

Orkney Islands Council

Annual report on the 2011/12 audit



Prepared for Orkney Islands Council and the Controller of Audit
October 2012

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Contents

Key messages	4
2011/12 audit findings	4
Outlook.....	5
Introduction	6
Financial statements	7
Audit opinion	7
Accounting issues	8
Financial position	12
Financial results	12
Capital investment and performance 2011/12	13
Treasury management	14
Financial planning to support priority setting and cost reductions	14
Outlook.....	16
Governance and accountability	17
Corporate governance.....	17
Prevention and detection of fraud and irregularities.....	18
Standards of conduct and arrangements for the prevention/ detection of bribery and corruption	19
Outlook.....	20
Best Value, use of resources and performance	21
Management arrangements	21
Overview of performance in 2011/12.....	22
Local performance reporting.....	24
National performance reports	25
Progress against audit risks identified in the SRA	25
Outlook.....	26
Appendix A: audit reports	27
Appendix B: action plan	28

Key messages

2011/12 audit findings

In 2011/12 we audited the financial statements and looked at aspects of governance and performance within Orkney Islands Council (the council). This report sets out our main findings.

We have given an unqualified opinion on the financial statements of Orkney Islands Council and its group for 2011/12. The accounts were certified by the target date of 30 September. They are now available for publication and are an essential means by which the council accounts for its stewardship of public money.

No material weaknesses in the accounting and internal control systems were identified during the audit.

In 2011/12, the council spent £140 million on the provision of public services, with £100 million on revenue services and £40 million on its capital programme. Overall, actual net expenditure was £0.082 million less than budgeted.

The general fund balance recorded a net increase for 2011/12 of £0.239 million, resulting in a balance of £22.808 million as at 31 March 2012. This balance includes earmarked commitments of £14.181 million and an unallocated general fund balance of £8.627 million. Uncommitted general fund reserves remain broadly in line with the council's target balance of £8 million.

Overall the council's governance arrangements in 2011/12 were sound and operated effectively. However, the council has not adopted best practice by including an Annual Governance Statement in its financial statements. This is a wider ranging statement than the Statement on the System of Internal Financial Control, reviewing the effectiveness of governance arrangements.

The council has implemented a senior management restructure to reduce the number of chief officers and restructure services under four Executive Directors. This includes Orkney Health and Care, which provides community health and social care services jointly with NHS Orkney. The new structure includes some additional posts at middle management level to retain management capacity. The chief financial officer (s95 officer) post is now at Head of Service level rather than Director level. The council will need to ensure that the status of the s95 officer is not impaired by the change in structure.

The council is progressing with a significant capital investment programme in relation to housing, harbour improvements and the schools investment programme. There has been some slippage in the programme leading to £18.852 million of works being re-programmed into future years. The council remains committed to invest over £58 million in its schools programme by 2014.

Outlook

Looking ahead, it is clear that the outlook for public spending for the period 2012/13 to 2014/15 remains very challenging. The high level figures for Scotland that were announced in the UK Comprehensive Spending Review indicate that significant budget reductions will be required in these years. Whilst the council is in a relatively strong financial position to deal with the challenges, the council must remain vigilant in its financial management to ensure it delivers planned savings and sustainable services.

Introduction

1. This report is the summary of our findings arising from the 2011/12 audit of Orkney Islands Council. The nature and scope of the audit were outlined in the Audit Plan presented to the Audit Committee on 15 March 2012, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011. The purpose of the annual audit report is to summarise the auditor's opinions (i.e. on the financial statements) and conclusions, and to report any significant issues arising. The report is divided into sections which reflect the public sector audit model.
2. A number of reports have been issued in the course of the year in which we make recommendations for improvements (Appendix A). We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of the council.
3. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that the council understands its risks and has arrangements in place to manage these risks. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.
4. This report is addressed to members and the Controller of Audit and should form a key part of discussions with audit committees, either prior to, or as soon as possible after, the formal completion of the audit of the financial statements. Reports should be available to the Scottish Parliament, other stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.
5. This report will be published on our website after consideration by the council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.
6. The management of the council is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. The auditor is responsible for auditing and expressing an opinion on the financial statements. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.
7. The co-operation and assistance given to us by council members, officers and staff is gratefully acknowledged.

Financial statements

8. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
9. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
 - the regularity of the expenditure and income (except for local government bodies).
10. Auditors review and report on, as appropriate, other information published with the financial statements, including the foreword by Head of Finance, statement on internal financial control and the remuneration report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit on the financial statements.

Audit opinion

11. We have given an unqualified opinion that the financial statements of Orkney Islands Council for 2011/12 give a true and fair view of the state of the affairs of the council and its group as at 31 March 2012 and of the income and expenditure for the year.

Legality

12. Through our planned audit work we consider the legality of the council's financial transactions. In addition the Head of Finance has confirmed that, to the best of his knowledge and belief, and having made appropriate enquiries of the council's management team, the financial transactions of the council were in accordance with relevant legislation and regulations. There are no legality issues arising from our audit which require to be brought to members' attention.

Statement on the system of internal financial control

13. We are satisfied with the disclosures made in the statement on the system of internal financial control and the adequacy of the process put in place by the council to obtain the necessary assurances. However, it is considered good practice to include an Annual Governance Statement in the financial statements, which covers wider corporate governance areas than the statement on the system of internal financial control.

