenue in the financial year in which the holiday entitlement arises.

Termination benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an employee's employment before the normal retirement date, or an employee's decision to accept voluntary redundancy in exchange for those benefits. They are charged on an accruals basis to the appropriate service or, where applicable, to a corporate service line in the CIES, at the earlier of when the Council can no longer withdraw the offer of those benefits or when the Council recognises costs for a restructuring.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, appropriations are required to and from the Pensions Reserve to remove the notional debits and credits for pension enhancement termination benefits, and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

Post-employment benefits

Employees of the Council may be members of one of two separate pension schemes:

- The Teachers' Pension Scheme, administered by the Scottish Government; or
- The Local Government Pension Scheme, administered by Shetland Islands Council.

Both schemes provide defined benefits to members (retirement lump sums and pensions) which are earned as employees work for the Council.

The arrangements for the teachers' Scheme mean that liabilities for these benefits cannot be identified specifically to the Council. It is therefore accounted for as if it was a defined contribution scheme and no liability for future payments of benefits is recognised in the Balance Sheet. The Children's Services line in the CIES is charged with the employer's contributions payable in respect of teachers' pensions in the year.

The Local Government Pension Scheme

The Local Government Pension Scheme is accounted for as a defined benefits scheme.

The liabilities of Shetland Islands Council's pension fund attributable to the Council are included in the Balance Sheet on an actuarial basis using the projected unit method, i.e.an assessment of the future payments that will be made in relation to retirement benefits earned to date by employees, based on assumptions about mortality rates, employee turnover rates, projections of earnings for current employees, etc.

Liabilities are discounted to their value at current prices using a discount rate derived from a corporate bond yield curve constructed from yields on high quality bonds and recognising the weighted average duration of the benefit obligation determined at the most recent actuarial valuation.

The pension fund assets attributable to the Council are included in the Balance Sheet at their fair value:

- quoted securities – current bid price;
- unquoted securities – professional estimate; and
- unitised securities – current bid price.

The change in the net pension liability is analysed into the following components:

- **current service cost** – the increase in liabilities as a result of years of service earned this year, allocated in the CIES to the services for which the employees worked;
- **past service cost** – the increase in liabilities arising from current year decisions whose effect relates to years of service earned in earlier years, which is debited to the Surplus or Deficit on the Provision of Services in the CIES;
- **net interest cost on the defined benefit liability** – the change during the period in the net defined benefit liability that arises from the passage of time charged to the Financing and Investment Income and Expenditure line of the CIES. This is calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the period to the net defined benefit liability at the beginning of the period, taking into account any changes in the net defined benefit liability during the period as a result of contribution and benefit payments;
- **return on scheme assets** – excluding amounts included in net interest on the net defined benefit liability which are charged to the Pensions Reserve as Other Comprehensive Income and Expenditure;
- **actuarial gains and losses** – changes in the net pension liability that arise because events have not coincided with assumptions made at the last actuarial valuation, or because the actuaries have updated their assumptions, which is charged to the Pensions Reserve. Actuarial gains and losses are shown within Other Comprehensive Income and Expenditure within the CIES; and
- **contributions paid to the pension fund** – cash paid as employer's contributions to the pension fund in settlement of liabilities which are not accounted for as an expense.

In relation to retirement benefits, statutory provisions require the General Fund Balance to be charged with the amount payable by the Council to the pension fund or directly to pensioners in the year, not the amount calculated according to the relevant accounting standards in the CIES.

In the Movement in Reserves Statement this means that there are transfers to and from the Pensions Reserve to remove the notional debits and credits for retirement benefits and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end. The negative balance that arises on the Pensions Reserve thereby measures the beneficial impact to the General Fund of being required to account for retirement benefits on the basis of cashflows, rather than as benefits are earned by employees.

Discretionary benefits

The Council also has restricted powers to make discretionary awards of retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff (including teachers) are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme.

G Events after the Balance Sheet date

Events after the Balance Sheet date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the annual accounts are authorised for issue.

Two types of events can be identified:

- those that provide evidence of conditions that existed at the end of the financial year, whereby the annual accounts are adjusted to reflect such events; and
- those that are indicative of conditions that arose after the financial year, whereby the annual accounts are not adjusted to reflect such events; where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the annual accounts.

H Financial Instruments

Financial liabilities

Financial liabilities are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument, and are initially measured at fair value and are carried at their amortised cost. Annual charges to the Financing and Investment Income and Expenditure line in the CIES for interest payable are based on the carrying amount of the liability, multiplied by the effective rate of interest for the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments over the life of the instrument to the amount at which it was originally recognised.

