



SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW



Orkney Islands Council

**Annual Report to Orkney Islands Council
and the Controller of Audit
2006/07**



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1	Summary	1
2	Introduction	3
3	Financial Statements	7
4	Governance.....	21
5	Performance Management and Audit	35
6	Action Plan.....	44

1 Summary

Financial Statements

- We are pleased to report that in 2006/07 the Council complied with The Code of Practice on Local Authority Accounting in the United Kingdom in all material aspects.
- The Council reported a general fund surplus of £14.222 million in 2006/07. The general fund balance brought forward of £1.662 million at 1 April 2006 increased to a cumulative net surplus of £15.884 million at 31 March 2007. The year end balance incorporates a Council decision in January 2007 to transfer the remaining balance on the relevant services contingency fund (£13.666 million) to the general fund. The Council is presently using £2 million per annum from this fund to support general fund expenditure. As part of its Medium Term Financial Strategy the Council is planning over the next 4 years to eliminate the use of such resources in setting a balanced budget.
- Orkney College continued to report a deficit position in 2006/07 (£923k). In November 2006 it was agreed that the College should be treated as part of the council activities and report to the Education, Recreation and Cultural Services committee. To date, one financial monitoring report has been presented to Committee. The Council is also currently considering the overall governance arrangements of the College.
- The Council commissioned an independent base budget review during 2006. The findings of this review have been used to inform budget considerations for 2007/08. Priority is to be given to spending on care of the elderly, transport and housing.
- Our report raises concerns over the standard of records maintained and the accounting treatment adopted for Common Good Funds.
- In overall terms we found the Council's accounting systems and internal financial controls to be operating effectively.

Corporate Governance Arrangements

- Ten of the twenty one councillors at Orkney Islands Council are new members. All members of the Council are independent. Following the 2007 elections, a number of changes have been implemented in the committee structure.
- Orkney Islands Council's governance arrangements have meant that the Council has been largely able to deliver the audit committee principles set out in the CIPFA guidance and the Monitoring and Audit Committee's work has had a positive impact on the Council's overall corporate governance framework.
- Orkney Islands Council participated in the National Fraud Initiative (NFI) in 2006/07. Overall we concluded that the Council has given the appropriate level of priority to this initiative and investigations are ongoing.
- The Council has made limited progress in implementing effective risk management arrangements. We

did however note the recent appointment of Zurich Municipal to assist in developing the risk management arrangements and a risk register.

Performance Management and Audit

- Orkney Islands Council is currently participating in an Audit Scotland audit of Best Value and Community Planning. The audit will provide the Council with a clear opportunity to assess progress and developments made against the Best Value agenda.
- Adequate arrangements are in place at Orkney Islands Council to ensure that published statutory performance indicators are accurate and complete.
- In response to the Community Scotland report the Council has submitted and has agreed an action plan although particular attention needs to be given to service planning.

Conclusion

This report concludes the 2006/07 audit of Orkney Islands Council. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland. Subject to the weaknesses and improvements identified in this report, we are satisfied that Orkney Islands Council has properly discharged its duties in accordance with the Code of Audit Practice.

This report has been discussed and agreed with the Chief Executive and Director of Finance and Housing and has been prepared for the sole use of Orkney Islands Council, the Controller of Audit and Audit Scotland.

We would like to thank all members of Orkney Islands Council management, staff and members who have been involved in our work for their co-operation and assistance during our audit visits.

**Scott-Moncrieff
September 2007**

2 Introduction

2.1 Audit Framework

The Accounts Commission for Scotland is a statutory independent body which through the audit process promotes the highest standards of financial stewardship and public accountability in Scottish local government and assists in achieving value for money. The Accounts Commission is also responsible for appointing external auditors within local government and for determining their terms of appointment. Scott-Moncrieff is the appointed auditor to Orkney Islands Council for the years 2006/07 to 2010/11.

Audit Scotland is an independent statutory body that provides services to the Accounts Commission. Audit Scotland has prepared a Code of Audit Practice, which describes how external auditors should carry out their functions, and embodies the best professional practice to be adopted.

This annual report summarises our 2006/07 audit of Orkney Islands Council and highlights the key issues arising from our work.

2.2 Responsibilities of Orkney Islands Council

The Council is accountable to the public for the conduct of public business and the stewardship of funds under its control. The Council is therefore responsible for:

- Establishing proper corporate governance arrangements
- Maintaining proper accounting records
- Preparing the financial statements
- Safeguarding assets
- Taking reasonable steps for the prevention and detection of fraud and other irregularities
- Managing its affairs to secure the economic, efficient and effective use of resources
- Publishing statutory performance indicators
- Making arrangements to secure best value

2.3 Responsibilities of Auditors

Our responsibilities as external auditors to the Council, which are significantly greater than those of auditors in the private sector, are derived from statute (principally the Local Government (Scotland) Act 1973) and from the Code of Audit Practice.

Our work can be classified under the following headings: financial statements and corporate governance, performance management and audit and reporting the audit. Our main responsibilities for each of these areas is summarised as follows:

Auditors' Responsibilities	
Financial Statements and Governance	
Financial Statements	<p>To provide an opinion on whether the financial statements:</p> <ul style="list-style-type: none"> • Present fairly, as appropriate, the financial position of the Council and its income and expenditure for the year. • Have been properly prepared in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
Corporate Governance	<p>To review and report on the Council's corporate governance arrangements as they relate to:</p> <ul style="list-style-type: none"> • The prevention and detection of fraud and irregularity. • Standards of conduct and arrangements for the prevention and detection of corruption. • The Council's financial position. • The Council's review of its systems of internal financial control, including reporting arrangements.
Performance Management and Audit	
Performance Management and Audit	<ul style="list-style-type: none"> • The Local Government (Scotland) Act 1973 places a duty on the auditors of local government bodies to be satisfied that proper arrangements have been made for securing Best Value and complying with responsibilities relating to community planning. • To review and report on the arrangements that the Council has made to prepare and publish performance information in accordance with directions issued by the Accounts Commission.
Reporting the audit	
	<p>As a minimum we are required to provide:</p> <ul style="list-style-type: none"> • An independent auditors' report addressed to the Council and the Accounts Commission including an opinion on the financial statements. • An annual audit report addressed to the Council and the Controller of Audit. • Reports or letters addressed to the management of the Council, and where required, council members bring their attention to matters arising from auditors' work under the Code. • An opinion on specific matters such as Whole of Government Accounts, grant claims and statistical returns.

2.4 Independence and ethical standards

Ethical Standard 1 – *Integrity, objectivity and independence*, issued by the Auditing Practices Board (APB), requires that external auditors ensure that the Audit Committee is appropriately informed on a timely basis of all significant facts and matters that bear upon the auditors' objectivity and independence.

We confirm that we have complied with APB Ethical Standards throughout our audit and that, in our professional judgement, we have remained independent and our objectivity has not been compromised in any way. In particular:

- There are and have been no relationships between Scott-Moncrieff and the Council, its members and senior management that may reasonably be thought to bear on our objectivity and independence,
- Scott-Moncrieff has not provided any consultancy or non-audit services to the Council

Our external audit fees for 2006/07 were:

Statutory audit fee (including VAT but excluding Audit Scotland charges) **£151,725**

2.5 Priorities and Risks Framework

Central to our audit is a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Council. This ensures that our audit focuses on the areas of highest risk.

The scope of our audit work is informed by Audit Scotland’s Priorities and Risks Framework (PRF) tool. The PRF is an audit planning tool designed by Audit Scotland and issued to all external audit providers within the sector. The PRF is designed to assist auditors in developing an understanding of a number of key issues which are impacting on the local government sector in Scotland and the potential risk areas associated with each issue. The PRF is used to assess the impact that each issue is having on Orkney Islands Council and the methods employed by the Authority to manage those risks of greatest significance.

The PRF guidance provided by Audit Scotland has identified key priorities and risk areas as follows:

<p>Governance & Performance Management</p> <ul style="list-style-type: none"> • Supporting Political Governance; • Community Planning and Partnership Working; and • Performance Management. 	<p>Efficient Government and the Efficient Use of Resources</p> <ul style="list-style-type: none"> • Financial Planning; • Workforce management; and • Procuring and managing assets.
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As part of our annual planning process we used the PRF tool to identify the key risks facing Orkney Islands Council and the steps taken by the Council to mitigate those risks from materialising.

2.6 Audit Reporting

We have prepared the following detailed audit reports during 2006/07:

- Corporate Governance Arrangements
- Interim Management Report – financial statements and accounting systems

This annual report summarises all of our work during the year and highlights the key issues we have identified under the headings of financial statements, corporate governance and performance management and audit. The action plan in section 6 details the significant recommendations we have made with regard to the findings in this report, along with management's responses.

3 Financial Statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their financial performance in the use of those resources. The Code of Audit Practice gives the external auditor a responsibility to review and, where appropriate, report findings on Orkney Islands Council's financial statements. Our responsibilities are summarised below:

Auditors' Responsibilities	Para Ref
Financial Statements	
To provide an opinion on whether the financial statements:	
<ul style="list-style-type: none">present fairly, as appropriate, the financial position of the Council and its income and expenditure	3.1
<ul style="list-style-type: none">have been properly prepared in accordance with relevant legislation, applicable accounting standards and other reporting requirements	3.3

3.1 Audit Opinion

Our audit report included on page 58 of the annual accounts is addressed to the Members of the Council and the Accounts Commission for Scotland. The report was issued on 28 September 2007 and is unqualified.

3.2 Accounts Timetable

Scottish local authorities are required under Regulation 4 of the Local Authority Accounts (Scotland) Regulation 1985 to submit a copy of an abstract of their accounts to the Controller of Audit by 30 June. We are pleased to confirm that the Council adhered to this requirement by lodging accounts with the Controller of Audit on 29 June 2007.

3.3 Format of the Accounts

The financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2006 (the SORP). The SORP specifies the principles and practices of accounting required to prepare a Statement of Accounts which 'presents fairly' the financial position and transactions of a local authority and to prepare group financial statements where they have material interests in subsidiaries, associates or joint ventures.

The SORP is reviewed and updated annually by the CIPFA/LASAAC Joint Committee and the 2006 version, applicable to 2006/07, was issued in July 2006. The 2006 SORP contains a number of substantive changes from the previous edition, including:

- Changes to the single entity statement of accounts comprising the replacement of the Consolidated Revenue Account and Statement of Total Movement in Reserves with an Income and Expenditure

Account (I&E account), Statement of Movement on the General Fund Balance and Statement of Total Recognised Gains and Losses.