Action Plan no. 1

Remuneration report

14. The Local Authority Accounts (Scotland) Act 1985 and Scottish Government finance circular 8/2011 introduced the requirement for a remuneration report to be included in the financial statements from 2010/11.
15. The Local Authority Accounts (Scotland) Amendment Regulations 2011 define a senior employee as someone who has the power to direct or control the major activities of the authority, holds a post that is politically restricted or whose annual remuneration is £150,000 or more.
16. In addition to disclosures on the chief executive and directors of the council, the 2010/11 remuneration report included disclosures relating to the Assistant Director (Legal and Admin). However, the 2011/12 remuneration report does not include the former Assistant Director (Legal and Admin) on the basis that:
 - the post does not have responsibility for management of the local authority and does not direct or control the major activities of the council;
 - the annual remuneration of the post holder was less than £150,000;
 - the post was not included within the defined list of statutory chief officers;
 - the post does not meet the test of non statutory chief officer under section 2(7). This post did not report directly nor was directly accountable to the Chief Executive, or the local authority itself, or to any committee or sub-committee, as respects all or most of the duties of this post.
17. The position of Assistant Director (Legal and Admin) included delegated authority as Solicitor to the Council within the council's Scheme of Delegation. In our opinion the extent of this authority, and the fact that in their monitoring officer role they reported direct to the Chief Executive, is such that it is good practice to include the post within remuneration report disclosures.

Accounting issues

18. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 (the 2011/12 Code). We are satisfied that the council prepared the 2011/12 financial statements in accordance with the 2011/12 Code.

Accounts submission

19. The council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. The accounts were certified by the target date of 30 September 2012 and have now been presented to the Monitoring and Audit Committee, and are ready for presentation to full council and publication on the council's website.

Presentational and monetary adjustments to the unaudited accounts

20. During the course of the audit a number of presentation and monetary errors were identified and appropriate adjustments made to the accounts initially submitted for audit. The most material adjustment was the correction of an error of £0.755 million in relation to accounting for heritage assets.
21. One minor error in depreciation was identified during the audit, where if adjustment was made this would have a net effect of increasing by £2,000 expenditure for the year shown in the comprehensive income and expenditure account. The net impact on the balance sheet would be that net assets would decrease by £2,000. This error was immaterial to the accounts as a whole. Officers in finance did not adjust the accounts for this error and we concurred on this.

Prior year adjustments

22. The 2011/12 Code requires authorities for the first time to separately account for heritage assets in accordance with Financial Reporting Standard 30. Heritage assets include historical buildings, archaeological sites, scientific equipment of historical importance, civic regalia, museum and gallery collections and works of art. In recognition of the difficulty in obtaining valuations for this class of assets, the Code permits value to be measured in any way which is appropriate and relevant. In accordance with this Code requirement, the council recognised assets to the value of £0.755 million based on their valuation.

This is a change in accounting policy and therefore required the prior year figures to be restated. The effect of the inclusion of heritage assets on the council's balance sheet was to increase net assets by £0.755 million.

Pension costs

23. Orkney Islands Council acts as the administering authority for the Orkney Islands Council Pension Fund, which is a Local Government Pension Scheme and is a statutory scheme established by the Superannuation Act 1972. In accordance with pensions accounting standard IAS19 'Retirement Benefits' the council has recognised its share of the net liabilities for the pension fund in the balance sheet.
24. The valuation at 31 March 2012 provided by the scheme's actuaries increased the council's share of the deficit from £15.669 million last year to £24.033 million this year. The £8.364 million increase is due to changes in actuarial assumptions such as salary increases, mortality levels and rates of inflation. Actuarial assumptions in general were lower this year with the result that scheme liabilities increased.

Merchant Navy Officers and Ratings Pension Fund

25. In April 2008 the council's participation in the Merchant Navy Officers Pension Fund (MNOFF) ended when the final council employee, who was a participant in the scheme retired. Under the scheme regulations the council is liable for the cost of exiting the scheme when it was under a deficit position, which is known as Section 75 debt. The actuarial valuation of the

Section 75 debt was £2.802m. The trustees of the MNOFF are currently involved in court cases to determine which existing and former employers involved in the scheme are liable to meet deficits accruing. Until these cases are determined the exact quantification of the council's liability cannot be determined and no claim has so far therefore been made for payment. The amount therefore remains as a provision in the 2011/12 accounts.