This means that the amount presented in the Balance Sheet is the outstanding principal repayable (plus accrued interest), and interest charged to the CIES is the amount payable for the year according to the loan agreement.

Financial guarantees are measured at fair value and are estimated by considering the probability of the guarantee being called.

Financial assets

Financial assets are classified into two types:

- loans and receivables – assets that have fixed or determinable payments but are not quoted in an active market; and
- available-for-sale assets – assets that have a quoted market price and / or do not have fixed or determinable payments.

Loans and receivables

Loans and receivables are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value. They are subsequently measured at their amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the CIES for interest receivable are based on the carrying amount of the asset, multiplied by the effective rate of interest for the instrument. For this Council it means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the CIES is the amount receivable for the year in the loan agreement.

On an annual basis loans and receivables are assessed for impairment. Events that provide objective evidence of impairment include significant financial difficulties of the counterparty, or a breach of contract. Impairment losses and gains or losses on derecognition are taken to the Cost of Services in the CIES.

A soft loan is one granted at less than market rates. When a soft loan is made, a loss is recorded in the CIES (debited to the appropriate service) for the present value of the interest that will be foregone over the life of the instrument, resulting in a lower amortised cost than the outstanding principal.

Interest is credited to the Financing and Investment Income and Expenditure line in the CIES at a marginally higher effective rate of interest than the rate receivable from the borrowing organisations, with the difference serving to increase the amortised cost of the loan in the Balance Sheet.

Statutory provisions require that the impact of soft loans on the General Fund Balance is the interest receivable for the financial year, the reconciliation of amounts debited and credited to the CIES to the net gain required against the General Fund Balance is managed by a transfer to or from the Financial Instruments Adjustment Account in the Movement in Reserves Statement.

Available-for-sale assets

Available-for-sale assets are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument, which initially is measured and carried at fair value.

Where the asset has fixed or determinable payments, annual credits to the Financing and Investment Income and Expenditure line in the CIES for interest receivable are based on the amortised cost of the asset multiplied by the effective rate of interest for the instrument. Where there are no fixed or determinable payments, income (e.g. dividends) is credited to the CIES when it becomes receivable by the Council.

Assets are maintained in the Balance Sheet at fair value. Values are based on the following techniques:

- instruments with quoted market prices – the market price;
- other instruments with fixed and determinable payments – discounted cashflow analysis; and

- equity shares with no quoted market prices – multiple valuation techniques (which include market approach, income approach and cost approach).

The inputs to the measurement techniques are categorised in accordance with the following three levels:

- Level 1 inputs – quoted prices (unadjusted) in active markets for identical assets that the Council can access at the measurement date;
- Level 2 inputs – inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly;
- Level 3 inputs – unobservable inputs for the asset.

Changes in fair value are balanced by an entry in the Available-for-Sale Financial Instrument (AFSFI) Reserve and the gain / loss is recognised in the Surplus or Deficit on Revaluation of Available-for-Sale Financial Assets in the Other Comprehensive Income and Expenditure section of the CIES.

The exception is where impairment losses have been incurred – these are debited to the Financing and Investment Income and Expenditure line in the CIES, along with any net gain or loss for the asset accumulated in the AFSFI reserve.

Where assets are identified as impaired because of a likelihood arising from a past event that payments due under the contract will not be made (fixed or determinable payments) or fair value falls below cost, the asset is written down and a charge made to the Financing and Investment Income and Expenditure line in the CIES. If the asset has fixed or determinable payments, the impairment loss is measured as the difference between the carrying amount and the present value of the revised future cashflows discounted at the asset's original effective interest rate. Otherwise, the impairment loss is measured as any shortfall of fair value against the acquisition cost of the instrument (net of any principal repayment and amortisation).

Any gains and losses that arise on the derecognition of the asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES, along with any accumulated gains or losses previously recognised in the AFSFI reserve.

Where fair value cannot be measured reliably, the instrument is carried at cost (less any impairment losses).

The Council invests through three Fund Managers, Baillie Gifford, Blackrock and Insight. These Fund Managers all invest on behalf of the Council into unitised products. They record income and account for transactions relating to these units as follows:

- Both Insight and Baillie Gifford receive and record income during the year. The income is re-invested into their units.
- No income is generated by Blackrock outwith their units.

I Foreign Currency Translation

Where the Council has entered into a transaction denominated in a foreign currency the transaction is converted into sterling at the exchange rate applicable on the date the transaction was effective. Where amounts in foreign currency are outstanding at the year-end, they are reconverted at the spot exchange rate at 31 March. Resulting gains or losses are recognised in the Financing and Investment Income and Expenditure line in the CIES.