- A requirement to follow a consistent approach to the order of the financial statements.
- Changes to the format of the Housing Revenue Account to bring it into line with the new format.
- Certain income and expenditure items such as depreciation, losses on impairment of fixed assets and releases from the government grants deferred account are now to be taken directly to services in the I&E account and shown as reconciling items on the statement of movement on the general fund balance.
- The gain or loss on disposal of fixed asset requires to be calculated and dealt with in the I&E account. It is then shown as a reconciling item on the statement of movement on the general fund balance.

As part of our 2006/07 audit we considered the arrangements Orkney Islands Council had in place to ensure the appropriate changes were made to the financial statements. Overall we concluded that the Council had complied with the new requirements of the SORP.

3.4 Summary Financial Position

3.4.1 General Fund

Orkney Islands Council achieved a general fund surplus of £14.222 million in 2006/2007. The general fund balance brought forward of £1.662 million at 1 April 2006 increased to a cumulative net surplus balance of £15.884 million at 31 March 2007. An analysis of the Council's general fund reserve at 31 March 2007 is presented below:

Analysis of General Reserves as at 31 March		
	2007 £million	2006 £million
General Fund surplus at end of year	15.884	1.662
Less Earmarked Reserves		
• Modernising Government Fund	(0.067)	(0.085)
• Corporate Development Fund	(0.152)	(0.121)
• Modernising Teachers Fund	(0.068)	(0.354)
• Community Council	(0.192)	(0.177)
• Devolved School Management Fund	(0.071)	(0.073)
• Orkney College	0.923	0.866
• Single Status Fund	(1.056)	(1.056)
• ALCO Development Fund	(0.250)	0
• Training Fund	(0.039)	0
Total Earmarked Reserves	(0.972)	(1.000)
Surplus on General Fund	14.912	0.662

The analysis above indicates that the Council has earmarked reserves of £0.972 million which leaves the Council with a general fund surplus of £14.912 million. The movement in the Council's general fund during the year can be analysed as follows:

Movement in the Council's General Fund during 2006/07			
	Earmarked General Fund £million	Un-earmarked General Fund £million	Total General Fund £million
Balance at 1 April 2006	1.000	0.662	1.662
Transfer of Relevant Services Contingency Fund from the Council's Harbour Authority Account	0	13.666	13.666
Other movements	(0.028)	0.584	0.556
Balance at 31 March 2007	0.972	14.912	15.884

The relevant services contingency fund existed as part of the Council's harbour authority account for a number of years and comprised the equivalent of Non-Domestic Rate Income paid voluntarily for a period by the oil terminal operator in the 1970's and 1980's. This fund has regularly been used to support general fund service expenditure and the Council agreed in January 2007 to transfer the remaining balance to the general fund. The Council is presently using £2 million per annum from this fund to support general fund expenditure. As part of its Medium Term Financial Strategy the Council is planning over the next 4 years to eliminate the use of such resources in setting a balanced budget.

The Council currently considers that a minimum balance of £5 million should be retained within the General Fund to meet unforeseen contingencies.

3.4.2 2006/07 General Fund Financial Performance

In comparison with the budget, the Council reported a favourable outturn position of £297,000. This comprised an under spend against budget of £139,000 combined with a surplus of £158,000 on sources of funding (council tax, revenue support grant and non-domestic rates).

Financial Performance Summary 2006/07				
	Actual Net Expenditure £000	Annual Net Budget £000	Over/(under) spend £000	Reference
Community Social Services	11,467	11,347	120	Note 1
Other Housing	388	215	173	Note 2
Environmental Services	3,105	3,362	(257)	
Planning	601	653	(52)	
Education	23,560	23,777	(217)	Note 3
Recreation & Cultural	3,386	3,180	206	
Transportation	6,346	6,411	(65)	
Roads	4,375	4,381	(6)	
Economic Development	568	598	(30)	
Central Administration	0	0	0	
Law, Order & Protective Services	3,378	3,282	96	
Other Services	7,797	7,904	(107)	
TOTAL	64,972	65,111	(139)	

Note 1: The most significant overspend within Community Social Services relates to childcare off-island placements (overspend £455,000). During 2006/07, eleven children were placed out with Orkney. The Service has noted that a significant reduction in the number of children placed out with Orkney should lead to a reduced overspend position in 2007/08.

Note 2: The Council has a statutory duty to provide this service and as a consequence there is little flexibility when it comes to spending decisions. As part of the 2007/08 budget setting process, the Council has increased the baseline budget by £100,000.

Note 3: An overspend was incurred in relation to Special Education Services due to the out of Orkney placements. This however has been offset against a number of underspends achieved by the Education Service. Pre-school education, for example reported an underspend (£114k) due to a loss of teaching posts.

Comprehensive budget training was provided to all budget holders in December 2005 and revised budget monitoring procedures were rolled out across the Council for the start of 2006/07. The revised budget monitoring procedures include a requirement for budget holders to:

- Report on material variances against each budget each month;
- Provide an explanation of the causes of each material variance; and
- To identify corrective action to remedy the situation.

In February 2007 the Council also approved, as part of its budget setting process, the following policy aspects in relation to the carry forward of under and overspends:

- The right to carry forward over or underspends within defined limits should be removed immediately.
- Any overspends will be automatically offset against the budget for the following financial year unless on the recommendation of the Policy and Resources Committee exceptional circumstances prevail.
- Any underspends should only be carried forward on the recommendation of the Policy and Resources Committee.

3.4.3 Harbour Authority Account

The Orkney County Council Act of 1974 authorises Orkney Islands Council to exercise harbour jurisdiction as a Competent Harbour Authority. The Act also requires the Council to keep separate accounts in respect of the harbour authority account. The trading position from the harbour operations is reflected within the Council's cost of services.

The Council reported a net decrease in the harbour authority account fund balance in the year of £9.347 million. As a result the fund balance brought forward of £183.437 million at 1 April 2006 decreased to a cumulative net surplus balance of £174.090 million at 31 March 2007. The main contributing factor to the decrease in fund balance for the year was the transfer of the relevant service contingency fund to the general fund (see section 3.4.1).

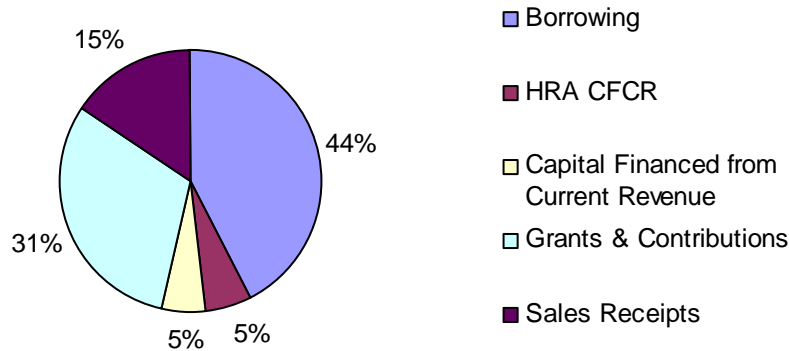
3.4.4 Housing Revenue Account

The Council does not retain a housing revenue account reserve. Instead any surplus is used to finance capital expenditure. In 2006/07 capital expenditure funded by the HRA amounted to £0.724 million (2005/06 £0.686 million).

3.4.5 Capital Expenditure

During the year the Council spent £13.196 million on capital expenditure. This was financed by borrowing, capital grants and capital receipts. (Note: The Council does not borrow externally but instead borrows from the harbour strategic reserve fund).

Sources of Funding for Capital Expenditure



3.4.6 Orkney College of Further Education

Orkney Islands Council provides further and higher education provision through the Orkney College using a devolved Board of Management arrangement. The Orkney College is funded by direct grant from the Scottish Funding Council (SFC).

During the financial year 2005/06 the College generated a deficit of £214k for the year, resulting in a further increase in the accumulated deficit position on the College to £866k as at 31 March 2006. This accumulated deficit position has increased to £923k in 2006/07.

A member/officer working group has been established with a view to preparing an action plan to address the cumulative deficit position. A report was presented to the Policy & Resources Committee in November 2006 highlighting the problems which have arisen at the College. The Council agreed that the College should be treated as part of the council activities and to report to the Education, Recreation and Environment Committee. The College also currently has a £1 million overdraft. The Policy and Resources committee agreed to give the College a 5 year interest free period (to be reviewed after 5 years). The College are required to repay the overdraft over a 20 year period.

Since this report was considered we have noted that the College has reported its financial position to Committee only once. We would encourage the Council to request financial reports in line with the current reporting arrangements for other Services of the Council.

We also noted that the Council is currently considering the overall governance and management arrangements of Orkney College. A recent paper presented to the Education, Recreation and Environment Committee proposed that the Board of Management of Orkney College be converted to an advisory group.

3.4.7 2007/08 Financial Position

General Fund Services

The 2007/08 financial year represents the final year of the Council's 3 year Medium Term Financial Strategy. In setting the 2007/08 budget the Council commissioned an independent base budget review during 2006 which analysed 129 service functions to determine:

- The level of statutory discretion
- Recent spend/income patterns
- Comparative service statistics from other Councils
- Employee assessment
- Cost/income behaviour
- Service demand/supply
- Scope for savings/re-provisioning

The findings from the review were used to inform the budget considerations for 2007/08. These considerations confirmed that priority should be given to spending on social services, transport and housing and also reached the following conclusions:

- The additional costs arising from the implementation of single status from 1 April 2007 will amount to £1.5 million
- New and additional spending pressures in 2007/08 amount to £1.4 million.

The main cost pressures can be summarised as follows:

Orkney Islands Council budget pressures (2007/08)	
Expenditure Categories	Cost Pressures £million
Additional utility costs	0.325
Corporate property staffing	0.050
Social Services – care home staffing	0.443
Social Services – child protection	0.182
Transport – island airline and airfield costs	0.200
Housing – provision for the homelessness	0.100
Provision for spend to save redundancy costs	0.100
Total	1.400

In order to fund these additional spending areas, together with price uplifts of £2.2 million, the Council agreed in January 2007 that:

- The band D Council Tax level for 2007/08 should be set at £1,037, an increase of 3% on 2006/07.
- All services should be asked to make total efficiency savings of at least £1 million

- A contribution from the relevant services contingency fund (now included in the general fund – see section 3.4.1) of £2 million should be made to support service expenditure.

The Council also agreed that a new 5 year Medium Term Strategy should be drawn up to inform the 2008/09 and subsequent budget decisions. It was agreed that this strategy should incorporate:

- The continuing need for efficiency savings to be recycled into priority areas of spending (i.e. statutory requirements and social work, transport and housing)
- The need for the strategy to release over a two year period at least £2 million for care provision for the elderly
- The achievement of a balanced budget within 4 years without the assistance of transfers from the relevant services contingency fund (now incorporated within the general fund)
- Council policies on charging for services to ensure charges are in line with best practice issued by the Accounts Commission and that this is applied consistently across all services.

