

# Orkney Islands Council

2018/19 Annual Audit Report



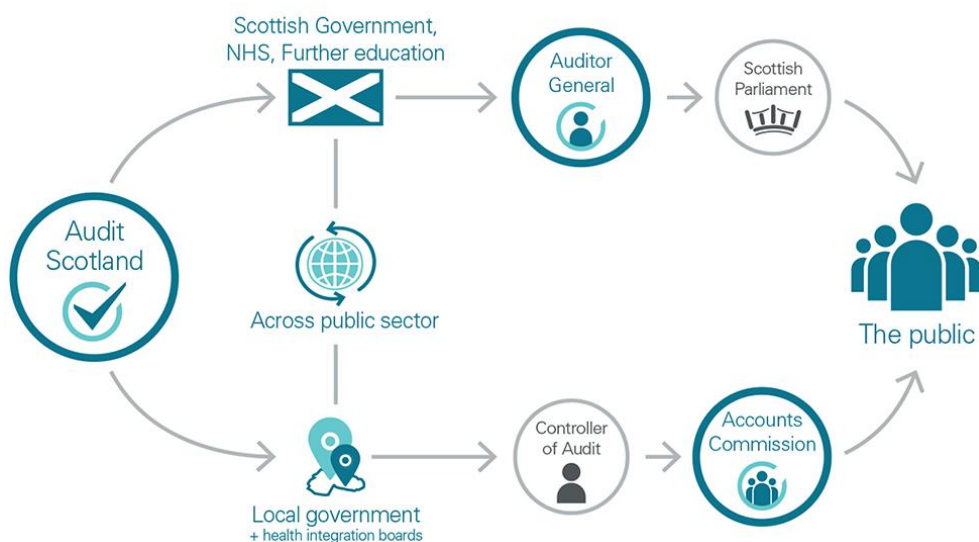
 AUDIT SCOTLAND

Prepared for the Members of Orkney Islands Council and the Controller of Audit  
26 September 2019

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Contents

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Key messages	4
Introduction	6
Part 1 Audit of 2018/19 annual accounts	9
Part 2 Financial management	14
Part 3 Financial sustainability	23
Part 4 Governance and transparency	25
Part 5 Value for money	28
Appendix 1 Action plan 2018/19	33
Appendix 2 Significant audit risks identified during planning	36
Appendix 3 Summary of national performance reports 2018/19	40

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# Key messages

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## 2018/19 annual accounts

- 1 In our opinion, Orkney Islands Council and its group financial statements give a true and fair view and were properly prepared.
- 2 The statement of accounts of the Orkney Islands Council General Charitable Trust administered by the council are free from material misstatement.

## Financial management

- 3 Financial management arrangements are satisfactory.
- 4 The council has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.
- 5 The council needs to consider reducing the level of General Fund expenditure to bring it into line with the financial support received.
- 6 The council holds usable reserves of £275 million of which £197 million is a strategic reserve fund. The council has made progress in agreeing a medium-term financial plan for the strategic reserve fund and now needs to develop a plan for the longer term.

## Financial sustainability

- 7 The council and its group financial position, taking account of its reserve position, is sustainable in the foreseeable future although rising demand, increasing costs of services and constraints to central funding will continue to place a strain on the council's capacity to deliver services at the current levels.
- 8 There are long-term financial plans which highlight a range of funding gaps over a 10-year period. The council is forecasting the most likely case to be a funding gap of £65 million.

## Governance and transparency

- 9 The council has satisfactory governance arrangements in place that support the scrutiny of decisions made by the council.
- 10 The council is open and transparent in the way it conducts its business and the public can attend meetings of the council and its standing committees.
- 11 Future leadership arrangements in the council are unclear. Appropriate governance arrangements should be put in place to resolve this in 2019/20.

## Value for money

- 12** The council continues to demonstrate progress in a number of areas in response to the Best Value Assurance Report published in December 2017.
- 13** The Change Programme is intended to drive an evaluation of key business processes, including a review of options for modernising and delivering frontline services more efficiently. However, the programme has proved difficult to manage and there has been a delay in delivering the intended outcomes.