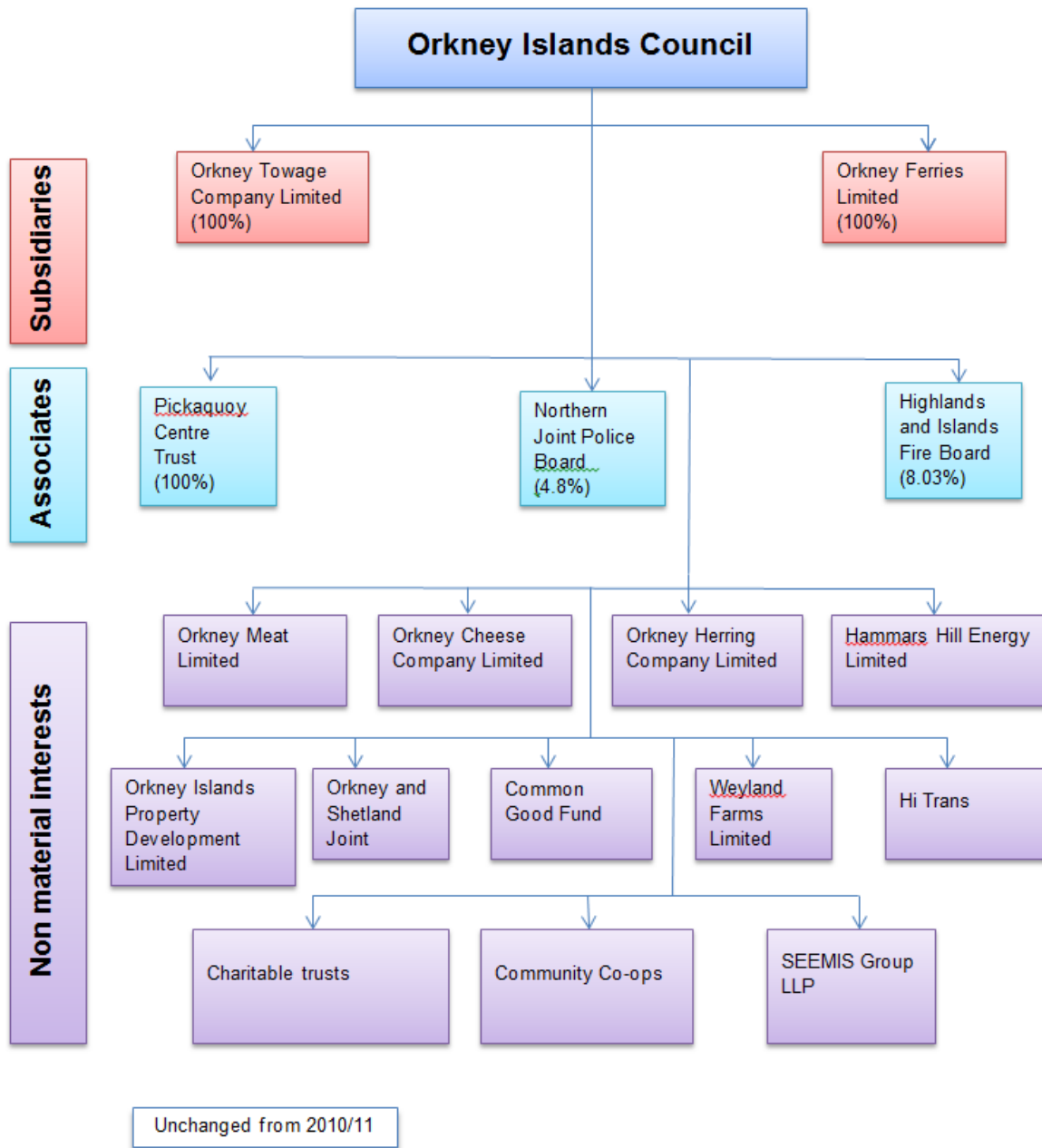
Group accounts

26. The diversity of service delivery vehicles means that consolidated group financial statements are required to give a true and fair view of the activities of the council. To enable the preparation of group financial statements, councils are required to consider their interests in all entities, including subsidiary companies, joint ventures and statutory bodies, such as police, fire and valuation boards. The bodies falling within Orkney Islands Council's group boundary for 2011/12 are shown in Exhibit 1.
27. Orkney Islands Council has consolidated its interest in two subsidiaries and three associates into its group accounts:
 - all bodies within the group received an unqualified audit opinion from their external auditors.
 - in accordance with recommended accounting practice, key policies for component bodies such as pension costs and the valuation of fixed assets have been aligned with the council.

Whole of Government Accounts

28. The whole of government accounts (WGA) are the consolidated financial statements for all branches of government in the UK. The council submitted the consolidation pack to the Scottish Government by the deadline of the 31 July. This enabled the audited return to be completed by the audit deadline of 5 October.

Exhibit 1: Orkney Islands Council Group Structure



Financial position

29. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
30. Auditors consider whether audited bodies have established adequate arrangements and examine:
 - financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
31. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

32. The council's net cost of services in 2011/12 was £74.961 million. This was met by central government and local taxation and non specific grant income of £107.243 million, giving a surplus on provision of services of £37.513 million. Other elements of income and expenditure during the year included a £16.786 million net surplus on revaluation of assets, (mainly on council dwellings,) £6.597 million of investment income, mainly from the Harbour Authority's strategic reserve fund, and £10.299 million actuarial losses on pensions. This results in a £44.000 million total surplus for the year.

Financial position

33. The General Fund budget for 2011/12 was based on Band D council tax of £1,037 and a contribution of £4.760 million from the reserves. Overall, actual net expenditure was £0.082 million less than budgeted. This represented an excess in expenditure of £0.119 million offset by an excess in collections of non domestic rates and council tax of £0.201 million.
34. While the results in the General Fund reflects well on the overall financial management of the council, the authority needs to pay particular attention to those areas such as housing and transportation which provide pressure points for the budget: In non-General Fund services, the Housing Revenue Account had net expenditure of £0.560 million against its budgeted break even position due to differences between estimated finance and capital charges and the actual impact of the revaluation of non-current assets. The Scapa Flow oil port had a £0.891 million overspend against budgeted net expenditure of £0.560 million, as a result of lower than forecast income levels.
35. The council's useable reserves have reduced by £10.233 million in 2011/12. The movement in council reserves resulted in a balance of £8.627 million of non earmarked general fund

reserves; this is in line with previous years and the medium term financial strategy. The medium term strategy is to use 50% of the interest earned on the harbour authority reserves to support the general fund expenditure. Harbour operations generated a net loss of £2.287 million and net investment income of £6.597 million. After transfers to other reserves this led to a net reduction in the Harbour Authority reserve of £0.789 million.

Exhibit 2: Reserves

Description	31 March 2012	31 March 2011
	£ million	£ million
General Fund	8.627	8.544
General Fund (earmarked)	14.181	14.025
Total General Fund	22.808	22.569
Housing Revenue Account	0	0.560
Capital Receipts	0.407	1.530
Capital Fund	0.508	3.508
Repairs and Renewals	3.691	8.691
Harbours	188.224	189.013
Total Usable Reserves	215.638	225.871

Source: Orkney Islands Council 2011/12 financial statements

Capital investment and performance 2011/12

36. The council is progressing with a significant capital investment programme in relation to housing, harbour improvements and the Schools investment programme.
37. There has been some slippage in the programme leading to £18.852 million of works being re-programmed into future years. The council remains committed to invest over £58 million in its schools programme by 2014. Projects committed to at the year end amounted to £48.119 million.
38. At 31 March the council was carrying debt of £40 million as part of its capital financing requirement. Capital expenditure in 2011/12 was £39.748 million of which £29.236 million related to assets under construction. This was financed by £28.081 million of grants and contributions plus other receipts and reserve transfers. Where the council commits to expenditure to be financed from future revenue this results in a capital finance requirement. This requirement fell in 20011/12 by £8.941 million.