The 5 year Medium Term Strategy is currently being drafted and will be finalised over the next few months prior to the 2008/09 budget being developed. We would commend the Council for its approach to future budget setting.

Housing

HRA expenditure was budgeted at £1.787 million in 2007/08 and the Council approved in January 2007 an increase in housing rents of 4.1% from 1 April 2007.

Capital

The Council's approved capital plan can be summarised as follows:

Orkney Islands Council approved capital plan				
	2007/08	2008/09	2009/10	Total
	£ million	£ million	£ million	£ million
General Fund	12.405	10.074	8.955	31.434
Non-General Fund	3.589	1.504	1.028	6.121
Total	15.994	11.578	9.983	37.555

The Non-General Fund capital programme includes housing services and harbours capital expenditure. The Council is free from external debt and the capital programme is financed from capital grants, capital receipts, revenue contributions or internal borrowing from the Council's strategic reserve fund.

Currently the capital programme covers a three year period. We recommend that this planning timescale is brought into line with the 5 year Medium Term strategy to allow the revenue implications of capital decisions to be more accurately forecast.

3.5 Trading Accounts

Section 10 of the Local Government in Scotland Act 2003 requires local authorities to maintain and disclose trading accounts for significant trading operations (STOs). Each STO is required to break-even over a rolling three year period. Under the terms of the Act the identification of significant trading operations is the responsibility of individual authorities. When considering the status of potential trading operations the Council applied a number of tests to determine the trading status of each activity and its level of significance.

In 2005/06, the Council included two STO's in the financial statements (Trade Waste Collection and Quarries). The Council carried out a re-assessment in February 2007 to ensure all potential STO's had been identified and reported. Of the sixteen operations identified, the Council concluded that they do not have any significant trading operations. The assessment also concluded that both waste disposal and quarries are provided for on the basis of recharge of cost and therefore should not be classified as trading operations. In 2006/07 the Council has not reported any STOs in the financial statements. We can confirm that Orkney Islands Council's assessment is not unreasonable.

3.6 Single Status/Equal Pay

The Single Status agreement was introduced in 1997 and was designed principally to harmonise the terms and conditions of service for manual employees and other employees. The main features of the agreement are a single spinal column for all staff and a new scheme of terms and conditions.

Following discussion with the unions over the implementation of the Single Status Agreement the Council has proposed a major overhaul of its grading structure and a review of its terms and conditions. The proposal by the Council also sees a 2 – 2.5% annual pay rise for those on protected posts.

The Council has validated the pay issues following a meeting with the Unions. The Council is keen that the detriment to individual staff is kept to a minimum with the Council estimating that there will be no "red flagged" posts after 3 years.

Letters regarding Single Status were sent out to Council employees in August 2007, following which the 90 day consultation period commenced. The Council intend to implement the new grading structure by 1 December 2007 with an effective date of 1 April 2007.

The ongoing costs of implementing the agreement are still unclear however £1.5million has been incorporated into the 2007/08 budget. This is considered to be on a "worst case" basis and the Council estimates suggest that this figure will not be incurred until four or five years after implementation. An implementation cost of £1.5 million would equate to roughly 5% of the AP&C and Manual staff wage bill.

Single Status goes wider than equal pay but it is equal pay compensation that has been causing major problems for local authorities. An amendment to the Equal Pay Act in 2004 extended the period over which back pay could be claimed from 2 to 5 years in Scotland (claims can be made going back 6

years in England) bringing UK legislation into line with the EU. In 2005/06, Orkney Islands Council's provided for such claims in the financial statements. This amounted to £2.35 million following acceptance of liability for claims. The compensation package offered by the Council was to the 31 March 2007 and extended back 5 years. The majority of these claims have now been settled and paid from this provision.

3.7 Group Accounts

The 2005 Code of Practice on Local Authority Accounting in the UK (the SORP) introduced for the first time the comprehensive consolidation of local authorities interests in subsidiaries, associates and joint ventures. The consolidation requirements were introduced to comply with generally accepted accounting principles and to coincide with the increased use of alternative service delivery vehicles by local authorities. In determining the extent of a Council's boundaries for group accounting purposes, local authorities were required to classify entities they had a group relationship with into three categories:

Subsidiaries – where the local authority is able to exercise control over the operating and financial policies of the entity and is able to gain benefit from the entity or is exposed to the risk of potential losses.

Associates – where the local authority has an interest and is able to exercise significant influence over the entity's operating and financial policies

Joint ventures – where a local authority has a long term interest in an entity but where the entity is jointly controlled with another party.

Orkney Islands Council has classified its interests in five companies/trusts as subsidiaries with a further one company as an associates. The Council's interests in three of the Joint Boards are also being classified as associates. The Council's interests in the Valuation Joint Board have been classified as a joint venture. The Council has a number of other interests in companies which have not been consolidated into the group accounts as they do not meet the SORP definitions.

We have audited the group accounts prepared by the Council and the judgements made by the Council regarding those entities included or excluded from the group accounts. The audit report covers our audit opinion on the group accounts and is unqualified.

We did however note the following matters during our review:

The Council has classified its interest in Pickaquoy Leisure Trust as a subsidiary. The SORP defines a subsidiary interest as one 'where the local authority is able to exercise control over the operating and financial policies of the entity and is able to gain benefit from the entity or is exposed to the risk of potential losses'. In our view Council does not exercise control over the operating and financial policies of Pickaquoy Leisure Trust and therefore should not classify its interest as a subsidiary. We recommend that the Council review the classification of Pickaquoy Leisure Trust in 2007/08 to ensure it is appropriately accounted for in the group financial statements.

A number of the Council's group bodies have prepared financial statements using the Financial Reporting Standard for Smaller Entities (FRSSE). As a result certain disclosures, for example cash flow statements or FRS 17 disclosures, have not been prepared for these entities. Whilst this was immaterial to the group financial statements, we would encourage the Council to request that its subsidiaries prepare full financial statements and do not take advantage of any exemptions or reduced disclosure opportunities.

We also noted that the Council took the decision not to consolidate common good and trust funds into the group accounts on the basis of materiality. In preparing group accounts, uniform group accounting policies should be used for determining the amounts to be included in the consolidated financial statements. If necessary, the amounts reported by subsidiary undertakings in their individual financial statements should be adjusted for consolidation. The Council's group financial statements are prepared on the basis that a full valuation on assets is carried out at least every five years. We noted however that the Council does not have a revaluation policy which is being applied for Common Good and Trust assets. During our audit we have obtained representations from the Council which confirm that were Common Good and Trust Fund assets to be revalued they would not materially impact on the Council's original conclusion that Common Good and Trust Funds should not be consolidated into the group accounts.

3.8 Matters Arising from the Audit of the Financial Statements

3.8.1 Investments

Orkney Islands Council has 100% interests in a number of private limited companies. These include Orkney Towage Company Ltd and Weyland Farms Ltd. During our review we noted that the value of these investments reported in the financial statements was considerably greater than the value of net assets reported by these companies. The table below summarises the position in the financial statements:

Council's Investment in Private Companies		
	Orkney Towage Company Ltd	Weyland Farms Ltd
	£ 000	£ 000
Investment Less Provision	501	510
Net Assets	(1,184)	29

Orkney Towage Company balance sheet reflects a number of tugs that the company holds at historic cost and are fully written down. During our review we obtained confirmation from the Council that the value of these tugs is approximately £4.5 million. We have therefore accepted that no write down of the Council's investment in Orkney Towage Company Ltd is required.

During the course of our audit, a potential adjustment has been raised to reflect the reduction in the value of investment in Weyland Farm Ltd (£481,000). Whilst this adjustment has not been made to the

annual accounts on the grounds of materiality we note that the inclusion of this write-down would have impacted on the Council's reported general fund surplus.

Based on our findings during the year, we would recommend that the Council carry out an annual review on the value of the Council's fixed asset investments.

3.8.2 Investment Properties

The SORP states that an asset should be classified as an investment property if it complies with the following three definitions:

- The asset is held solely for investment purposes;
- It does not support the service or strategic objectives of the authority; and
- The rental income is negotiated at arms length.

During our review we noted that the Council has classified £22.258 million as investment properties of which £16.598 million has been disclosed under investments. We understand that these amounts relate to harbour fund investment properties. We recommend in future years this amount is classified, where it complies with the SORP definition above, as a non-operational investment property on the balance sheet. We would also encourage the Council to review those assets classified under this heading to ensure they comply with the definition of non-operational investment properties.

3.8.3 Fixed Assets

The balance sheet shows that Orkney Islands Council's portfolio of tangible fixed assets was valued at over £199 million as at 31 March 2007. During the course of our audit we carried out detailed testing to determine whether the assets of the Council were fairly presented and accounted for in accordance with the SORP. We identified a number of weaknesses in Orkney Islands Council's approach to fixed asset accounting which we have incorporated into this report's action plan.

3.8.4 Common Good and Trust Funds

Local Authorities are required to administer Common Good Funds under Section 15 of the Local Government (Scotland) Act 1994. The purpose of Common Good Funds is to provide a benefit to the population of the area either through the financial disbursement of funds, securing assets for the ongoing use of the population or contributing to specific local projects/initiatives.

It is acknowledged that the history and context of Common Good and Trust assets can increase the complexity of record keeping. However, based on our audit work performed we have noted concerns over the accounting treatment for fixed assets of the Common Good and Trust Funds. In particular we encountered problems in agreeing property details back to title deeds. In many cases the Council were unable to locate the title deeds. Furthermore, the Council does not maintain a comprehensive Common Good and Trust Fund asset register.

We also appreciate that the accounting treatment across Scottish Local Government varies with some authorities depreciating common good assets and others not. Accounting standards however dictate that the assets of the Common Good and Trust Funds should be subject to depreciation and that this should be charged to the revenue account on an annual basis. The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful economic life. The depreciation method used should reflect as fairly as possible the pattern in which the asset's economic benefits are consumed.

The Council has recognised that the existing arrangements surrounding the stewardship and accounting for Common Good and Trust Funds require immediate attention. We understand the 2007/08 budget includes an allocation to recruit a staffing resource and to upgrade systems to deal with these matters and asset management arrangements generally (see section 5.6.1)

3.9 Future Developments

3.9.1 PPP

Orkney Islands Council has joined the PPP building programme to create 21st Century Schools, with Scottish Government support for a £50 million project. The initial business case identified three projects, including Kirkwall Grammar School, a new primary school in Stromness and Halls of Residence at Kirkwall. Options also included plans for joint working with NHS Orkney in the development of their built estate. Discussions have been ongoing with the Scottish Government on how to deliver this project where conventional PPP is not considered appropriate. The Council intend to deliver these projects through an arms length council company model (ALCCO model) as being developed by the Western Isles Council.