J Government Grants and Contributions

Government grants, third party contributions and donations are recognised as due to the Council and credited to the CIES when there is reasonable assurance that the Council will comply with any conditions attached to payment of the grants and that the grants and contributions will be received.

Amounts recognised as due to the Council are not credited to the CIES until conditions attached to the grant or contribution have been satisfied.

Monies advanced as grants and contributions for which conditions have not been satisfied are carried in the Balance Sheet as creditors. When conditions are satisfied, the grant or contribution is credited to the relevant service line (attributable revenue grants and contributions) or Taxation and Non-Specific Grant Income (non-ring fenced revenue grants and all capital grants) in the CIES.

Where capital grants are credited to the CIES they are reversed out of the General Fund Balance in the Movement in Reserves Statement. Where the grant has yet to be used to finance capital expenditure, it is posted to the Capital Grants Unapplied Reserve. Where it has been applied, it is posted to the Capital Adjustment Account. Amounts in the Capital Grants Unapplied Reserve are transferred to the Capital Adjustment Account once they have been applied to fund capital expenditure.

K Heritage Assets

Heritage assets are those assets that are intended to be preserved in trust for future generations because of their cultural, environmental or historical significance. Heritage assets include historical buildings and the museum collection.

Heritage assets are recognised on the Balance Sheet where the Council has information on the cost or value of the asset. Where information on cost or value is not available, and the cost of obtaining the information outweighs the benefits to the users of the financial statements, the asset is not recognised on the Balance Sheet.

The carrying amounts of heritage assets are reviewed where there is evidence of impairment, e.g. where an item has suffered physical deterioration or breakage or where doubts arise as to authenticity. Any impairment is recognised and measured in accordance with the Council's general policies on impairment.

It is likely that disposals of heritage assets will be made only very occasionally. Where this does occur, the proceeds of such items will be accounted for in accordance with Council's provisions relating to the disposal of property, plant and equipment.

Historical buildings

These are held on the Balance Sheet at fair value, determined as the amount that would be paid for the asset in its existing use value but, where there is no market-based evidence of fair value because of the specialist nature of an asset, depreciated replacement cost is used as an estimate of fair value. They are depreciated on a straight-line basis over their remaining useful life.

Museum collection

The Council's museum collection is reported in the Balance Sheet at valuations based on specialist judgement. Assets are valued in the year of acquisition and reviewed periodically.

L Intangible Assets

Expenditure on non-monetary assets that do not have physical substance, but are controlled by the Council as a result of past events (e.g. software licences) is capitalised when it is expected that future economic benefits or service potential will flow from the intangible asset to the Council.

Intangible assets are measured initially at cost. Amounts are revalued where the fair value of the assets held by the Council can be determined by reference to an active market. Fishing quota and fishing licences meets this criterion. The depreciable amount of an intangible asset is amortised over its useful life on a straight-line basis to the relevant service lines in the CIES.

An asset is tested for impairment whenever there is an indication that the asset might be impaired; any losses recognised are posted to the relevant service lines in the CIES. Any gain or loss arising on the disposal or abandonment of an intangible asset is posted to the Other Operating Expenditure line in the CIES.

Where expenditure on intangible assets qualifies as capital expenditure for statutory purposes, amortisation, impairment losses and disposal gains and losses are not permitted to have an impact on the General Fund Balance. The gains and losses are therefore reversed out of the General Fund Balance in the Movement in Reserves Statement and posted to the Capital Adjustment Account and the Capital Receipts Reserve.

M Inventories and Long-term Contracts

Inventories are included in the Balance Sheet at the lower of cost and net realisable value. The cost of inventories is assigned using the weighted average costing formula, except for fuel which is calculated on a first in first out (FIFO) basis.

Long-term contracts are accounted for on the basis of charging the Surplus or Deficit on the Provision of Services with the value of works and services received under the contract during the financial year.

N Leases

Operating leases

The Council as lessee

Rentals paid under operating leases are charged to the CIES as an expense to the services benefitting from use of the leased property, plant or equipment.

The Council as lessor

Where the Council grants an operating lease over a property or an item of plant or equipment, the asset is retained in the Balance Sheet. Rental income is credited to the CIES. Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the relevant asset and charged as an expense over the lease term on the same basis as rental income.

Finance leases

Leases are classified as finance leases where the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the property, plant or equipment from the lessor to the lessee.

The Council as lessee

Property, plant and equipment held under finance leases is recognised on the Balance Sheet at the commencement of the lease at its fair value measured at the lease's inception (or the present value of the minimum lease payments, if lower).