Treasury management

39. The value of the council's short term investments had fallen from £173.707 million to £149.613 million during the year. This was partly due to the liquidation of £29.5 million to be managed in-house. The performance of the strategic reserve fund continued to be below expectations as the volatility in the markets continues. The investment sub committee is currently reviewing the current mandates for the Strategic Reserve Fund managed funds, in consultation with professional advisors.
40. Long term borrowing remains at the same £40 million level as 2010/11. There has been no restructuring of loans in the year.

Financial planning to support priority setting and cost reductions

41. In setting its revenue budget for 2011/12 the authority identified the need for savings of £4 million in each of the next three years. It was agreed, following consultation with staff and the general public through its Tough Times - Tough Choices engagement exercise, that where possible steps should be taken to preserve resource allocations in:
 - Care for older and vulnerable people
 - Education
 - Transport.

Workforce reduction

42. In order to achieve the levels of savings identified it was estimated that a reduction in staffing would be required of 81.5 full time equivalents. Of this 47.3 posts were either temporary or vacant. During 2011/12 there were 50 exit packages agreed at a total cost of £1.406 million. This was across all sectors and included an exercise to reduce the senior management by 25%.
43. In August 2011, the Policy and Resources Committee considered a report on proposed management restructuring within the council. The restructure was intended to streamline the management of the council by reducing the number of chief officers from 34 to 18 full time equivalents, and deliver annual savings of up to £1.159 million. These savings would be offset by the estimated costs of £0.575 million to accommodate up to 8 of the disestablished posts within the existing staff structure below chief officer level. The exit costs associated with the restructure were not quantified in the report, as these would be dependent on which individuals were appointed in the new structure. Nor was a range of possible outcomes included for members' information. The report was subsequently considered and approved by the council, and the Chief Executive was delegated authority to take the proposals forward.
44. A competitive recruitment process for posts in the new structure commenced in September 2011. The two stage process involved internal recruitment, followed by external recruitment where posts had not been filled by internal candidates. Recruitment of Executive Directors was undertaken prior to the recruitment of Heads of Service. Chief officers who were unsuccessful in securing a post in the new structure were redeployed, retired or made

redundant in line with the council's existing policies on redundancy or retirement. Statutory minimum redundancy payments were made in line with years of service. No added years' pensionable service was awarded, although payment in lieu of notice was made, for varying periods of time up to five months.

45. The costs associated with any restructuring mean there will be a payback period before savings start to accrue. As noted earlier, the overall costs will be dependent on a number of factors, including the exit costs associated with those leaving the organisation. Officers intend to report back to the council on the full cost of the exercise following finalisation of the remaining issues.

Partnership working

46. One of the main council partnerships is Orkney Health and Care, which is a health and social care partnership between the council and NHS Orkney. It operates under the leadership of the Chief Executive of NHS Orkney, who is also the council's Executive Director of Orkney Health and Care. Heads of Service have been appointed and recruitment is underway for other posts to create integrated service delivery teams. These integrated teams will be responsible for providing services tailored to the needs of the community. The Local Area Network of scrutiny bodies plans to carry out an assessment in 2012/13 of the impact on outcomes of this joint approach to service provision.
47. The Orkney Community Plan 2011-14 combines and replaces two previously separate plans and requirements for the Orkney Community Planning Partnership: the Community Plan (2007) and the Single Outcome Agreement (2009-11).
48. Orkney Islands Council is one of the six equal partners of the Orkney Community Planning Partnership (OCP). The council has a statutory duty to lead Community Planning and the other key partners are NHS Orkney, Highlands and Islands Enterprise, Voluntary Action Orkney, Highlands and Islands Fire and Rescue Service and Northern Constabulary.
49. On 29 March 2012 Orkney's second Partnership Single Outcome Agreement was signed by Keith Brown, Minister for Housing and Transport, on behalf of the Scottish Government and Councillor Stephen Hagan, then Chair of the OCP Steering Group, on behalf of the OCP.
50. The annual report was presented to the council's Policy and Resources Committee on 25 September 2012. The report set out the level of achievement across the 15 National Outcomes. Each one is measured on whether performance has improved and whether targets have been met. In ten of the 15, performance had improved on average; one had seen no improvement and in four cases performance had decreased. In 12 cases the targets set had been achieved. For three outcomes the target had not been met and performance had decreased. These were:
 - Our young people are successful learners, confident individuals, effective contributors and responsible citizens.
 - We have improved the life chances for children, young people and families at risk.

- We have strong, resilient and supportive communities where people take responsibility for their own actions and how they affect others.

51. Although in many ways this report shows promising performance improvements for the people of Orkney, the Community Planning Partnership needs to focus on improving outcomes for vulnerable citizens.

Action Plan no. 2

52. In response to a request from the Cabinet Secretary for Finance, Employment and Sustainable Growth the Accounts Commission has led development work, with scrutiny partners, on how audit and inspection can support the delivery of better outcomes by Community Planning Partnerships. This will continue to evolve in 2012/13.

Outlook

2012/13 budget

53. Following the issue of the Scottish government three year settlement to 2015, the council has held its band D Council tax level at £1,037 for 2012/13 and set a general fund revenue budget of £82.773 million. This will require efficiency savings of £1.592 million to be made and result in the loss of 17.7 FTE posts.
54. The budget will be supported by a transfer of £4.76 million from the Strategic Reserve Fund and require no contribution from the General Fund reserve. The budget is thereby balanced and allows for £1.099 million for new service pressure growth. The position against the budget at 31 July 2012 shows a net surplus on the General Fund of £2.578 million and a non-General Fund overspend of £0.179 million. It is still too early in the year to predict actual outturns but actions have been put in place to correct any large variances and it still looks likely that the budget will be met.