3.9.2 2007 SORP

As noted previously, a number of substantive changes were introduced in the 2006 SORP. Further changes are to be introduced in the 2007 SORP. From 1 April 2007 the Fixed Asset Restatement Account and Capital Financing Account will be replaced with a Revaluation Reserve and Capital Adjustment Account. This change will be a change in accounting policy and will require a prior year adjustment. It is essential that the Council starts preparing for these changes, which are likely to involve significant changes to the fixed asset register systems and data as soon as possible.

3.9.3 International Financial Reporting Standards

The Budget 2007 included a number of policy announcements regarding future public sector financial reporting. In particular it was announced that:

- In order to bring benefits in consistency and comparability between financial reports in the global economy and to follow private sector best practice, from 2008/09 central government accounts would be prepared using International Financial Reporting Standards (IFRS) adapted as necessary for the public sector.

- Whole of Government Accounts would now be published for the first time for the 2008/09 financial year. This revised timetable is to allow time to complete alignment of local and central government accountancy policies and to enable WGA to be prepared on the new IFRS basis.

The impact of the adoption of IFRS within Whole of Government Accounts and ultimately within local authority accounts is currently being considered by CIPFA and the Board responsible for issuing the SORP. The two major effects are likely to be:

- The requirement to value local authority infrastructure assets (roads, paths, bridges, coastal defences) on a current valuation basis.
- The expectation that under IFRS more PPP and similar schemes will come 'on to' the public sector balance sheet. Up until now it has generally been a feature and requirement of such schemes that they be treated as 'off' the balance sheet of the public sector. This would mean for example that new schools built under PPP financing schemes may revert back to an authority's balance sheet.

The detail behind these proposals is still being considered however it is likely to mean there will be substantial changes to local authority accounts over the next 2-3 years.

4 Governance

4.1 Introduction

Corporate Governance is concerned with the structures and processes for decision-making, accountability, control and behaviour at the upper levels of organisations. Through the chief executive and section 95 officer, Orkney Islands Council is responsible for ensuring the proper conduct of its affairs including compliance with relevant guidance, the legality of activities and transactions and for monitoring the adequacy and effectiveness of these arrangements.

4.2 Code of Audit Practice

The Code of Audit Practice gives the external auditor a responsibility to review and, where appropriate, report findings on Orkney Islands Council's corporate governance arrangements.

Auditors' Responsibilities	Para Ref
Corporate Governance	
To review and report on the Council's corporate governance arrangements as they relate to:	
• The prevention and detection of fraud and irregularity	4.7
• Standards of conduct and arrangements for the prevention and detection of corruption	4.6
• The Council's financial position	3.4
• The Council's review of its systems of internal financial control, including reporting arrangements	4.5

In discharging these responsibilities we carried out a review of the Council's governance arrangements during 2006/07. This review included consideration of the Council's structures for decision making before and after the 2007 local government elections, the Council's codes of conduct, procedures for the prevention and detection of fraud and irregularity and risk management arrangements. Our work in this area concluded that whilst the Council's corporate governance arrangements are generally robust there are a number of areas with scope for improvement which, if addressed, would bring the Council's corporate governance regime in line with best practice. These issues were brought to the attention of Council officials and elected members through the issue of our interim management report on corporate governance arrangements. The report contained an action plan which committed the Council to addressing each audit issue within an agreed timescale. The key findings from our work on corporate governance are summarised below:

4.3 2007 Elections

The Local Governance (Scotland) Act 2004 introduced a range of measures representing the biggest change to local government since the reorganisation of 1996. The overall objective of the Act was to strengthen local democracy by:

- Introducing the proportional Single Transferable Vote system of election;
- Removing unnecessary political restrictions on standing for local authority election;
- Lowering the age limit for local government candidates to 18; and
- Establishing an independent remuneration committee for councillors.

4.3.1 Proportional Representation

The Act introduced proportional representation to the 2007 local government elections. As a result there was the potential for significant changes to council membership, including a number of new members and more hung councils. The outcome from the local government elections in Orkney Islands are summarised in the table below:

Orkney Islands local government election results		
Political Party	Pre 2007 Elections	Post 2007 Elections
Independent	<u>21</u>	<u>21</u>
	Pre 2007 Elections	Post 2007 Elections
Number of new councillors	-	10
Number of returning councillors	-	11
Average age of councillors	61	54
Youngest councillor age	45	38

There are 6 wards: Kirkwall East (4 Councillors to be elected); Kirkwall West & Orphir (4 Councillors); Stromness & South Isles (3 Councillors); West Mainland (4 Councillors); East Mainland, Burray & South Ronaldsay (3 Councillors); North Isles (3 Councillors). Overall, the results at Orkney Islands Council demonstrate that some progress has been made in contributing to the overall objective of The Local Governance (Scotland) Act 2004.

4.3.2 Remuneration for Councillors

Prior to the 2007 elections, elected members were not paid a salary for their council duties, but compensated under The Local Authorities etc (Allowances) (Scotland) Regulations 1995 through a system of allowances that vary according to the population of the local authority area. Members were also able to claim travel and subsistence expenses incurred in carrying out council duties. In 2006/07, Orkney Islands Council member allowances amounted to £402,540. A breakdown is provided in the table below:

Orkney Islands Council 2006/07 Member Allowances	
	£'000
Basic Allowance	126
Responsibility Allowance	202
Subsistence Allowances	33
Expenses/Travel	41
TOTAL	<u>402</u>

Under the Local Governance (Scotland) (Remuneration) Regulations 2007 however elected members are now remunerated. The regulations provide that all Councillors receive a remuneration of £15,452 per annum. In addition, councils may pay remuneration to Councillors designated to hold positions of responsibility. The regulations group councils into bands having regard to their size and remuneration is payable according to the provisions which apply to each band. Orkney Islands Council is grouped in Band A. Under the regulations, Orkney Islands Council shall pay remuneration to each of its senior councillors at an amount determined by the Council. The total yearly amount payable by Orkney Islands Council for remuneration of all its senior councillors however shall not exceed £156,456. Furthermore, the number of senior councillors should not exceed 9 (excluding the Leader and Civic Head and up to 4 Councillors with responsibility for Police and/or Fire and Rescue functions). Orkney Islands Council agreed the maximum allowances paid for positions of responsibilities as follows:

Orkney Islands Council Remuneration Scheme		
	£	No of Councillors
Convenor	25,754	1
Vice Convenor (Civic Head)	19,316	1
Senior Councillors:		
Chairs of Main Committees	18,000	6
Chair of Orkney Ferries	16,502	1
Chair of Licensing Board	16,502	1
Total remuneration paid to senior councillors	£141,004	8
Maximum set in Regulations	£156,456	9
Designation of one Councillor paid a basic Councillor allowance of £15,542 as a senior Councillor would increase the number of senior councillors to 9 and the remuneration paid to senior councillors to the maximum set in the regulations of £156,456		
The following posts are remunerated but are excluded from both the financial limit and maximum number of posts set in the regulations:		
Convenor	25,754	1
Vice Convenor – Highlands & Islands Fire Brigade Board	20,281	1

4.3.3 Committee Structure

Orkney Islands Council recognised that the 2007 local government elections provided the Council with a clear opportunity to review its current structures and protocol arrangements. Elected members, senior officers and policy writers were consulted on the processes and structures in place to identify areas of good practice, areas of duplication and any areas which could be streamlined or where changes were required. In February 2007, a paper was presented to the Policy and Resources Committee regarding proposed changes to committee structures and political management

arrangements. The following changes were agreed in relation to committee structures (with effect from June 2007):

- The Education Committee and the Recreation and Environment Committee have been amalgamated into the Education, Recreation and Environment Committee.
- The Planning Referrals Sub-Committee has been dis-established and its functions subsumed within the remit of the Environment, Planning and Protective Services Committee
- A Finance Sub-Committee of the Policy and Resources Committee has been established comprising of the Convenor, Vice Convenor, 5 Chairman of the Standing Committees and the Chairman of the Monitoring and Audit Committee (non-voting member). This group will provide strategic guidance and decisions on key issues affecting the Council.
- The budget strategy group and Strategy Working Group have been dis-established
- The Staff Appeals Sub-Committee has been dis-established (due to the amended remit of Personnel Sub-Committee). The Personnel Sub-Committee was identified as giving too much detail to non-strategic issues. The review has led to a revised and more focussed agenda to ensure it takes a more strategic role and provides a strategic scrutiny of Council staffing numbers.

Members of the Council sit on seven main committees. A cycle of meetings involving each of the committees takes place five times a year. Once a cycle has been completed, a meeting of the full council is held. All 21 councillors take part and make final decisions on the recommendations made by the committees. The cycle of committee meetings, following the elections, commenced in June 2007.

Over the remaining four years of our appointment we will continue to monitor the Council's governance developments at committee and senior management level.

4.3.4 Elected Member Training

Orkney Islands Council recognised that the May 2007 elections would result in a significant turnover in the make up of elected members. In advance of the elections the Council began a work programme which would enable potentially returning councillors and potential new councillors to become equipped to effectively serve office.

The Council developed a service charter for members and a 'Reference Guide for Elected Members' which was described as an elected members' toolkit. This was given to all councillors when they took the oath of office and seeks to give them a first stop guide for handling the many issues and situations which a councillor may deal with.

Following the elections the Council has held a series of structured training sessions on a range of issues. The training commenced on 9th May and is scheduled to continue until at least October. As part of its training programme the Council held a mock Council meeting. Using a former vice-convenor to play the role of the Convenor the Council simulated an inaugural meeting of the Council. The Council sought to remove the embarrassment factor of members attending their first Council meeting using the meeting to outline issues such as standard Council protocol, how to use the microphones and the voting process for appointing members to enhanced roles within the Council. Elected

members informed officers that this was a very useful process, with returning elected members also stating that they had benefited from the session.

Specific training has also been provided for councillors in enhanced posts. The Council has undertaken training sessions for the members of the Monitoring and Audit Committee and members of the Licensing Board. Recognising that planning issues are an area in which all elected members will be contacted by their constituents the Council provided training on planning for every councillor.

Although the Council has undertaken an extensive training programme, officers recognised that it has not been exhaustive. To ensure that all elected members receive appropriate levels of training and feel that they have appropriate support the Council has given every member a 'Training Needs Analysis Return.' Every member is to complete this return stating any areas where they would like further training from the Council. This return has been used to identify further training sessions and to carry on the training programme beyond the October deadline.