The asset recognised is matched by a liability for the obligation to pay the lessor. Initial direct costs of the Council are added to the carrying amount of the asset. Premiums paid on entry into a lease are applied to writing down the lease liability. Contingent rents are charged as an expense in the periods in which they are incurred.

Lease payments are apportioned between:

- a charge for the acquisition of the interest in the property, plant or equipment which is applied to write down the lease liability; and
- a finance charge (debited to the Financing and Investment Income and Expenditure line in the CIES).

Property, plant and equipment recognised under finance leases is accounted for using the policies applied generally to such assets, subject to depreciation being charged over the lease term if this is shorter than the asset's estimated useful life (where ownership of the asset does not transfer to the Council at the end of the lease period).

The Council is not required to raise Council Tax to cover depreciation or revaluation and impairment losses arising on leased assets. Instead, a prudent annual contribution is made from revenue funds towards the deemed capital investment in accordance with statutory requirements. Depreciation and revaluation and impairment losses are therefore substituted by a revenue contribution in the General Fund Balance, by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

The Council as lessor

Where the Council grants a finance lease over a property or an item of plant or equipment, the relevant asset is written out of the Balance Sheet as a disposal. At the commencement of the lease the carrying amount of the asset in the Balance Sheet (whether property, plant and equipment or assets held for sale) is written off to the Other Operating Expenditure line in the CIES as part of the gain or loss on disposal. A gain, representing the Council's net investment in the lease, is credited to the same line in the CIES also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal), matched by a lease (long-term debtor) asset in the Balance Sheet.

Lease rentals receivable are apportioned between:

- a charge for the acquisition of the interest in the property which is applied to write down the lease debtor (together with any premiums received); and
- finance income (credited to the Financing and Investment Income and Expenditure line in the CIES).

The gain credited to the CIES on disposal is not permitted by statute to increase the General Fund Balance and is required to be treated as a capital receipt. Where a premium has been received, this is posted out of the General Fund Balance to the Capital Receipts Reserve in the Movement in Reserves Statement. Where the amount due in relation to the lease asset is to be settled by the payment of rentals in future financial years, this is posted out of the General Fund Balance to the

Capital Receipts Reserve in the Movement in Reserves Statement.

The written-off value of disposals is not a charge against Council Tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing. Amounts are therefore appropriated to the Capital Adjustment Account from the General Fund Balance in the Movement in Reserves Statement.

O Overheads and Support Services

The costs of overheads and support services are charged to service segments in accordance with the Council's internal reporting arrangements for accountability and financial performance. In line with LASAAC guidance, these are removed from gross income and expenditure in the CIES.

P Property, Plant and Equipment

Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and that are expected to be used during more than one financial year are classified as property, plant and equipment.

Recognition

Expenditure on the acquisition, creation or enhancement of property, plant and equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Council and the cost of the item can be measured reliably. Expenditure that maintains, but does not add to, an asset's potential to deliver future economic benefits or service potential (i.e. repairs and maintenance) is charged as an expense when it is incurred.

Measurement

Assets are initially measured at cost, comprising:

- the purchase price;
- any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and
- the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

Assets are carried in the Balance Sheet using the following measurement bases:

- infrastructure assets are held at depreciated historical cost;
- community assets and assets under construction are held at historical cost;
- surplus assets are held at fair value, estimated at highest and best use from a market participant's perspective;
- council dwellings are held at current value, determined using the basis of existing use value for social housing; and
- all other assets are held at current value, determined as the amount that would be paid for the asset in its existing use value.

Where there is no market-based evidence of current value because of the specialist nature of an asset, depreciated replacement cost is used as an estimate of current value.

Where non-property assets have short useful lives or low values (or both), depreciated historical cost basis is used as a proxy for current value.

Assets included in the Balance Sheet at current value are revalued every five years. Increases in valuations are matched by credits to the Revaluation Reserve to recognise unrealised gains. Unrealised gains arise from notional changes in value that have not been converted into cash.

Where decreases in value are identified, they are accounted for as follows:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains); and
- where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service lines in the CIES.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007, the date of its formal implementation. Gains arising before this date have been consolidated into the Capital Adjustment Account.

Impairment

Assets are assessed at each year-end as to whether there is any indication that they may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for as follows:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service lines in the CIES; and
- where an impairment loss is reversed subsequently, the reversal is credited to the relevant service lines in the CIES, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

Depreciation

Depreciation is provided for all property, plant and equipment assets by the systematic allocation of their depreciable amounts over their useful lives. An exception is made for assets without a determinable finite useful life (i.e. freehold land and certain community and heritage assets) and assets that are under construction).