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# Introduction

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1. This report summarises the findings arising from the 2018/19 audit of Orkney Islands Council and its group (OIC).

2. The scope of the audit was set out in our 2018/19 Annual Audit Plan presented to the February 2019 meeting of the Monitoring and Audit Committee. This report comprises the findings from:

- an audit of the annual report and accounts
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1 Audit dimensions



Source: *Code of Audit Practice 2016*

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3. The main elements of our audit work in 2018/19 have been:

- an audit of the council and its group 2018/19 annual report and accounts and the statement of accounts of the section 106 charity administered by the council including the issue of independent auditor's reports setting out our opinions
- a review of the council's key financial systems
- an update on our 2018/19 audit work covering the council's arrangements for securing Best Value
- consideration of the four audit dimensions.

## Added value through the audit

4. We add value to OIC through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements that have been accepted by management
- reporting our findings and conclusions in public
- sharing intelligence and good practice through our national reports ([Appendix 4](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

5. In so doing, we aim to help OIC promote improved standards of governance, better management and decision making, and more effective use of resources.

## Responsibilities and reporting

6. The council has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with proper accounting practices.

7. The council is also responsible for compliance with legislation, and putting arrangements in place for governance, propriety and regularity that enable it to successfully deliver its objectives.

8. Our responsibilities as independent auditor appointed by the Accounts Commission are established by the Local Government in Scotland Act 1973, the [Code of Audit Practice 2016](#) and supplementary guidance, and International Standards on Auditing in the UK.

9. As public sector auditors we give independent opinions on the annual accounts. Additionally, we conclude on:

- the effectiveness of the council's performance management arrangements,
- the suitability and effectiveness of corporate governance arrangements, and financial position
- the arrangements for securing financial sustainability and,
- best value arrangements.

10. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#).

11. This report raises matters from the audit of the annual accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

12. Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers and dates for implementation.

**13.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and the 2018/19 audit fee of £186,000 (including £1,000 for the audit of the charitable trust) as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**14.** This report is addressed to both the council and the Controller of Audit and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

**15.** We would like to thank all management and staff for their cooperation and assistance during the audit.



# Part 1

## Audit of 2018/19 annual accounts



### Main judgements

**In our opinion, Orkney Islands Council and its group financial statements give a true and fair view and were properly prepared.**

**The audited part of the remuneration report, management commentary and annual governance statement are all consistent with the financial statements and prepared in accordance with proper accounting practices.**

**The statement of accounts of the Orkney Islands Council General Charitable Trust administered by the council is free from material misstatement.**

The council and its group annual accounts are the principal means of accounting for the stewardship of resources and performance in the use of resources.

### Audit opinions on the annual accounts

**16.** The annual accounts for the council and its group for the year ended 31 March 2019 were approved by the Monitoring and Audit Committee on 26 September 2019. We reported, within the independent auditor's report that the:-

- financial statements give a true and fair view and were properly prepared
- the audited part of the remuneration report, management commentary and the annual governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant regulations and guidance.

**17.** We have nothing to report in respect of misstatements in information other than the financial statements, the adequacy of accounting records, the information and explanations we received, or the achievement of prescribed financial objectives.

### Audit opinions on section 106 charity – the charitable trust

**18.** Due to the interaction of the Local Government in Scotland Act 1973 with the charities legislation, a full and separate audit and auditor's report is required for each registered charity where members of Orkney Islands Council are sole trustees, irrespective of the size of the charity.

**19.** Our duties as auditors of the Charitable Trust administered by Orkney Islands Council are to:

- express an opinion on whether the charity's financial statements properly present the charitable trusts financial position and are properly prepared in accordance with charities legislation
- read the trustees' annual report and express an opinion as to whether it is consistent with the financial statements

- report on other matters by exception to the trustees and to the Office of the Scottish Charity Regulator.

**20.** We received the Charitable Trusts' accounts in line with the agreed timetable and after completing our audit we issued unqualified audit opinions in respect of the 2018/19 financial statements.

## Submission of the council and its group annual accounts for audit

**21.** We received the unaudited annual accounts on 28 June 2019 in line with the audit timetable set out in our 2018/19 Annual Audit Plan.