4.3.5 Job Descriptions for Councillors

The Council has not formally set job descriptions for elected members. All prospective councillors who stood for election were sent a generic job description of a councillor's role. This needs to be developed into an approved job description and the Council must also establish job descriptions for the Convenor, Vice-Convenor and enhanced posts.

4.3.6 Elected Member Support

The Council has also used the recent elections and high turnover in elected members to bring in a number of changes to its protocol and arrangements to support elected members. Every elected member has been given their own Orkney.gov.uk email address and personal blackberries to enable them to access their emails at any time and in any location.

In addition to these simple changes the Council is also developing a web discussion forum for elected members and an Orkney Islands Information Portal. Only councillors can access the discussion forum meaning that councillors can discuss information in a secure and confidential location. The Information Portal is a web based system which aims to provide as much information and resource for elected members and Council employees as possible. The Information Portal is to be trialled on elected members but the Council hopes this will provide a councillor on an outlying island with as much support and access to resources as a councillor on the mainland who can go to the Council offices in person.

4.4 Audit Committee Principles

Audit Committees are increasingly viewed as a critical component in the overall corporate governance process. As part of our review of the Council's corporate governance arrangements we assessed the effectiveness of the audit committee arrangements in place within the Council. In doing this we considered the audit committee arrangements against publications which illustrate best practice. These included:

- Audit Committee Principles in Local Authorities in Scotland – a Guidance Note (CIPFA)
- Audit Committees – Practical Guidance for Local Authorities (CIPFA)
- The Smith Report

Overall we concluded that Orkney Islands Council's arrangements were largely able to deliver the audit committee principles set out in the CIPFA guidance and have had a positive impact on the Council's overall corporate governance framework. The local government elections have however resulted in changes to the membership of the body fulfilling the audit committee role at the Council.

The Monitoring and Audit Committee now comprises eight members (previously seven members) and includes two members who sat on the previous committee, one of whom is now the chair of the committee. The committee has responsibility for undertaking the functions of an audit committee in line with Audit Scotland recommendations and the guidance set out in Audit Committee Principles in Local Authorities in Scotland. The committee met for the first time on 19 June 2007.

As part of our annual review we issued a questionnaire to members of the Monitoring and Audit Committee (pre-election). The questionnaire was based upon best practice as set out in the above documents. Our intention was that the results from the questionnaire would complement our independent review of the audit committee arrangements. The findings are summarised in the table below:

Summary of findings from audit committee questionnaire		
	Satisfactory Arrangements	Paragraph Reference
Meetings	✓	Meetings
Training and Resources	✓✓	Training and Resources
Financial Reporting	✓	Financial Reporting
Internal Financial Controls and Risk Management Systems	✓✓	-
Internal Audit Process	✓✓	Internal Audit Process
External Audit Process	✓✓	-
Key:		
✓✓	Responses conclude adequate arrangements are in place	
✓	Responses conclude that adequate arrangements are in place however there is scope for improvement	

Meetings

The Smith Report was designed to assist company boards in making suitable arrangements for their audit committees and to assist directors serving on audit committees in carrying out their role. As part of the recently revised Combined Code on Corporate Governance it is directed at companies listed on the London Stock Exchange however its principles are widely regarded as best practice and are recognised throughout all sectors as the benchmark to which audit committees should aspire.

The Smith Report recommends that audit committees conduct an annual review of their work. Whilst this is not a mandatory requirement, we recommend that the Standards and Audit Committee consider conducting an annual review of their work.

Training and Resources

To be an effective audit committee, members should possess certain skills and have appropriate experience in some of the key areas to be considered by the committee. These include for example:

- Governance
- Risk Management
- Internal Control
- Accounting Issues

As highlighted in section 4.3.4 (elected member training), Orkney Islands Council has undertaken a comprehensive training programme which covered sessions such as governance and standards. Specific and compulsory training was also provided to elected members appointed to committees.

Financial Reporting

The Audit Committee should review the financial statements, for example, before they are approved, and again in conjunction with the external auditor's ISA 260 report to those charged with governance following the completion of the audit (Audit Committees Practical Guidance for Local Authorities, CIPFA 2005). We noted that in the past this approach has not been adopted by the Council. We recommend that arrangements are established to ensure the 2007/08 financial statements are presented to the Monitoring and Audit Committee alongside our annual report in future years.

Internal Audit Process

Guidance issued by CIPFA (Audit Committees Practical Guidance for Local Authorities) suggests that the audit committee may wish to judge the effectiveness of internal audit by receiving feedback on the work carried out. We noted during our review that the Monitoring and Audit Committee does not currently receive feedback on the performance of the Internal Audit department. Furthermore, we noted that the Monitoring and Audit Committee does not receive an annual report prior to the financial statements being approved.

We also noted that arrangements are not currently in place for the Monitoring and Audit Committee to meet with the external and internal auditors during the year without the presence of management. It is generally regarded as good practice for audit committees to meet with internal and external audit at least once during the annual cycle of meetings in the absence of other officials to discuss issues of a confidential or sensitive nature.

4.5 System of Internal Financial Control

Local authorities are required to include within their statement of accounts a statement on the system of internal financial control. This statement sets out the framework within which financial control is managed and reviewed and the main components of the system including the arrangements for

internal audit. Where the authority is in a group relationship with other entities and undertakes significant activities through the group these activities should be encompassed within the statement of internal financial control.

Orkney Islands Council has published a group statement of internal financial control with the 2006/07 statement of accounts. The statement provides an overview of the key elements of the Council and its group governance arrangements and systems of internal financial control.

The system is based on a framework of delegation and accountability governed by the Council's standing orders, financial regulations, schemes of administration and the Council's committee structure. This is supported by a series of administrative procedures which include the implementation of appropriate segregation of duties to limit the scope of fraudulent and irregular activity. The system also relies on the preparation and review of regular financial management information to ensure the financial activity of the Council is subject to an appropriate level of scrutiny and review at a senior management and elected member level.

The system of internal financial control is administered through a number of key financial systems with an internal audit section in place to provide management and elected members with assurance that these key controls are operating in an effective and efficient manner.

As part of our audit work we are required to review the information disclosed in the statement of internal financial control and assess whether the Council's opinion on the effectiveness of its internal financial controls is consistent with our understanding of the Council's internal financial control framework. To inform our understanding of the Council's system of internal financial control we carried out a review of a number of specific areas during our 2006/2007 audit. Our assessment of the Council's corporate governance arrangements included consideration of the authority's risk management system and its mechanism for the prevention and detection of fraud. We also carried out systems reviews of the following systems at Orkney Islands Council:

- Capital Contracts
- Council Tax
- Housing Benefit and Council Tax Benefit
- Housing Rents
- Nominal Ledger
- Pension Fund
- Sundry Income
- Treasury Management

Overall we found the systems of internal financial control reviewed to be of a good standard with controls operating at an adequate or effective level.

The Council's review of the effectiveness of the system of internal financial control procedures is informed by the views of the Chief Internal Auditor and the managers within the Group entity. The

results of this work allowed the Council to conclude that the system of internal financial control was largely effective.

Overall we concluded that the Council's statement of internal financial control is consistent with our knowledge and understanding of the financial control framework operating at the Council.

4.6 Codes of Conduct

Propriety requires that public business is conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance. In 2006/07, our work in this area included a review of the arrangements for adopting and reviewing standing orders, financial instructions and schemes of delegation and complying with national and local Codes of Conduct. We have also placed reliance on the work of internal audit in relation to registers of members and officers interests. Overall we concluded that controls at Orkney Islands Council are satisfactory in relation to standards of conduct. However we did identify one area for scope for improvement. While Orkney Islands Council maintains a register of members interests this is not available for inspection on an electronic basis. We therefore recommended as part of our interim management report that the Council publish its register on the Council's web site.

4.7 Fraud and Irregularity

The integrity of public funds is at all times a matter of concern. As external auditors we are required to consider the arrangements made by management for the prevention and detection of fraud and irregularities.

As part of our 2006/07 corporate governance review we reviewed the controls for the prevention and detection of fraud, irregularity and corruption. Our review concluded that controls at Orkney Islands Council were generally satisfactory to prevent and detect fraud and other irregularities. However we did identify a number of areas for improvement as follows:

Fixed Assets

- We noted that checks were not carried out on a regular basis to confirm that the assets recorded in the asset register physically exist.

Security Access

- We identified a number of issues surrounding security access during our review

Housing Benefit and Council Tax Benefit

- The Council's fraud referral and investigation policy and administrative penalty policy had not been updated to take account of Northern Constabulary wishing to withdraw from the existing arrangements.
- The Council's housing benefit and council tax benefit application forms do not currently refer to civil partnerships.

- We also noted there is only one member of staff trained as a fraud officer who is responsible for fraud investigations that contribute towards the intervention target.
- The changing of passwords on the Northgate system removes the automatic programming of reports that a user may have set on their user identification.
- Whilst a training programme is available to support staff involved in the investigation of housing and council tax benefit fraud no similar training has been provided to staff responsible for the investigation of fraudulent activity associated with other aspects of the Council's business.

An action plan was agreed with management as part of our interim management report to address the weaknesses identified.

4.8 National Fraud Initiative

In 2006/07 the Council again took part in the National Fraud Initiative (NFI) in Scotland. The exercise is undertaken as part of the audits of the participating bodies. NFI brings together data from councils, police and fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. For 2006/07 the exercise was extended to include information about tenants and councils were asked to submit further specified datasets where the risks merited their inclusion. The NFI has generated significant savings for Scottish public bodies (£27M to 2005) but, if fraud or overpayments are not identified in a body, assurances may be taken about internal arrangements for preventing and detecting fraud.

The NFI 2006/07 results (data matches) were made available to councils on 29 January 2007 via a new secure web-based application. Participating bodies follow up the matches, as appropriate, and record the outcomes of their investigations in the application. We have monitored the Council's involvement in NFI 2006/07 during the course of our audit.

During 2006/07 we have reviewed the procedures in place for receipt of the matches, methodologies and timetables set for completion of data match investigations. This has been reported in both our interim management report on Corporate Governance Arrangements and Financial Systems. Overall we have found that the approach taken by Orkney Islands Council to NFI has been satisfactory and reasonable given the size of the authority.

Our review of NFI also involved the completion of a checklist drawn up by Audit Scotland that encompassed all actions which required to be taken with respect to NFI during the year. Part of this work was to review a sample of matches and their resultant investigations to conclude on the appropriateness of the conclusions made. Our testing found no errors and we are satisfied that the investigations are being undertaken where appropriate and that correct conclusions are being made.