The following useful lives and depreciation rates have been used in the calculation of depreciation (straight-line method):

- council dwellings: 30 years
- other land and buildings: 1 - 120 years
- vehicles, plant, furniture and equipment: 1 - 50 years
- infrastructure: 5 - 60 years

Surplus assets are depreciated on a straight-line basis over their useful economic life. The relevant economic life for surplus assets is in line with those stated above for each category of asset.

Where an item of property, plant and equipment has major components whose costs are significant in relation to the total cost of the item, the components are depreciated separately.

Revaluation gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the Revaluation Reserve to the Capital Adjustment Account.

Disposals and non-current assets held for sale

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an asset held for sale. The asset is revalued immediately before reclassification and then carried at the lower of this amount and fair value less costs to sell. Where there is a subsequent decrease to fair value less costs to sell, the loss is posted to the Other Operating Expenditure line in the CIES. Gains in fair value are recognised only up to the amount of any previous losses recognised in the Surplus or Deficit on Provision of Services. Depreciation is not charged on assets held for sale.

If an asset no longer meets the criteria to be classified as an asset held for sale, it is reclassified back to a non-current asset. It is valued at the lower of its carrying amount before the asset was classified as held for sale, adjusted for depreciation, amortisations or revaluations that would have been recognised if the asset had not been classified as an asset held for sale, and its recoverable amount at the date of the decision not to sell.

Assets that are to be abandoned or scrapped are not reclassified as assets held for sale.

When an asset is disposed of or decommissioned, the carrying amount of the asset in the Balance Sheet (whether property, plant and equipment or assets held for sale) is written off to the Other Operating Expenditure line in the CIES as part of the gain or loss on disposal. Receipts from disposals (if any) are credited to the same line in the CIES, also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal). Any revaluation gains accumulated for the asset in the Revaluation Reserve are transferred to the Capital Adjustment Account.

Amounts received for a disposal are categorised as capital receipts. The balance of receipts is required to be credited to the Capital Receipts Reserve and can then only be used for new capital investment. Receipts are appropriated to the Reserve from the General Fund Balance in the Movement in Reserves Statement.

The written-off value of disposals is not a charge against Council Tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing.

Q Fair Value Measurement

The Council measures some of its non-financial assets, such as surplus assets and some of its financial instruments, such as equity shareholdings, at fair value at each reporting date. Fair value is the price that would be received to sell an asset or paid to transfer a liability between market participants at the measurement date. The fair value measurement assumes that the transaction to sell the asset takes place either in the principal market for the asset or liability; or, in the absence of a principal market, in the most advantageous market for the asset or liability.

The Council measures the fair value of the asset using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their economic best interest.

When measuring fair value, the Council takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Council uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available. Inputs to the valuation techniques in respect of assets and liabilities for which fair value is measured or disclosed in the Council's accounts are categorised within the fair value hierarchy, as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets that the authority can assess at the measurement date;
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly;
- Level 3 – unobservable inputs for the asset.

R Private Finance Initiatives (PFI) and Similar Contracts

PFI and similar contracts are agreements to receive services, where the responsibility for making available the property, plant and equipment needed to provide the services passes to the PFI contractor. As the Council is deemed to control the services that are provided under its PFI schemes, and as ownership of the property, plant and equipment will pass to the Council at the end of the contracts for no additional charge, the Council carries the assets used under the contracts on its Balance Sheet as part of Property, Plant and Equipment.

The original recognition of these assets at fair value (based on the cost to purchase the property, plant and equipment) was balanced by the recognition of a liability for amounts due to the scheme operator to pay for the capital investment. For the Anderson High School contract, there was no initial capital contribution by Shetland Islands Council.

Non-current assets recognised on the Balance Sheet are revalued and depreciated in the same way as property, plant and equipment owned by the authority.

The amounts payable to the PFI operators each year are analysed into five elements:

- fair value of the services received during the year – debited to the relevant service in the CIES;
- finance cost – an interest charge on the outstanding Balance Sheet liability, debited to the Financing and Investment Income and Expenditure line in the CIES;
- contingent rent – increases in the amount to be paid for the property arising during the contract, debited to the Financing and Investment Income and Expenditure line in the CIES;
- payment towards liability – applied to write down the Balance Sheet liability towards the PFI operator (the profile of write-downs is calculated using the same principles as for a finance lease); and
- lifecycle replacement costs – proportion of the amount payable is posted to the Balance Sheet as a prepayment and then recognised as additions to property, plant and equipment when the relevant works are carried out.