**22.** The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team during the audit. This helped ensure that the audit of the annual accounts process ran smoothly.

## Whole of Government Accounts

**23.** In accordance with the WGA guidance, the council submitted a consolidation pack for the whole of government accounts audit on 26 July 2019 in line with the deadline. We completed the required assurance statement and submitted it to the National Audit Office (NAO) by the 28 September 2019 deadline.

## Risk of material misstatement

**24.** [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual accounts and any wider audit dimension risks that were identified during the audit planning process. It also summarises the work we have done to gain assurance over the outcome of these risks.

## Materiality

**25.** Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves considering both the amount and nature of the misstatement.

**26.** Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit. With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

**27.** On receipt of the annual accounts we reviewed our original materiality calculations and concluded that they required to be revised. The revised materiality figures are shown in [Exhibit 2](#). As the revised figures were not significantly different to those calculated at the planning stage of the audit, we did not need to change our audit approach.

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## Exhibit 2 Materiality values

Materiality level	Amount
Overall materiality	£1.542 million
Performance materiality	£0.771 million
Reporting threshold	£15 thousand

Source: 2018/19 OIC Unaudited Annual Report and Accounts.

## Significant findings from the audit in accordance with ISA 260

**28.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices covering accounting policies, accounting estimates and financial statements disclosures.

**29.** The significant findings are summarised in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) has been included.

### Qualitative aspects of the audit

**30.** We identified three significant findings in relation to the qualitative aspects of accounting practices and these are highlighted in [Exhibit 3](#).

## Exhibit 3

### Significant findings from the audit of the financial statements

Issue	Resolution
<p><b>1. IAS 19 actuarial valuation</b></p> <p>The actuarial valuation of the IAS 19 pension liability in the unaudited accounts was revised to take account of the McCloud Supreme Court ruling. As a result, a revised valuation was carried out which resulted in an overall increase to the pension liability of £1 million.</p> <p>The ruling on McCloud was issued after the accounts were submitted for audit, so the Council would not have been in a position to obtain reports prior to submission of the draft accounts.</p>	<p>The council obtained a revised actuarial valuation which took into account the Supreme Court's ruling and adjusted the financial statements to reflect the revised pension liability. The impact of the adjustment was to increase the employer's liability by £1 million with a corresponding increase to the pension reserve.</p>
<p><b>2. IFRS9 – presentational and disclosure changes</b></p> <p>The unaudited accounts contained a significant number of presentational and disclosure errors, resulting from the introduction of IFRS9, including:</p> <ul style="list-style-type: none"> <li>Note 17 – Gains and losses on the revaluation of financial assets at fair value through profit and loss were included below the Surplus/Deficit on Provision of Services (SDPS). The gains and losses should be included in income and expenses in the SDPS. The net effect is to increase the surplus on the provision of services by £0.4 million.</li> <li>Note 11 - Interest expenses of -£28k were shown in the Financing and Investment Income line of the analysis. The correct figure is £1.2 million, and the error was due to an incorrect cell reference in a working paper. Officers noticed the error and it was highlighted prior to our detailed testing of the Note. Adjusting the</li> </ul>	<p>We worked closely with management to ensure the revised accounts were updated for all the errors. This involved a significant amount of time during the audit. The revised accounts were assessed as satisfactory.</p>

Issue	Resolution
<p>accounts has no effect on the overall total of Financing and Investment Income.</p> <ul style="list-style-type: none"> <li>Accounting policies covering financial instruments were not updated to take into account the adoption of IFRS 9 in 2018/19.</li> </ul>	
<p><b>4. Financial Instruments – impairment loss</b></p> <p>The council's investment in ORIC is valued at cost which is allowed for group entities. However, no impairment review has been carried out for this investment.</p> <p>Audit testing found that an impairment review should have been carried out and calculated the total value of impairment to be £1.7 million</p>	<p>The accounts have been updated to reflect the impairment loss. The effect of accounting for the impairment loss is to reduce the harbour reserves balance by £1.7 million.</p> <p>The ORIC accounts valued the Old Stromness Primary and Old Stromness Academy properties as investment properties. These properties were undergoing significant levels of renovation at 31 March 2019 and accordingly had high vacancy levels at that time which resulted in an impairment being made in the ORIC accounts of £4.3 million. As the renovations have been completed tenants have moved in and it is expected that the impairment at 31 March 2019 will be significantly reversed in the year to 31 March 2020.</p>