The Council has now reviewed the majority of all matches and has identified no significant savings or system errors from the work performed. Investigations are still continuing on a number of housing benefit matches and we will continue to monitor their progress. We have noted however, that there

has, as yet, been no formal reporting of progress on NFI to members. We recommend that this is done as NFI 2006/07 reaches an end.

4.8.1 Future Developments

During the year the Audit Commission, with whom Audit Scotland works in partnership with for the purposes of NFI in Scotland, has carried out data matching at a number of pilot sites in England and Wales to detect fraudulently claimed council tax single person discount (SPD). This has been a successful exercise and the matching process will be rolled out to all local authorities in Scotland during 2007/08.

4.9 Risk Management

An important feature of a robust system of internal control is a developed and integrated approach to risk management. Effective risk management will deliver an appropriate balance between risk and control, more effective decision making, better use of limited resources and greater innovation.

We carried out a review of the Council's risk management arrangements during our interim visit. The results of our work were reported in our interim management report on corporate governance. Overall we noted that limited progress had been made in implementing risk management arrangements at the Council. In particular we noted:

- The Council's approved risk management policy statement and associated strategy had not been reviewed since its approval in October 2004. Furthermore, formal monitoring arrangements documented in the Council's Risk Management Strategy are not being followed.
- The Risk Management Group had not met regularly since its inception. The Risk Management Group has overall responsibility for ensuring risk management is effective and demonstrably implemented through the Council.
- Since 2004, various working groups have been established to take risk management forward within the Council. At the time of our review however all these working groups had been suspended.
- The Council had yet to formally identify its strategic risks. Nor had it identified the operational risks that could impact on Council services and key projects.
- No formal training programme exists to support staff in the ongoing delivery of their risk management roles and responsibilities.

An action plan was agreed to address these issues and to assist in developing the risk management arrangements during 2007/08.

Since our review, the Council has appointed Zurich Municipal to assist in the development of risk management arrangements and a risk register. Zurich Municipal conducted risk management workshops with key strategic officers in August 2007. These workshops enabled the Council to identify the key issues and risks impacting on its work but also to identify the risks which are specific to a department and those which are of key strategic concern to the Council.

4.10 Internal Audit

During the course of our audit we carry out an assessment of the internal audit function to assess its effectiveness and ascertain whether specific areas of internal audit work can be relied upon to inform the external audit of the Council's financial statements.

Our review concluded that the Council maintains an effective internal audit function and that we were able to rely on the work of internal audit during 2006/07 in a number of areas. Areas with scope for improvement were identified and included within our interim management report on corporate governance. These included:

- Circulating Internal Audit's terms of reference across the Council
- Establishing an inventory of skills and experience within the internal audit department
- Informing the Monitoring and Audit Committee of the time taken between the issue of draft and final report to allow members to challenge officers and internal audit as to the reasons for significant delays in issuing reports.

An action plan was agreed with the Chief Internal Auditor to address the recommendations made.

4.11 Following the Public Pound

Councils fund arms-length and external organisations (ALEOs) for a range of purposes related to council services and their broader objectives. These arrangements are often more complex than standard purchase contracts for goods or services and are usually designed to deliver wider public benefits. They involve the transfer of public funds from the direct control of a council to the control of an ALEO. In practice these can range from relatively small grants to voluntary organisations and small community organisations, to payments to trusts set up by councils to manage all of their leisure facilities. A council may make a fixed payment to an ALEO, or the ALEO may have the power to commit council funds.

To ensure that public funds are used properly, to maintain accountability, and to ensure that value for money is secured, it must be possible to trace the funds from the point at which they leave the council to the point at which they are ultimately spent by the receiving organisation. In other words, it is important to be able to 'follow the public pound' across organisational boundaries.

4.11.1 Scope of our review

In 2003, Audit Scotland carried out a survey of all Scottish Councils to establish the nature and extent of their financial involvement with ALEOs and what monitoring and accountability arrangements had been established with these organisations. Based on Audit Scotland's research, the Accounts Commission issued their findings in March 2004. The Accounts Commission raised concerns about councils' funding of arms length bodies and subsequently requested that Audit Scotland carry out further work in this area as a matter of priority.

A comprehensive study was undertaken by Audit Scotland in 2005 to provide more information about funding ALEOs and how councils perform against the 'Code of Guidance on Funding External Bodies and Following the Public Pound' (the Code). Local reports were prepared for each council following this review. These reports included a local action plan agreed with the council.

In 2006/07 our review has focussed on the follow-up of recommendations made in the local action plan.

4.11.2 Follow Up Review

In December 2005 the Council's previous external auditor issued their report in relation to Orkney Islands Council's 'following the public pound' arrangements. The report raised several recommendations to improve the Council's 'following the public pound' framework, focussing on areas such as funding purpose, financial management arrangements, governance and representation.

The Council's Internal Audit team have taken the lead in following up on the original recommendations. The results of this work suggest that the Council has made progress in a number of areas, including the setting up a Council-wide approach, developing and implementing Service Level Agreements (SLAs) with ALEOs and the establishment of a comprehensive listing of all ALEOs with which the Council has an arrangement with.

Internal Audit has however also identified areas where the implementation of recommendations has not progressed to the same extent. The issue of ongoing monitoring of performance and regular measurement against the SLA has been highlighted as an area requiring particular management attention.

4.11.3 Companies Act 2006

It is important that all Orkney Islands Council representatives are aware of their legal duties and responsibilities when undertaking their roles in what are separate legal entities. All UK companies, whether charitable or non-charitable, are required to comply with UK company law. During the year the Companies Act 2006 replaced all existing company law provisions. The Companies Act 2006 has been brought in over a phased time period with most provisions coming into effect by October 2008. Some of the provisions have been introduced during 2006/07.

The new Act introduces a wide range of changes including new provisions for company directors. The Department for Business, Enterprise and Regulatory Reform has summarised the provisions in to guidance for company directors as set out in the table below.

Guidance for company directors:

- 1) Act in the company's best interests, taking everything you think relevant into account
- 2) Obey the company's constitution and decisions taken under it
- 3) Be honest, and remember that the company's property belongs to it and not to you or to its shareholders
- 4) Be diligent, careful and well informed about the company's affairs. If you have any special skills or experience, use them
- 5) Make sure the company keeps records of your decisions
- 6) Remember that you remain responsible for the work you give to others.
- 7) Avoid situations where your interests conflict with those of the company. When in doubt disclose potential conflicts quickly
- 8) Seek external advice where necessary, particularly if the company is in financial difficulty

The Companies Act also brought in new provisions covering:

- The need for an expanded business review in accounts
- New provisions on directors liabilities for statements
- New provisions for communicating with shareholders
- Revised share capital and capital maintenance rules
- Various changes to company secretarial rules.

We understand that neither Council members nor employees who are appointed to companies in which the local authority has an interest have received any training on the new Companies Act provisions. Given the level of Orkney Islands Council member involvement in group and other companies we would strongly recommend that such training is carried out so that the full implications and responsibilities of those appointed are understood.

5 Performance Management and Audit

5.1 Introduction

Local authorities have a statutory duty to make arrangements to secure Best Value, which is defined as continuous improvement in the performance of functions. In securing Best Value, local authorities are required to maintain a balance of quality and cost considerations and must have regard, among other things, to economy, efficiency and effectiveness and the need to meet equal opportunity requirements and contribute to the achievement of sustainable development. Local authorities also have a duty to undertake effective community planning.

5.2 Code of Audit Practice

Our responsibilities in relation to performance management and audit are detailed within the Code of Practice and within the Local Government (Scotland) Act 1973:

Performance Management and Audit	
Performance Management and Audit	<ul style="list-style-type: none">The Local Government (Scotland) Act 1973 places a duty on the auditors of local government bodies to be satisfied that proper arrangements have been made for securing Best Value and complying with responsibilities relating to community planning.
	<ul style="list-style-type: none">To review and report on the arrangements that the Council has made to prepare and publish performance information in accordance with directions issued by the Accounts Commission.

5.3 Overall Performance Management Arrangements

The Council reviewed a range of performance monitoring systems to identify the system most appropriate for the Council. Following this review Orkney Islands Council is currently undertaking work to roll out a balanced scorecard scheme across the Council. Under the balanced scorecard system each department would report to their service committee twice a year. The first round of reports will be made in January 2008 and the second report is to be presented in June 2008. The report in January is to outline the department's targets and objectives for the coming year, with the June report stating the department's performance for the previous year and the key issues arising.

As there is no overarching corporate scorecard the Council decided that each department could develop its own scorecard and measurement system. This was to enable departments which had existing scorecard arrangements in place to develop and adapt these rather than start afresh. As part of the development of its scorecard each department was also required to develop their own indicators and targets. Each department presented its draft scorecards, containing indicators and targets, to the Council's Corporate Management Team on 14 February 2007.

The Council is aware that departmental scorecards must be linked to departmental service plans. Not only will this ensure that no information is missed from the scorecard but will result in the key objectives and targets of the service plans being reflected in the assessed targets of the scorecards.

Departments have had difficulty in keeping scorecard indicators to a minimum. Although departments were encouraged to use existing indicators most have struggled to prioritise these and a greater number of indicators were proposed than the Council sought. In some cases the statutory indicators which departments must report against are greater than the number of indicators included within the scorecard. Departments have therefore had to prioritise indicators in order to finalise scorecards.

The Council has decided to use a traffic lights system within the scorecards to enable members to see the key issues and pressure points. Standard performance reports such as finance and budget monitoring reports will continue to be presented to Council on a regular quarterly basis.

5.4 Best Value

Orkney Islands Council is currently participating in an Audit Scotland audit of Best Value and Community Planning. This high profile report is a key document for the Council and will result in significant media focus on the Council. The audit will provide the Council with a clear opportunity to assess progress and developments made against the Best Value agenda. A team of specialist staff from Audit Scotland is currently carrying out the Best Value audit, together with a member of our Business Improvement Consultancy team. The on-site review will commence in October 2007.

5.5 Efficient Government

The Council submitted a joint bid with NHS Orkney to the Efficient Government Fund. This bid is to cover shared services, which include joint procurement, catering arrangements, staff training and improved co-ordination of non-emergency patient transport. The Minister and key Scottish Executive officers have indicated their Executive's approval of the bid.

In April 2007, Orkney Islands Council wrote to the Improvement Service about concerns about the proposed funding it would receive. The Improvement Service indicated that the pilot was viewed as a very clear example of good practice and the Executive believed that it could be used to highlight very good practice and used for other island authorities. The Executive however, did not wish to commit to funding beyond the current spending review period and therefore would be likely to merely offer funding for the first year of the bid in any initial confirmation.