S Provisions, Contingent Assets and Contingent Liabilities

Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that will likely require settlement by a transfer of economic benefits and a reliable estimate can be made of the obligation's value.

Provisions are charged as an expense to the appropriate service lines in the CIES when the obligation arises and are measured at the best estimate at the Balance Sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried in the Balance Sheet. Estimated values are reviewed at the end of each financial year. Where it becomes less likely that a transfer of economic benefits will be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service.
Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received if the Council settles the obligation.

Contingent Assets

A contingent asset is disclosed in a note to the accounts where it is probable that there will be an inflow of economic benefits or service potential not recognised in the Balance Sheet when an event has taken place that gives the Council a possible asset whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council.

Contingent Liabilities

Contingent liabilities are disclosed in the accounts but not recognised in the Balance Sheet, in circumstances where:

- an event has taken place that gives the Council a possible obligation whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council; or
- a provision would otherwise be made but either it is not probable that an outflow of resources will be required or the amount of the obligation cannot be measured reliably.

T Reserves

Reserves are created by transferring amounts from the General Fund Balance. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year in the CIES. The value is then transferred to the General Fund so that there is no net charge against Council Tax.

The Council also operates a Harbour Reserve Fund, as permitted under statute by the Zetland County Council Act 1974. Only surpluses from the Harbour Account can be credited to this reserve.

Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments, retirement and employee benefits and do not represent usable resources for the Council; these reserves are explained in the relevant policies.

U Revenue Expenditure funded from Capital under Statute

Expenditure incurred during the year that may be capitalised under statutory provisions, but does not result in the creation of a non-current asset, has been charged as expenditure to the relevant service in the CIES in the year. Where the Council has determined to meet the cost of this expenditure from existing capital resources or by borrowing, a transfer in the Movement in Reserves Statement from the General Fund Balance to the Capital Adjustment Account reverses out the amounts charged so that there is no impact on the level of Council Tax.

V Value Added Tax

VAT payable is included as an expense only to the extent that it is not recoverable from Her Majesty's Revenue and Customs. VAT receivable is excluded from income.

ZETLAND EDUCATIONAL TRUST SCHEMES

1961 TO 1965

Shetland
Islands Council

TRUSTEES' ANNUAL REPORT AND

FINANCIAL STATEMENTS

FOR THE YEAR ENDED

31 MARCH 2018

Contents

Introduction

The trustees present their annual report together with the financial statements and the auditor's report for the year ended 31 March 2018.

Administration Information

Charity Name	Zetland Educational Trust Schemes 1961 to 1965, known as Zetland Educational Trust (ZET)
Charity Number	SC001146
Contact Address	Shetland Islands Council Office Headquarters 8 North Ness Business Park Lerwick Shetland ZE1 0LZ
Current Trustees	Shetland Islands Council
Auditor	Deloitte LLP 1 City Square Leeds LS1 2AL

Structure, Governance and Management

Constitution

The Zetland Educational Trust (ZET), as currently constituted, was formed in 1961 (amended in 1965) through the amalgamation of a number of bequests. It is registered with the Office of the Scottish Charity regulator (OSCR) and its governing document is a trust deed.

The Zetland Educational Trust comprises a number of endowments as specified in the ZET schemes 1961 and 1965, which are vested in Shetland Islands Council as the governing body and statutory successors to the County Council for the County of Zetland.

Trustees

The trustees of ZET are the elected members of Shetland Islands Council and are appointed through their election to the Council.

The Executive Manager – Finance is the designated officer within Shetland Islands Council with responsibility for the proper administration of the trust's financial affairs and for keeping adequate and up to date accounting records.

The Executive Manager – Finance is responsible for ensuring that the financial statements of ZET are produced in accordance with the Charities Accounts (Scotland) Regulations 2006 (as amended), for making judgements and estimates that are both reasonable and prudent, and for taking steps to prevent and detect fraud and other irregularities.

The Executive Manager – Finance has considered and taken steps to address any risks to which the charity may be exposed, in particular those related to its operation and finances. The trustees are satisfied that adequate systems are in place to mitigate exposure to such risks.

The unaudited Trustees' Annual Report and Financial Statements were signed by the then Executive Manager – Finance and Section 95 officer, Jonathan Belford, who took up a new post at Aberdeen City Council on 1 September 2018. Jamie Manson has been appointed as the new Executive Manager – Finance and will start on 24 September 2018. In the interim Hazel Tait, Acting s95 Officer, has been given delegated authority to sign the audited Annual Report and Financial Statements.

Management

The elected members, as trustees, are responsible for all major decisions relating to the trust.

Authority to award grants has been delegated by the trustees to Shetland Islands Council Children's Services. The nominated officer is the Executive Manager – Quality Improvement.