Financial forecasts beyond 2012/13

55. At the time the budget was set it was just prior to the local council elections therefore the council has only set a budget for 2012/13. It is accepted however that with a reduction in external funding of £0.5 million over the next 3 years and potential cost pressures up to £7.9 million the gap will need to be met by a combination of efficiency savings, use of reserve balances and restricting the level of service pressures built into the budget.

Governance and accountability

56. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
57. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
58. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
- corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption.
59. In this part of the report we comment on key areas of governance.

Corporate governance

Processes and committees

60. The council's political decision making structure is based around the new service structure. Service committees scrutinise the performance of the council's services. Scrutiny of processes and procedures is provided by the Monitoring and Audit Committee. Some key governance documents, such as the scheme of administration and scheme of delegation to officers, are still to be revised to reflect the new structure.

Action plan no.3

61. The council has implemented a senior management restructure to reduce the number of chief officers and restructure services under four Executive Directors. The chief financial officer (s95 officer) post is now at Head of Service level rather than at Director level. In August 2010 Audit Scotland published a national report in the 'How Councils Work' series¹ which highlighted the vital role that such statutory officers have in supporting good governance and decision making. Although the council's new arrangements are not unusual, the council must ensure that it does not compromise the effectiveness of the s95 officer's statutory role.

Action plan no. 4

¹ How Councils Work: an improvement series for councillors and officers - Roles and Working Relationships: are you getting it right. August 2010

Internal control

62. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.
63. We reviewed the adequacy of internal audit as part of our annual planning and risk assessment process. Our review concluded that the internal audit service provided by the Internal Audit section in Orkney Islands Council operates in accordance with the CIPFA code of practice for internal audit in local government. We have relied on internal audit's work in certain areas (treasury management, stock checks and housing benefits) to reduce duplication of effort and focus our resources on other risk areas.
64. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Computer services review

65. We requested information from the council in order to carry out a Computer Services Review, a high level risk assessment of ICT services. We have not received sufficient evidence from the council to reach a conclusion on the effectiveness of management of ICT related risks.

Action Plan no. 5

Prevention and detection of fraud and irregularities

66. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements. The council has put in a place a range of measures to prevent and detect fraud including guidance contained in Financial Regulations; Codes of Conduct for Employees and Members and a 'whistleblowing' policy.
67. We have concluded that the council has adequate arrangements for the prevention and detection of fraud and we are not aware of any specific issues that we require to bring to members attention.

NFI in Scotland

68. Audit Scotland has coordinated another major counter-fraud exercise working together with a range of Scottish public bodies, external auditors and the Audit Commission to identify fraud and error. These exercises, known as the National Fraud Initiative in Scotland (NFI), are undertaken every two years as part of the statutory audits of the participating bodies. The latest exercise started in October 2010 and was reported upon in May 2012. The next round of NFI commenced in June 2012, and expands the range of data sets and bodies.

69. The NFI works by using data matching to compare a range of information held on bodies' systems to identify potential inconsistencies or circumstances that could indicate fraud or error which are called 'matches'. Where matches are identified these are made available to bodies to investigate via a secure web application. Bodies investigate these and record appropriate outcomes based on their investigations.
70. Previous NFI matches have given assurance that the council's internal control systems are operating effectively with only three fraud cases amounting to £5,219 identified and proven. These cases related to DWP benefit overpayments and did not affect any housing benefit or council tax benefit. There were four further (non-fraudulent) housing benefit/council tax benefit overpayments identified.

Housing and council tax benefits performance audit

71. A risk assessment of the council's Housing and Council Tax Benefit systems was carried out by Audit Scotland in 2011/12. The key objective of the risk assessment is to determine the extent to which the benefits service is meeting its obligations to achieve continuous improvement in all its activities.
72. The audit found that of the 21 risks identified in its 2008 risk assessment, the council had made the following progress:
- 15 actions fully completed
 - 4 actions partially completed
 - 2 actions outstanding.
73. Audit Scotland's risk assessment report and the council's action plan in response to the risks identified were presented to the Monitoring and Audit Committee in March 2012.

Standards of conduct and arrangements for the prevention/detection of bribery and corruption

74. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. We have concluded that the arrangements in Orkney Islands Council are satisfactory and we are not aware of any specific issues that we need to identify in this report.

Complaints handling procedures

75. In March 2012, the Scottish Public Services Ombudsman published a model complaints handling procedure for the local government sector which aims to simplify and improve complaints handling through a standardised system for complaints across all local authorities. All councils were required to adopt the model complaints handling procedure as soon as possible and to provide the Ombudsman with a compliant model procedure by 14 September 2012.

76. The council presented its new complaints handling procedure, including an employee guide and a customer guide to the OIC complaints handling procedure, to the Policy and Resources Committee in June 2012 and sent the new procedure to the Ombudsman by the September deadline. The Ombudsman has confirmed the information submitted is a compliant model procedure.

Media coverage, correspondence and investigations

77. Audit Scotland has recently received correspondence from an individual in relation to the council's proposed ballast water management policy. As the correspondence has also been sent directly to the council, we will wait for the council's response to the correspondent, to see if this resolves the issue, and then decide what further action, if any, may need to be taken.

Outlook

78. The Welfare Reform Act 2012 received royal assent in March 2012. The Act provides for the introduction of a 'Universal Credit' to replace a range of existing means-tested benefits and tax credits for people of working age, starting from 2013. Councils will face challenges in understanding and acting upon welfare reform changes, and communicating these accurately and effectively to local residents. The introduction of Universal Credit will also have a significant impact on councils' strategies and plans in areas such as housing, asset management, finance, ICT and customer service. Councils will be challenged during this period of change to maintain service delivery and performance around housing benefit claims.
79. As part of our work on the 2012/13 audit, we will consider the council's preparedness for introduction of these changes, and how it is developing and taking forward its strategies and plans to address the risks arising from these changes.