Source: 2018/19 OIC Annual Report and Accounts

## Impact of McCloud/Sergeant rulings on Pension costs

**31.** The courts have ruled that the transitional protections provided as part of the 2015 public sector pension scheme changes discriminate on the grounds of age. (The cases are known as the 'McCloud/Sergeant' rulings.). All local government pension schemes are affected including the Orkney Islands Council Pension Fund.

**32.** On 27 June 2019, the Supreme Court denied UK Government leave to appeal. The UK Government still had the option to appeal through the Employment Tribunal but declined to pursue that option and conceded the legal point that the protections in place were discriminatory on grounds of age. In accordance with IAS 37, this is an adjusting post balance sheet event as the court confirmed an obligation in relation to conditions which existed at 31 March 2019.

**33.** In June, the Government Actuary's Department (GAD) provided actuarial firms with a methodology for estimating the likely impact of the rulings on pension liabilities. In general, the size of pension liabilities across the UK will increase. In due course employers will likely experience a funding pressure through the additional employer contributions that may have to be paid to cover the increased liabilities.

**34.** Hymans Robertson, as the council's fund actuary, was requested to apply the GAD assumptions which resulted in an increase in the net pension liability of £1m.

## Follow up of prior year recommendations

**35.** The council has made progress in implementing our prior year audit recommendations. For those actions not yet implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1 \(points 1, 3 and 4\)](#)

## Integration Joint Board

**36.** The council reflects its share of the financial transactions of Orkney Integration Joint Board (Orkney IJB) within its group financial statements. Our work on group

disclosures included testing the accuracy and reliability of the Orkney IJB figures used in the group consideration process. This provided us with the required assurances on the accuracy and completeness of the Orkney IJB figures included in the accounts. Further information regarding the performance of the Orkney IJB is included in [part 4 of this report](#).

## Other findings

**37.** Our audit identified several presentational and disclosure issues in the unaudited accounts. The issues were discussed with management and the accounts were subsequently updated and assessed as satisfactory.

## Objections

**38.** The Local Authority Accounts (Scotland) Regulations 2014 require a local authority to publish a public notice on its website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period. The council complied with the regulations. There were no objections to the accounts.

# Part 2

## Financial management



### Main judgements

**Financial management arrangements are satisfactory.**

**Based on audit work undertaken, we concluded that appropriate and effective internal controls were in place for the key financial systems we reviewed.**

**The council needs to consider reducing the level of General Fund expenditure to bring it into line with the financial support received.**

**The council has made progress in agreeing a medium-term financial plan for the strategic reserve fund and now needs to develop a plan for the longer term**

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

### Financial performance in 2018/19

**39.** The council approved its 2018/19 budget in February 2018. The budget was set at £82 million with a funding gap of £7 million. Plans to address this gap included £2 million of savings and a transfer of £5 million from reserves. During the year, a further £2 million was transferred from reserves to give a final budget for the year of £84 million.

**40.** The actual net cost of General Fund services amounted to £84 million. Sources of finance were realised at £84million, including a contribution of £7 million from reserves.



### Recommendation 1

**The council needs to consider reducing the level of General Fund expenditure to bring it into line with the financial support received.**

**41.** In reviewing the financial performance of the council, the trading activities including the Housing Revenue Account, the Harbour Authority, and Orkney College all need to be recognised in addition to that of General Fund Services. Including these accounts, the council planned to generate a surplus of £7 million on its activities for financial year 2018-19. During the year, the budget surplus was revised downwards to £4 million on account of additional approved expenditure funded from reserves. The reversal of a prior year Merchant Navy pension provision of £3 million and improved trading results on Scapa Flow Oil Port and Miscellaneous Piers and Harbours meant that the council actually achieved a surplus of £9 million for the year against the £4 million budget.