On 28 June 2007 the Council received a letter from the Scottish Executive confirming funding of £580,000 for the financial year 2007/08. The letter did not confirm any funding beyond 2008 and therefore the Council has only received funding for year one of the scheme. The Council will need to decide how to fund year two of the bid if no further funding is provided centrally.

5.5.1 Taking the Work Forward

A full update of the progress and development on the EGF bid was presented to the Council's Policy and Resources Committee.

The Council recognised that the funding announced by the Executive on 28 June is for the full financial year and therefore the Council must begin to undertake work to deliver against the conditions of the funding award. To enable this work to begin emergency powers may be required to be invoked. This could either be through a special meeting of the P&R Committee or by through a select approval group which would include the Convenor, the Vice Convenor, the Chief Executive and other senior figures as would be deemed appropriate.

5.5.2 Sub-Areas of the Efficient Government Bid

The proposed merger of the HR function has been agreed in principle by the P&R Committee. There are still some areas to be finalised and agreed, such as insurance and governance arrangements but both the Council and the Health Board are committed to the merger.

The proposed Information Management & Technology efficiency move is an extension to the original proposal made in the Efficient Government Bid. Following a report by an external consultant the Council is proposing a full TUPE transfer of IM&T services from the Health Board to the Council. Following this transfer a Service Level Agreement (SLA) would be put in place between the Council and the Health Board for the delivery of IM&T services.

Three corporate services within Orkney Islands Council and NHS Orkney are currently managed by a single shared officer for each. These include communications, emergency planning and HR/personnel services. It is the intention that the Joint Working project will expand into a number of area including procurement, information, communications and technology services (ICT), corporate property management, property maintenance, and non-emergency patient and service user transport.

Funding for the merger of the HR/personnel services is being provided through the Efficient Government Fund (EGF). Officers within the Council have outlined a proposed design for the new function which must be consulted on as well as being vetted by both the Council and the Board. Officers have stated that the two areas which need to be addressed are governance protocols and financing arrangements. The Council therefore believes that it will be late 2007 before the single HR function is fully established.

In addition to these areas the Efficient Government funding will also be used to establish a joint purchasing function for the Council and NHS Orkney with a shared head of procurement. The funding will also provide an independent project manager to look at catering needs and current levels of provision to assess the options for a future joint provision of catering services. The funding is also proposed to develop joint posts in corporate property and also the role of a central transport co-ordinator to reduce duplication and increase capacity between the Council's Dial-a-Bus service and non-emergency patient services within the Health Board.

5.5.3 Public Sector Reform Agenda

The initial EGF bid submitted to the Scottish Executive has been expanded and developed by the Council. Whilst the funding received is only for the initiatives within the bid the Council is seeking to

develop a fuller Public Service Reform Agenda. Working closely with NHS Orkney the Council is developing a joint building project, joint futures work and is reviewing the potential for other joint projects. Within this move towards a joined up Orkney Islands public service, discussions have taken place regarding the possibility of a joint Finance function. Initial discussions are looking at the possibility of a joint finance and internal audit function.

5.6 Procuring and Managing Assets

The Council's procurement arrangements do not currently meet any of the key points of good practice identified within the McClelland report. This weakness is acknowledged by the Council and the Council's joint bid with NHS Orkney to the Efficient Government Fund includes the proposal to buy central supplies and services through a joint procurement arrangement. The bid also outlines the need to recruit a procurement manager. This will move forward an initiative that started some two years ago when the Council started to look at trying to centralise its supplies and services procurement function. This initiative was not progressed due to a lack of resources.

The Council does not currently have a clear and overarching asset management strategy, which links to asset plans for Council Services. In addition, the Council does not currently provide member training on asset management. The Council has recognised that a considerable amount of work still needs to be done to actively ensure that all assets are properly documented and asset management plans are produced.

5.6.1 Asset Registers

Asset registers are records of all fixed assets whose value is material or significant to the organisation. In 1993, CIPFA developed a new system of capital accounting designed to improve the quality of financial reporting and help authorities manage their assets efficiently and effectively. As part of the new system, authorities were required to compile an asset register and value all land and property with a material value. Orkney Islands Council maintains a record of their assets on two systems: a property maintenance database held by Technical Services and a fixed asset register maintained by the Finance Department.

The fixed asset register maintained by the Finance Department is used in the preparation of the annual financial statements. This register, which comprises of a series of spreadsheets, aims to provide a comprehensive record of all assets to be accounted for on the Council's balance sheet. Whilst the asset register is primarily used as an accounting tool, the Corporate Property Division (part of Technical Services) maintains a more detailed record of the Council's land and buildings containing such information as size, value, location and status of each property.

During the course of our audit we noted that the Council does not regularly reconcile the information held on these two databases. The absence of regular reconciliations could result in inconsistencies in the records held on each database and therefore the potential for misstatement in the financial statements. We understand the Technical Services department is working to implement regular

reconciliations between the two databases however no such reconciliation has been undertaken to date.

As highlighted in section 3.7.3 and 3.7.4, we identified a number of weaknesses in the Council's approach to accounting for fixed assets and common good assets in the financial statements. We would encourage the Council to take into account these weaknesses when reviewing their overall asset management arrangements and in particular consider whether the existing databases for maintaining asset records are the most effective and appropriate.

5.7 Community Planning

5.7.1 Orkney 2020: Orkney's Community Plan

The Council has taken the lead in the development of the Orkney 2020 document which outlines the community planning arrangements within Orkney Islands Council and whilst it is written by interagency staff officers no logo's of any agency are on the document so it is viewed as a community-wide document.

Orkney 2020 was launched on the 30th May 2007 and clearly outlines the Community Partnership's six key principles for delivering services within the Islands. The document also discusses the work being delivered in the eight priority themes. Actions from Orkney 2020 can be traced through to organisational objectives and are reflected within Council and Health Board plans.

Public Consultation

Within each of the eight priority themes the Orkney 2020 document outlines issues raised by local people. To enable this information to be identified an extensive public consultation was undertaken by Voluntary Action Orkney. As a result of the commitment to this work Voluntary Action Orkney is now a member of the Community Partnership Steering Group.

The overarching targets for the Council's Community Planning objectives are included within the Chief Executive's departmental reports. Objectives relating to the delivery of Community Planning initiatives are included within the relevant service department plans.

The Council is aware that the existing community planning arrangements can be improved and refined. For example, the Community Planning Partnership is reviewing its existing monitoring arrangements as it is felt that the current arrangements do not provide sufficient scope for effective performance measurement.

5.7.2 Linking the Council and Community Planning Arrangements

The Council's Policy Unit is seen as the formal link between the Council and the Community Planning Partnership (CPP) and therefore must ensure that Community Planning objectives are within Council plans. Under the current structure the Head of the Policy Unit is the designated lead officer responsible for ensuring that all relevant Council issues are raised at the CPP Steering Group. There

is no formal information or communication link established and unless the Council is specifically raising issues to the CPP any other business highlighted is at the professional judgement of the post holder. Neither is there a formal method of reporting CPP issues to the Council with the Head of the Policy Unit expected to keep the Council informed on any key issues or matters arising by using their professional judgement on what should be reported.

Both the Council and CPP recognise that this is not an ideal situation and there is a risk of a loss of information or key issues not being effectively communicated. The Council and CPP must review the current situation and ensure that appropriate reporting arrangements and formal communication links are established.

5.8 Statutory Performance Indicators

The Local Government Act 1992 sets out the requirement for councils to prepare and publish performance indicators. In meeting this duty, Orkney Islands Council must ensure that it:

- establishes systems and procedures to ensure that the required information is gathered;
- undertakes checks to ensure that, as far as practicable, the information gathered for publication is accurate and complete;
- arranges to keep all working papers and any other sources which may be examined by appointed auditors, and is able to make these available on request; and
- maintains a publicly available record of the reported information.

As external auditors we have a statutory duty to ensure that the Council has made such arrangements for collecting, recording and publishing performance data as required to ensure as far as practicable that published information is accurate and complete.

Our audit of the performance indicators found that services were well organised and produced excellent working papers within the requested timescales. The table below summarises the results of our audit on the SPI's for 2006/07.

2006/07 Orkney Islands Council Statutory Performance Indicators				
	Number of SPI's assessed	Rating of assessed SPI's		
		Reliable	Unreliable	Failed to Report
Adult Social Work	8	8	0 (0)	0 (0)
Benefits Administration	3	3	0 (0)	0 (0)
Corporate Management	8	6	1 (1)	1 (0)
Cultural and Community Services	6	5	1 (0)	0 (0)
Development Services	3	3	0 (0)	0 (0)
Education and Children's Services	8	8	0 (0)	0 (0)
Housing	6	6	0 (0)	0 (0)
Protective Services	5	5	0 (0)	0 (0)
Roads and Lighting	5	5	0 (0)	0 (0)
Waste Management	5	5	0 (0)	0 (0)
Orkney Islands Council	57	54	2 (1)	1 (0)
(j) 2005/06 figures				

5.8.1 Unreliable Indicator – Sickness Absence

The indicator is intended to show a measure of sickness absence in local authorities by comparing the number of days lost to sickness during the year with the total number of days that all council staff were available to work. While we found that sickness absence recording was accurate within the Council, we have found that for the purposes of SPI reporting they are unreliable.

The initial information provided to us was based on full-time equivalent numbers of staff and not on a headcount basis as requested by Audit Scotland. Manual adjustments then had to be made to figures to take account of part time staff who are contracted to work on average less than five days a week. Further manual adjustments were required to the figures reported for homecare workers to take account of their working patterns when on sick leave. Testing of the information provided has not given us assurance that the indicator is reliable as it was extremely difficult to agree the total staff days and sick days to supporting documentation due to the manner in which the figures had been recorded. We have spent a considerable amount of time on the audit of this indicator and would urge the Council to put in place our recommendations as noted in the action plan to reduce the time spent in 2007/08 and to ensure the reliability of the indicator.

5.8.2 Unreliable Indicator – Museum Services

The indicator is intended to report the usage - through visits or enquiries - of local museums that are managed or supported by councils per 1,000 population. Part of the measurement of visits is calculated by measuring usage of the website for the attraction. Audit Scotland guidance requires that measurement of usage of the website is differentiated between general enquiries and more specific enquiries regarding the collections housed in the museums. The Council-run museums that are being counted for the purposes of this indicator are unable to make this differentiation and as a result we have classed this indicator as unreliable. We recommend that appropriate steps are put in place during the year so that this information can be recorded accurately in 2007/08.