Best Value, use of resources and performance

80. Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value.
81. 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. Auditors of local government bodies also have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission.
82. As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:
 - a performance audit which may result in the publication of a national report
 - an examination of the implications of a particular topic or performance audit for an audited body at local level
 - a review of a body's response to national recommendations.
83. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments
84. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.
85. This section includes a commentary on the Best Value/ performance management arrangements within the council. We also note any headline performance outcomes/ measures used by the council and comment on any relevant national reports and the council's response to these.

Management arrangements

Best Value

86. The council carries out three types of service reviews under its Best Value duties to achieve continuous improvement: high level, management and efficiency reviews. The framework for service reviews is publicly available on the council website. These reviews are reported to the relevant service committee, and also reported to the Monitoring and Audit Committee so that members can scrutinise the effectiveness of the process.

87. The audit of Orkney's best value and community planning was completed in June 2008. Since then the council has reported progress to committee as part of its own corporate improvement plan. The latest update on the corporate improvement plan, which covers the council's priorities for change, was presented to the Policy and Resources Committee in July 2012. Progress towards achieving thirteen priorities were assessed as Green (likely to meet or exceed target), twelve were assessed as Amber (experiencing minor issues, with a low risk of failure) and two were assessed as Red (significant issues with a medium to high risk of failure). The two priorities assessed as Red were: "Implement ferry replacement programme" and "Complete corporate land and property asset strategy and management plan/ Establish a link between asset management plan and service improvement plans". The council's reported progress in November on these areas will form part of the shared risk assessment in late 2012, to determine if further scrutiny work is required.

Performance management

88. The Corporate Improvement Plan is one of the performance management tools within the Council's overall Strategic Planning Framework. Section A of the Corporate Improvement Plan monitors progress against the Council Plan (OIC Corporate Strategic Plan 2008-13) and section B of the Corporate Improvement Plan monitors recommendations from the Audit of Best Value and Community Planning and other significant Council-wide issues. The Corporate Improvement Plan enables progress of the council's most significant priorities to be monitored by the Corporate Management Team on a quarterly basis, and is scrutinised by the Policy and Resources Committee on a six-monthly basis.
89. Service performance is reported to service committees on a six monthly basis. Reporting covers the service plan, service performance indicators and service complaints, suggestions and compliments.
90. The council publishes an annual performance report on its website, which summarises key achievements and areas for improvement. The Performance and Statistics section of the website contains a range of information including the annual performance report and statutory performance indicators. However, the service monitoring reports on the website are out of date and there is no information on where to find the up to date service performance reports.
91. The council is aware that improvements could still be made to its current performance management arrangements, and is in the process of procuring an electronic performance management system which should assist with performance reporting.

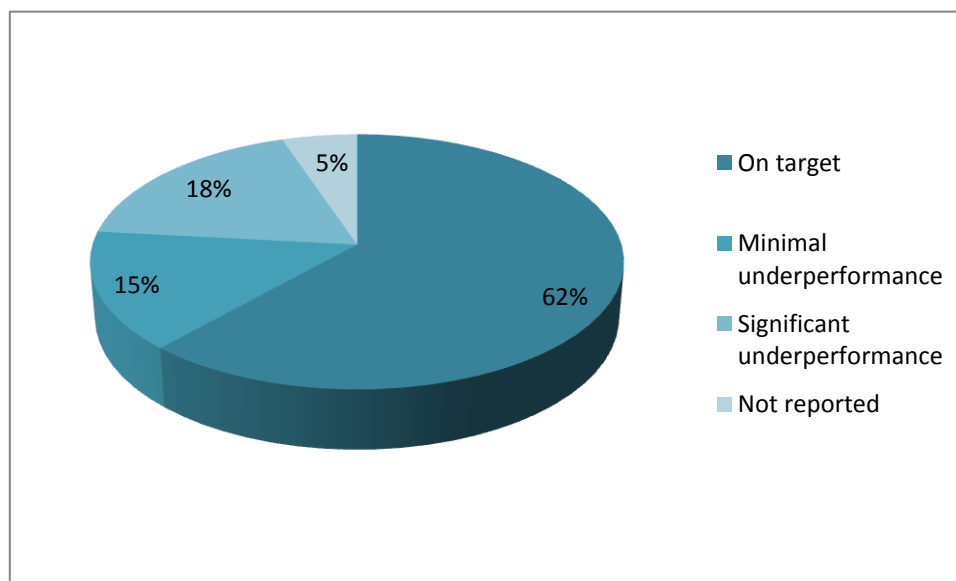
Overview of performance in 2011/12

Orkney Islands Council's performance measurement outcomes

92. Performance is reported six-monthly to committee: progress against the corporate improvement plan and service performance for Corporate Services and the Chief Executive's Service are reported to Policy and Resources Committee, and the other services (Education, Leisure and Housing; Development and Infrastructure; Orkney Health and Care) report to the

corresponding Service Committee. The most recent performance reports, reported at the June committee cycle, were for a three month period only, as the change in service structure occurred during the standard six month period. Most performance indicators were reported as likely to meet or exceed the target: Chief Executive's Service 63%; Corporate Services 56%; Development and Infrastructure 65%; Education, Leisure and Housing 68%; Orkney Health and Care 50%. The performance indicators reported include statutory performance indicators and Single Outcome Agreement indicators.

Exhibit 3: Council Performance Indicators to 31 March 2012



93.