The Executive Manager – Quality Improvement has the power to authorise expenditure within the limits of the trust's annual income. Designated staff within Children's Services are responsible for the day-to-day administration of the funds.

Objectives and Activities

Charitable purposes

The purpose of the trust is the advancement of education of people belonging to Shetland.

The Zetland Educational Trust generally provides grants amounting to 75% of total project costs, with the remainder of project costs to be met by fundraising activities or in-kind support. The Trust does not give funds retrospectively. Applications are invited on an annual basis from individuals, schools and other educational organisations operating in Shetland.

The amount of funds available for disbursement will vary each year depending on interest received by the trust.

The trust will fund projects that fall under the following headings:

- **Educational excursions**

  The trust may provide assistance to meet the costs of organised educational excursions for the benefit of pupils attending school centres in Shetland. The pupils should derive some educational benefit from attending the excursion.

- **Special equipment**

  The trust may fund the enhancement of education by assisting the provision of special equipment additional to that which the local authority may reasonably be expected to supply.

- **Promotion of ability and skill in swimming**

  The trust may fund the promotion and encouragement of swimming among pupils in Shetland through organised instruction by paying fees, travelling expenses and personal expenses of teams, instructors and any other appropriate costs.

- **Promotion of knowledge of Shetland**

  The trust may fund the promotion of knowledge of Shetland: its character, its skills and its arts, among persons being educated in Shetland by, for example, assisting to meet the costs of museum provision, making films designed to develop the knowledge of Shetland and any other appropriate costs.

- **Educational experiments and research**

  The Trust may fund bodies, or other persons it approves, to undertake educational experiments and research, including archaeological research that, in its opinion, will be for the educational benefit of persons in Shetland.

Performance

For the year ended 31 March 2018, the Trust received bank interest of £941 and investment income of £22,005.

There were 14 bursaries (2016/17: 12) awarded to university students in support of their studies, totalling £2,800 (2016/17: £2,400). These bursaries are issued in the name of the original donors: E&M Gair (8 awards) and Arthur Anderson (6 awards). These bursaries will continue to be awarded as the students' progress through their degree programmes.

The Trust also provides grants for projects of a general educational nature in line with the objectives set out above. There were 42 grants awarded to local clubs and schools totalling £12,784 in the year to 31 March 2018 (2016/17: nil).

Financial Review

Overview

In the year to 31 March 2018, the Trust made a surplus of £6,139 (2016/17: £1,579).

At 31 March 2018 the trust held cash and investments amounting to £673,459 (2016/17: £667,320).

Reserves Policy

Following approval on 7 March 2017, Trust reserves of £660,000 previously held in a fixed term deposit account were transferred to a Corporate Bond Fund with investment managers Baillie Gifford with effect from 28 April 2017. The reserves policy is to maintain capital balances, with disbursements being made from investment income.

Declaration

This report was signed on behalf of the trustees on 19 September by:

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Hazel Tait, CPFA
Acting Section 95 Officer
Shetland Islands Council

INDEPENDENT AUDITOR'S REPORT TO THE TRUSTEES OF ZETLAND EDUCATIONAL TRUST SCHEME 1965 AND THE ACCOUNTS COMMISSION

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the statement of accounts of Zetland Educational Trust Scheme 1965 for the year ended 31 March 2018 under Part VII of the Local Government (Scotland) Act 1973 and section 44(1)(c) of the Charities and Trustee Investment (Scotland) Act 2005. The financial statements comprise the Statement of Receipts and Payments, the Statement of Balances and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and a receipts and payments basis.

In our opinion the accompanying financial statements:

- properly present the receipts and payments of the Zetland Educational Trust Scheme 1965 for the year ended 31 March 2018 and its statement of balances at that date; and
- have been prepared in accordance with the requirements of the Charities and Trustee Investment (Scotland) Act 2005, and regulations 9(1), (2) and (3) of The Charities Accounts (Scotland) Regulations 2006.

Basis for opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)). Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Zetland Educational Trust Scheme 1965 in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the trustees for the financial statements

The trustees are responsible for the preparation of financial statements which properly present the receipts and payments of the Zetland Educational Trust Scheme 1965, and for such internal control as the trustees determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the audit of the financial statements

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

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other information in the statement of accounts

The trustees are responsible for the other information in the statement of accounts. The other information comprises the information other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission or required by applicable law to the extent explicitly stated later in this report.

In connection with our audit of the financial statements, our responsibility is to read all the other information in the statement of accounts and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Report on other requirements

Opinion on matter prescribed by the Accounts Commission

In our opinion, based on the work undertaken in the course of the audit the information given in the Trustees' Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Charities Accounts (Scotland) Regulations 2006.