**42.** The most significant underspends which contributed to the surplus are summarised in [Exhibit 4](#).

## Exhibit 4

### Summary of significant underspends against budget

Area	Under / over spend £m	Reason for variance
<b>Underspends</b>		
Other income and expenditure	£6 million	Increase in Scapa flow oil port surpluses and reversal of a £3 million provision in respect of the Merchant Navy Officers Pension Fund.  Slippage on strategic projects commitments.
Harbour authority	£1 million	Slippage on planned programme of repairs and maintenance.

Source: OIC Council 2018/19 Annual Accounts

## Housing revenue account

**43.** The council is required by legislation to maintain a separate Housing Revenue Account (HRA) and to ensure that rents are set to a level which will at least cover the costs of its social housing provision.

**44.** The HRA delivered an underspend of £0.280 million in 2018/19 mainly due to slippage on the planned programme of repairs and maintenance. The underspend had the effect of increasing the HRA balance to £0.5 million at 31 March 2019 (£0.2 million as at 31 March 2018).

**45.** Due to a period of slippage on the house build programme, capital charges for 2018/19 were less than estimated and so the HRA had surplus funds in its loan charges budget. There were also further capital receipts from the end of the Right-to-Buy scheme which had left the HRA in a better than planned position. The council agreed to use the surplus funds which totalled £0.625 million to accelerate loan charges for outstanding debt, and the period of repaying the debt was reduced from 40 to 30 years. Using the surplus funds for this purpose is considered prudent by the council as it will reduce interest payments over the remaining period of the debt. However, this has to be weighed up against slippage in both the repairs and maintenance of housing stock as well as slippage in the house build programme.

## Reserves

**46.** One of the key measures of the financial health of a local authority is the level of reserves held. The level of usable reserves held by the council increased from £262 million in 2017/18 to £275 million in 2018/19.

**47.** Usable reserves are those reserves the council is able to apply to fund expenditure or reduce taxation and comprise both capital and revenue reserves. A summary of movement in usable reserves in 2018/19 is shown below in [Exhibit 5](#).

## Exhibit 5

### Summary of movement in usable reserves (>£1 million) in 2018/19

Usable reserve	2018/19 £ m	2017/18 £ m
Harbour Funds (including Strategic Reserve Fund)	250	237
General Fund balance	13	15
Capital Receipts Reserve	3	3
Repairs and Renewals Fund	9	8
<b>Total usable reserves (&gt;£1 million)</b>	<b>275</b>	<b>262</b>

Source: OIC Council 2018/19 Annual Accounts Source:

**48.** Harbour Funds account for 90% of total usable reserves. Around 70 percent of the value of usable reserves, (£197 million at 31 March 2019) are held in the Strategic Reserve Fund (SRF). The SRF is an investment fund established under the Orkney County Council Act 1974. It holds investment returns from surplus funds relating to harbour dues from ships using the Scapa Flow Oil Port and previous marine services and disturbance payments made by Flotta Oil Terminal operators.

**49.** The purpose of the SRF is to provide for the benefit of Orkney and its inhabitants. The fund is used for projects and initiatives such as the development of industrial estates, harbour infrastructure, recreational projects, and supporting economic development activity across the council area, whilst having regard to the Fund's long-term commitments in terms of the decline and decommissioning of the Flotta Oil Terminal in the future.

**50.** The council is clear that responsibility for decommissioning costs of the Flotta Oil Terminal rests with the operator, Repsol, but has earmarked a proportion of the Harbour Fund balance to ensure it can meet the cost of any unexpected events. The sum which has been earmarked is based on a report prepared by consultants in 1997, uprated for inflation. Economic conditions and oil terminal operations have changed significantly since the consultants provided their initial estimate of costs therefore the council should obtain an up-to-date estimate of the potential decommissioning costs.



## Recommendation 2

**The council should ensure the sum set aside to support any unexpected events in relation to the decommissioning of Flotta is fair and reasonable.**

**51.** The high level of reserves supports the need for long term financial planning to ensure the funds will be used to achieve strategic aims and benefit the people of Orkney. The council has made progress in agreeing a medium-term financial plan for the strategic reserve fund covering the period 2018/19 to 2021/22.