Source: Service performance report, June 2012 committee cycle

94. There were a number of indicators where data was not available from the underlying systems. For example, the PARIS and Staffplan systems were unable to provide data for four Orkney Health and Care indicators. The council (with NHS Orkney for Orkney Health and Care) should ensure that it has systems in place to provide the relevant data for reporting its key performance indicators.

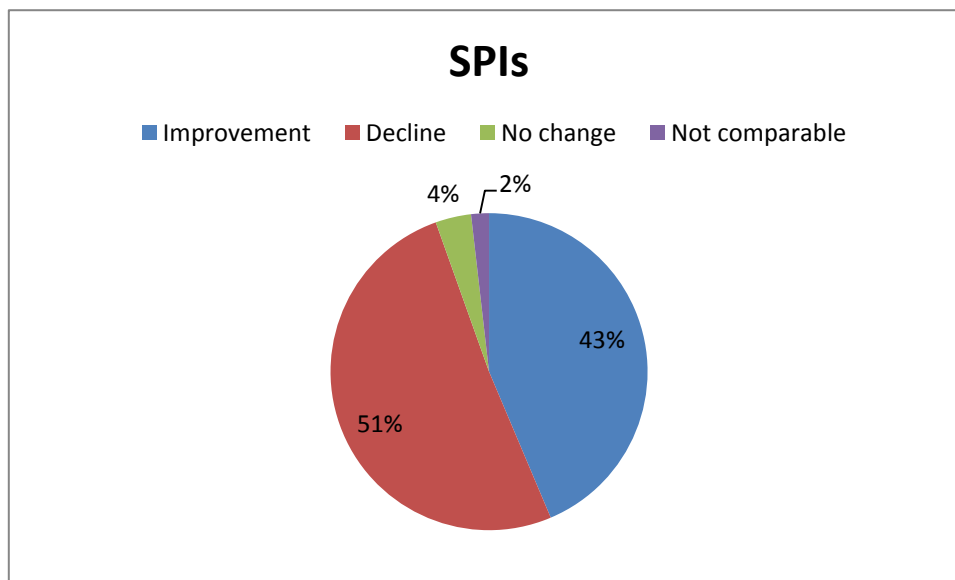
Action Plan no.6

Statutory performance indicators

95. In 2011/12, a total of 25 SPIs were required and these indicate a mixed picture of performance (see Exhibit 4 below).
96. The improved indicators include carriageway condition, the cost of collecting council tax and teachers' sickness absence levels, and the council continues to achieve a very high council tax collection rate at 97.5%. The council's performance in paying invoices within 30 days is slightly improved but is still under 80%. Declining performance was observed in planning applications processing times (due to a large increase in the number of applications, including a high volume of wind turbine applications). Some of the decline in performance shown above

is very slight year on year. Waste recycling is not directly comparable over time as the indicator has changed.

Exhibit 4: Improvements demonstrated by SPIs (Total 25 indicators)



Source: Orkney Islands SPI data returns

Local performance reporting

97. In February 2011, the Auditor General and the Accounts Commission published the national report '*Maintaining Scotland's roads: a follow-up report*'. As part of our 2011/12 audit we considered the council's progress against the recommendations in the national report. Improving the roads network is a priority action for all councils and is likely to be a considerable challenge against the backdrop of reducing levels of funding and competing pressures on services. The operation of a comprehensive roads asset management planning process and agreement of a long term investment strategy are both essential requirements if this challenging priority is to be met.
98. The council is continuing to make progress in its approach to managing the road network. Although it has yet to produce a formal Roads Asset Management Plan (RAMP) it has completed all the tasks outlined by Society of Chief Officers in Transportation in Scotland (SCOTS) required to do so. The council already has in place a Roads Management and Maintenance Plan (RMMP) covering the period from 2010 - 2013, which incorporates most of the features of a RAMP. The council is still committed to producing the formal RAMP which will co-ordinate both its RMMP and its planned capital replacement programme for roads. The challenge for the council going forward is to consider whether, in weighing up competing priorities for resources, its current performance on roads maintenance is sustainable.
99. Our follow up report will be considered by the Development and Infrastructure Committee in November 2012.

National performance reports

100. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest are detailed in Exhibit :

Exhibit 5: A selection of national performance reports 2011/12

- | | |
|---|---|
| • Commissioning social care | • The role of community planning partnerships in economic development |
| • An overview of local government in Scotland - challenges and change in 2012 | • Modernising the planning system |
| • Arms-Length External Organisations: are you getting it right? | • Scotland's public finances: addressing the challenges |
| • Transport for health and social care | • Community Health Partnerships |

Source: www.audit-scotland.gov.uk

101. Audit Scotland encourages local authorities to review national reports, assess local performance against them and identify actions required to improve performance. The expectation is that these reports are presented to an audit or scrutiny committee for members to review and to question management on key issues.
102. National reports are presented to the relevant service committee, for consideration and decisions on relevant action to be taken. Committee members receive a summary from officers on the council's progress regarding the key messages of each report. Monitoring and Audit Committee members also receive a briefing on each report and can request that the report is considered by the Monitoring and Audit Committee if they wish to scrutinise it in detail.

Progress against audit risks identified in the SRA

103. The Local Area Network (LAN) of scrutiny partners conducted a Shared Risk Assessment (SRA) which reviewed progress in the attainment of the objectives in the Single Outcome Agreement. This assisted in the identification of future audit and scrutiny activity. Orkney Islands Council was assessed by the LAN as "a low risk council which shows good self awareness and a positive response to external scrutiny bodies". The only significant scrutiny risk highlighted was in respect to some elements of the Housing service: progress towards achievement of the Scottish Housing Quality Standard in 2015, high service costs and the performance of response repairs. The Scottish Housing Regulator is seeking information from the council on these areas and plans to carry out some scrutiny work in autumn 2012 based on the council's self assessment.
104. During the initial shared risk assessment, uncertainties were identified over the impact that the Orkney Health and Care partnership arrangements would have on staff and the delivery of services. Uncertainty remained in the 2012 shared risk assessment regarding the impact of

Orkney Health and Care arrangements. Governance arrangements have been reviewed by the LAN in relation to Orkney Health and Care, as a new model of shared service provision, and a number of areas for improvement were noted. Scrutiny work on the impact of Orkney Health and Care arrangements on performance outcomes is planned for autumn 2012.