Matters on which we are required to report by exception

We are required by The Charity Accounts (Scotland) Regulations 2006 to report to you if, in our opinion:

- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Use of our report

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

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Sarah Anderson, FCCA (for and on behalf of Deloitte LLP)
1 City Square,
Leeds,
LS1 2AL,
United Kingdom

19 September 2018

Deloitte LLP is eligible to act as an auditor in terms of section 1212 of the Companies Act 2006.

STATEMENT OF RECEIPTS AND PAYMENTS FOR THE YEAR ENDED 31 MARCH 2018

The Statement of Receipts and Payments, as required by the Charities Accounts (Scotland) Regulations 2006, provides an analysis of the incoming and outgoing cash and bank transactions for the year.

	Note	Restricted Funds £	2017/18 £	2016/17 £
Receipts				
Investment income	3	22,005	22,005	0
Bank interest		941	941	3,979
Total receipts		**22,946**	**22,946**	**3,979**
Payments				
Service charges		5	5	0
Fund Manager fees	3	1,218	1,218	0
Disbursements	4	15,584	15,584	2,400
Total payments		**16,807**	**16,807**	**2,400**
Surplus for the year		**6,139**	**6,139**	**1,579**

The Statement of Balances, as required by the Charities Accounts (Scotland) Regulations 2006, reconciles the cash and bank balances at the start and end of the financial year with any surpluses shown in the Statement of Receipts and Payments.

	Note	Restricted Funds £	2017/18 £	2016/17 £
Cash and bank	**3**			
Opening balance		**7,320**	**7,320**	**10,741**
Less transfer to investments		0	0	(5,000)
Surplus for the year		6,139	6,139	1,579
Closing cash balance		**13,459**	**13,459**	**7,320**
Investments	**3**			
Bank of Scotland - Fixed Term Deposit		0	0	660,000
Baillie Gifford Corporate Bond		660,000	660,000	0
Total Investments		**660,000**	**660,000**	**660,000**
Opening Trust Balance at 1 April		**667,320**	**667,320**	**665,741**
Add surplus for the year		6,139	6,139	1,579
Closing Trust Balance at 31 March		**673,459**	**673,459**	**667,320**

Signed on behalf of the trustees on 19 September 2018 by:

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Hazel Tait, CPFA
Acting Section 95 Officer
Shetland Islands Council

1. Basis of Accounting

The financial statements have been prepared on a receipts and payments basis in accordance with the Charities & Trustee Investment (Scotland) Act 2005 and the Charities Accounts (Scotland) Regulations 2006.

2. Trustee Remuneration, Expenses and Related Party Transactions

a) No remuneration or expenses were paid during the period to any trustee, persons connected to a trustee, or on behalf of a trustee during 2017/18;

b) There were no related party transactions during the year; and

c) Shetland Islands Council has not charged the Trust any fees relating to the legal advice, financial accounting, or grant administration and payment services provided during the year.

3. Cash and Investments

There is currently one bank current account held by the trust, used mainly for payments. The balance on this account at 31 March 2018 was £13,459.

Investment balances are held in a Baillie Gifford Corporate Bond Fund with an average annual return of 4.5% and Fund Manager fees of 0.3%. At 31 March 2018, the market value of the Baillie Gifford Corporate Bond was £654,605.

4. Disbursement of Bursaries and Grants

Disbursements: bursaries	2017/18		2016/17	
	Number	£	Number	£
E & M Gair student bursaries	8	1,600	9	1,800
Arthur Anderson student bursaries	6	1,200	3	600
Total	**14**	**2,800**	**12**	**2,400**

Disbursements: grants	2017/18		2016/17	
	Number	£	Number	£
Type of activity or project supported				
Special equipment	18	4,491	0	0
Promotion of knowledge of Shetland	14	2,091	0	0
Educational excursions	9	4,522	0	0
Promotion of swimming skills	1	1,680	0	0
Total	**42**	**12,784**	**0**	**0**

All 42 grants awarded in the year were to local clubs and schools. No individuals were awarded grants.

5. Audit Fees

Shetland Islands Council has an agreement with ZET whereby the independent audit fee is borne by the Council unless the Trust earns a minimum income of £10,000 in the year. For 2017/18, this income threshold was exceeded and therefore audit fees of £400 are chargeable to ZET. This transaction will take place in 2018/19.

6. Taxation

The Zetland Educational Trust is not liable to income or capital gains tax on its activities. Irrecoverable VAT is included in any expense to which it relates.