5.8.3 Failed to Report Indicator – Asset Management

This indicator is being reported for the first time in 2006/07. The purpose of the indicator is to report on the operational accommodation that is in use by an authority and the proportion of it that is in a satisfactory condition and also that is suitable for use and the delivery of services. The assessment of the satisfactory condition of operational accommodation was undertaken by the Council using a variety of methods and the information we received was assessed as reliable. However, the Council have made no formal assessment of the accommodation that is suitable for use and for this reason we have classed the indicator as a 'Failed to Report'. We recommend that appropriate steps are put in place during the year to allow the Council to report on an actual assessment of accommodation that is suitable for use.

5.8.4 Notable performance changes

Orkney Islands Council commitment to recycling more waste has become evident during our audit of the waste management performance indicators. During 2006/07 there has been a marked reduction in the tonnes of municipal waste that are being land-filled, with a corresponding increase in the tonnes of municipal waste that are being composted or recycled. We hope to see this commitment continue with the levels of land filled waste being reduced in line with the EC Landfill Directive targets for 2020.

5.9 Inspection Reports

During the year Orkney Islands Council has been subjected to a number of external inspections. These included two reviews by the Social Work Inspection Agency (SWIA), an inspection by HM Inspectorate of Education (HMIE) and a Communities Scotland inspection report. On the whole, the inspection reports indicate positive action by the Authority, although all do indicate areas for improvement. The reports reflect concerted effort and investment by the Council and reflect its desire to make continuous improvement and effective use of external advice and guidance. The Communities Scotland report does however highlight a concern for the Authority and it is important that the Council responds to its findings and seeks to take action on the areas highlighted.

5.9.1 SWIA Inspectorate Reports

SWIA conducted two reviews of Orkney Islands Council, a performance inspection and a review of the criminal justice social work services. The performance inspection identified a committed and motivated social work workforce that was effectively supported by management and demonstrated good leadership. Service users were found to be generally happy with the services provided and that effective assessment and case management was taking place. The report did however identify that some improvements could be made through closer working with the local Health Board and voluntary groups.

The review of criminal justice social work services identified a robustly managed service that was continuing to monitor and seek ways of improving its performance. SWIA stated that the Council's performance in complying with the National Standards was "impressive." The review did find areas for further improvement, such as the range of the community service scheme, but the review does expect that the Council will seek to address these.

5.9.2 Inspection of Education (INEA)

The INEA review was follow up to the inspection report in March 2005. The review found that the Council had made "significant progress" since the original inspection. HMIE stated that the "very good progress" made by the Council against the action points raised in the March 2005 inspection means that no further follow up visits will be required.

5.9.3 Communities Scotland Inspection Report

Communities Scotland undertook an external assessment of the effectiveness of the Council's housing service delivery. The report found the Council's homelessness services and property maintenance to be poor. Although the review found strengths in both areas it also found major areas where improvements must be made. These include the length of time homeless people are in temporary accommodation and Council performance in completing repairs. The Council's housing management service was assessed as being fair but in addition to areas where improvement could be made the review found a small number of areas which had significant weaknesses. These included the Council's approach to allocating houses and planning and managing the performance of its housing management service. It is important that the Council seeks to address these issues and turnaround performance in these areas.

6 Action Plan

Our annual report action plan details the key weaknesses and opportunities for improvement that we have identified during 2006/07. To assist the Council in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised as follows:

- Priority 1 High risk, material observations requiring immediate action.
- Priority 2 Medium risk, significant observations requiring reasonably urgent action.
- Priority 3 Low risk, minor observations which require action to improve the efficiency, effectiveness or economy of operations or which otherwise require to be brought to the attention of senior management.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
3.4.6	The Council should ensure arrangements are in place to ensure Orkney College report on their financial position to Committee on the same frequency as Services of the Council Priority 2	Director of Education and Recreation Services/ Director Finance & Housing	Part of ongoing governance review with College	April 2008
3.4.7	We recommend that the planning timescale for the Council's capital programme is brought into line with the 5 year Medium Term Strategy Priority 2	Director of Finance & Housing	Part of review of overall strategy and resources	June 2008
3.7	We recommend that the Council review the classification of Pickaquoy Leisure Trust in 2007/08 to ensure it is appropriately accounted for in the group financial statements. Priority 1	Director of Finance & Housing	Will be reviewed as part of the work on SLA and governance arrangements	December 2007

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
3.7	We would encourage the Council to request that its subsidiaries prepare full financial statements and do not take advantage of any exemptions or reduced disclosure opportunities. Priority 2	Director of Finance & Housing	Will be included in notification to group entities	December 2007
3.8.1	We recommend that the Council carry out an annual review on the value of their fixed asset investments. Priority 2	Director of Technical Services/ Director of Finance & Housing/	Will be factored into workload for additional staffing resource	June 2008
3.8.2	We recommend that the Council review those assets classified as investment properties and ensure they comply with the SORP definition of a non-operational investment property and are correctly classified in the balance sheet. Priority 2	Director of Finance & Housing	Will be built into final accounts programme of work	June 2008

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
3.8.3	<p>The Council should revisit its approach to accounting for subsequent expenditure on fixed assets to ensure compliance with generally accepted accounting principles.</p> <p>A formal decision should be recorded of any decision taken.</p> <p>Priority 1</p>	Director of Finance & Housing	This will be viewed as a priority involving the CMT	March 2008
3.8.3	<p>We recommend that the Council consider implementing component accounting for future capital projects.</p> <p>Priority 2</p>	Director of Finance & Housing	Will be reviewed as part of the Capital Appraisal process	June 2008
3.8.3	<p>We would encourage the Council to perform annual impairment reviews on assets where the estimated remaining useful life of the asset exceeds 50 years to ensure compliance with the Statement of Recommended Practice.</p> <p>Priority 2</p>	Director of Finance & Housing/ Director of Technical Services/	Will be factored into workload for additional staffing resource	June 08

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
3.8.3	<p>The valuation of assets provided by Estates does not currently separate out the valuation of land and building. We recommend that separate valuations are provided to ensure depreciation is not charged on the land element of the asset.</p> <p>Priority 2</p>	<p>Director of Finance & Housing/ Director of Technical Services/</p>	<p>Will be factored into workload for additional staffing resource</p>	<p>June 08</p>
3.8.4	<p>We recommend that the Council make arrangements for locating title deeds and updating records with regard to Common Good and Trust Fund assets.</p> <p>Priority 1</p>	<p>Head of Legal Services</p>	<p>Priority commitment given to completing this work</p>	<p>March 08</p>
3.8.4	<p>The Council should ensure that the fixed assets of the Common Good are accounted for in accordance with relevant accounting standards. This will require assets to be valued using an appropriate basis and depreciation being charged to the revenue account over the useful economic lives of all relevant assets.</p> <p>Priority 2</p>	<p>Director of Finance & Housing/ Director of Technical Services/</p>	<p>Work has Commenced on this matter</p>	<p>June 2008</p>

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
4.3.5	Appropriate arrangements should be established to ensure the Council develops specific job descriptions for Councillors, the Convenor, Vice Convenor and enhanced posts. Priority 2	Assistant Chief Executive	Work has Commenced on this matter	March 2008
4.4	We recommend that the Standards and Audit Committee consider conducting an annual review of their work. Priority 3	Assistant Chief Executive	This will be included in the wider review of the role of the committee	March 2008
4.4	We recommend that arrangements are established to ensure the 2007/08 financial statements and annual audit report are presented to the Monitoring and Audit Committee for approval. Priority 1	Assistant Chief Executive/ Director of Finance & Housing	Arrangements will be made to accommodate this recommendation	March 2008
4.4	We recommend that Internal Audit prepare an annual report to be presented to the Monitoring and Audit Committee prior to approval of the financial statements. This should include any feedback internal audit has received from Services. Priority 2	Chief Internal Auditor	The annual report which is prepared at present will be presented to the Committee at an earlier date	June 2008

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
4.4	Arrangements should be established for the Standards and Audit Committee to meet with external and internal auditors during the year without the presence of management. Priority 3	Assistant Chief Executive	This will be included in the review of the role of the Committee	March 2008
4.8	Formal reporting arrangements should be established to report progress on NFI to members. Priority 2	Director of Finance & Housing	This will be progressed within the next few months	March 2008
4.11.2	The Council should ensure where it is involved in ALEOs that there are formal arrangements in place for the ongoing monitoring of performance and regular measurement against the SLA. Priority 2	Assistant Chief Executive/ Corporate Management Team	This is an issue which the CMT will address	June 2008
4.11.2	We recommend that arrangements are put in place to ensure recommendations made by Internal Audit with regard to 'following the public pound' are implemented. Priority 2	Assistant Chief Executive/ Corporate Management Team	This is an issue which the CMT will address	June 2008

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
4.11.3	<p>We understand that neither Council members nor employees who are appointed to companies in which the local authority has an interest have received any training on the new Companies Act provisions. We would strongly recommend that such training is carried out so that the full implications and responsibilities of those appointed are understood.</p> <p>Priority 2</p>	<p>Assistant Chief Executive/ Director of Finance & Housing</p>	<p>Plans are being made for this to be progressed within the seminar programme arrangements</p>	<p>December 2007</p>
5.6.1	<p>We recommend that regular reconciliations are performed between the property maintenance database and fixed asset register.</p> <p>Priority 2</p>	<p>Director of Technical Services/ Director of Finance & Housing</p>	<p>Some initial work has started on this matter</p>	<p>June 2008</p>
5.6.1	<p>The Council should consider whether the existing databases for maintaining asset records are the most effective and appropriate.</p> <p>Priority 1</p>	<p>Director of Finance & Housing</p>	<p>Assessment completed. Logotech system ordered for early delivery</p>	<p>Complete</p>

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
5.6.1	The Council should ensure those weaknesses identified in accounting for fixed assets and common good assets are taken into account when reviewing their overall asset management arrangements. Priority 1	Director of Technical Services/ Director of Finance & Housing	Will be factored into work programme for new staffing resource	June 2008
5.7.2	The Council must ensure that appropriate reporting arrangements and formal communication links are established between the Council and the CPP. Priority 3	Assistant Chief Executive	Work already underway	June 2008
5.8	The Council should ensure the appropriate processes are in place to prevent indicators being marked as unreliable or failed to report in future years. Priority 2	Assistant Chief Executive/ Corporate Management Team	Will be considered as part of corporate improvement actions	June 2008
5.9.3	The Council must seek to respond to the Communities Scotland review of its housing service delivery. The report identifies areas of weakness and where improvements can be made. Priority 2	Director of Finance & Housing	Action plan submitted and approved by CS subject to particular attention being given to service planning.	Complete



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