105. Also, at the request of Scottish Ministers, the Care Inspectorate will lead a Joint Inspection of Children's Services in each local authority area in Scotland. Orkney Islands Council has been selected for inspection in October 2012.
106. There was no additional scrutiny identified by the LAN for years 2 and 3 of the Assurance and Improvement Plan. The LAN will meet again towards the end of 2012 to update the Shared Risk Assessment and determine whether any further scrutiny work is required for Orkney Islands Council.

Outlook

107. There are currently no plans for any best value work in Orkney Islands Council over the next three years. However, the Assurance and Improvement Plan includes planned activity by scrutiny bodies to review the impact on performance/outcomes of providing integrated health and social care services through Orkney Health and Care.
108. The Accounts Commission has developed an audit approach for the audit of Community Planning Partnerships. This approach is being piloted in the autumn of 2012 and rolled out across the sector thereafter.
109. In April 2011, the Equality Act 2010 introduced a new public sector 'General Duty' which encourages equality to be mainstreamed into public bodies' core work so that it is not a marginal activity but part and parcel of how public bodies operate. Following on from this the Scottish Government consulted on a set of 'Specific Duties' which came into force in May 2012. There are nine specific duties listed which aim to support public bodies to better perform against the 'General Duty,' including the duty to assess the impact of equalities in all policies and decisions as well as the requirement to publish a set of equality outcomes (and reporting requirements) no later than 30 April 2013. We will consider progress made by the council in implementing these requirements as part our 2012/13 audit.

Appendix A: audit reports

External audit reports and audit opinions issued for 2011/12

Title of report or opinion	Date of issue	Date presented to Audit Committee
Annual Audit Plan	6 March 2012	15 March 2012
Shared Risk Assessment/Assurance and Improvement Plan	16 May 2012	27 June 2012
Maintaining Scotland's roads - follow-up review	13 September 2012	To Development & Infrastructure Committee 13 Nov 2012
Report on financial statements to those charged with governance	17 September 2012	27 September 2012
Audit opinion on the 2011/12 financial statements	17 September 2012	27 September 2012
Audit opinion on the 2011/12 Whole of Government Accounts consolidation pack	5 October 2012	N/A
Report to Members on the 2011/12 audit	31 October 2012	29 November 2012

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	13	<p>Annual Governance Statement</p> <p>The council includes a Statement on the System of Internal Financial Control (SSIFC) within its financial statements. It is considered best practice, although not currently a Code requirement, to include an Annual Governance Statement, which is wider ranging than the SSIFC.</p> <p><i>Risk: the council does not follow good practice in governance arrangements and financial statements disclosure.</i></p>	An Annual Governance Statement will be developed for inclusion in the 2012/13 Statement of Accounts.	Head of Finance	June 2013
2	51	<p>Single Outcome Agreement (SOA) Performance Outcomes</p> <p>Although the latest SOA performance report shows some promising performance improvements, the Community Planning Partnership, in which the council is a key partner, needs to focus on improving outcomes for vulnerable citizens.</p> <p><i>Risk: resources are not targeted to priority areas and improved outcomes are not achieved.</i></p>	The point raised will be communicated to the Partnership and the Partnership will be encouraged to focus on outcomes for vulnerable citizens, however it must be recognized that the Council has a lead role in the Partnership but cannot dictate to the Partnership where its efforts are directed.	Community Planning Partnership	June 2013

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
3	60	<p>Governance documents</p> <p>The council has not yet approved a revised scheme of administration or scheme of delegation to officers to reflect the revised service and committee structure.</p> <p><i>Risk: members and officers are not aware of the most up to date governance arrangements and do not comply with them.</i></p>	Revised schemes of administration and delegation to officers to reflect the revised service and committee structure are being developed and will be submitted to Council for approval in the Committee Cycle commencing in January 2013.	Chief Executive	March 2013
4	61	<p>Section 95 officer</p> <p>The section 95 officer (chief finance officer) role has transferred from a Director to a Head of Service; the council should ensure that the S95 officer has adequate authority and profile so that the importance of this role is not compromised.</p> <p><i>Risk: the s95 officer role is not given an appropriate level of importance in the organisation and financial probity and stewardship is weakened.</i></p>	The Section 95 officer has direct access to the Chief Executive at all times and is a full member of the Senior Management Team along with the Chief Executive and the four Executive Directors. All reports to members contain input and comments from the Head of Finance. How the new management structure is bedding down will continue to be reviewed as a matter of course.	Chief Executive	On-going
5	65	<p>Computer Services Review</p> <p>We have not received sufficient evidence from the council to reach a conclusion on our Computer Services Review. We will follow this up as part of our 2012/13 audit.</p> <p><i>Risk: risks relating to the council's ICT systems are not identified or addressed.</i></p>	Following further feedback from External Audit a planning meeting is scheduled to take place on the 27 November 2012 to finalise the Computer Services Review.	Head of IT and Support Services	March 2013

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
6	94	<p>Performance reporting</p> <p>A number of service performance indicators could not be reported as systems could not provide the relevant data. The council (and NHS Orkney for Orkney Health and Care) should ensure that they have systems capable of providing the data required for their key performance indicators.</p> <p><i>Risk: performance cannot be effectively reported, monitored and managed.</i></p>	<p>The Council will shortly have in place a performance management system that will enable the production of data required for key performance indicators.</p>	<p>Head of HR and Performance</p>	<p>March 2013</p>