## Recommendation 3



## **A longer-term financial plan for the strategic reserve fund should now be developed to ensure the funds will be used to achieve strategic aims and benefit the people of Orkney.**

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**52.** The council has an established policy on disbursements from the SRF which ensures that the value of the fund does not fall in real terms, measured against a minimum floor balance. In recent years SRF investments have performed well with an overall increasing trend in value. The council has approved contributions from the fund to supplement its funding from the Scottish Government and local taxes raised through council tax and non-domestic rates.

**53.** The council recently purchased the Islands of Faray, Holm of Faray and Red Holm with monies from the Strategic Reserve Fund. This relates to the potential development of large-scale wind farms which would serve as an important source of income as well as providing benefit for the community. As part of this project, the council has applied for grid connections and it is hoped this can be operational by 2024.

**54.** The SRF medium term financial plan highlights that over-reliance on the SRF as a means of balancing the General Fund budget as part of a long-term financial strategy would not be considered best practice, particularly given the levels of volatility that may continue to impact adversely on investment returns. We concur with this judgement.

### **Efficiency savings**

**55.** With constraints on funding from government and increased demand for services, efficiency savings are an important means of bridging the gap between funding received and spending commitments.

**56.** The council is required to make an annual return to the Scottish Government in respect of recurring efficiency savings. The Policy and Resources Committee routinely receives budget monitoring reports including savings plans which have been risk assessed.

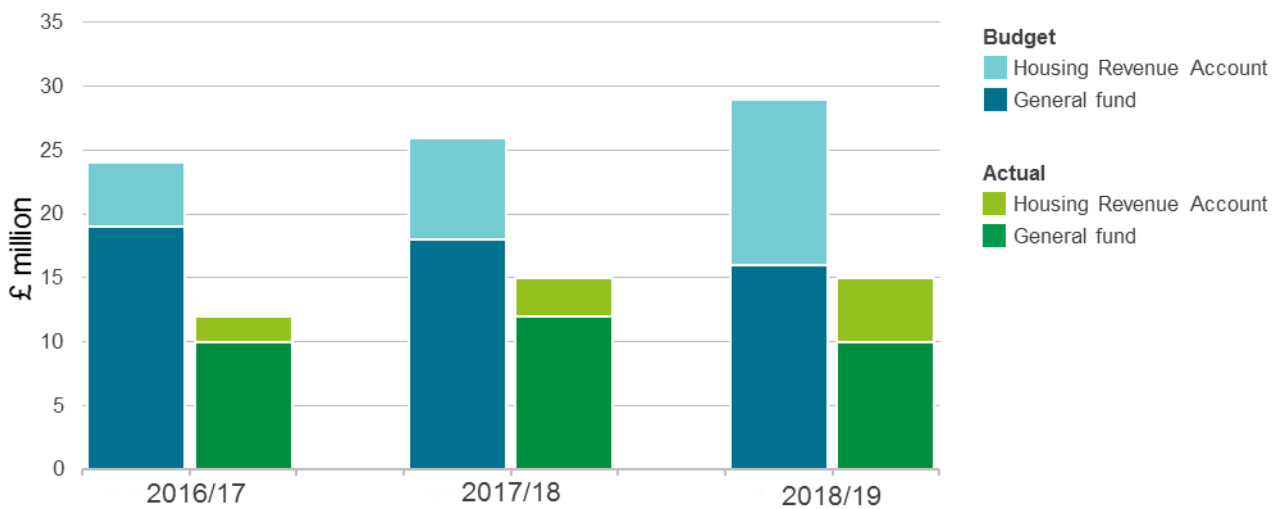
**57.** The council had planned to secure efficiency savings of £2 million in 2018/19 but only achieved £1 million of savings for the year. Going forward, the council recognises that achievement of further savings will prove challenging.

### **Capital programme 2018/19**

**58.** The council has a history of slippage in its capital programme as outlined in [Exhibit 6](#).

## Exhibit 6

### Capital slippage compared to budget (general fund and HRA)



Source: OIC Council audited Annual Accounts

**59.** The original approved limit for capital expenditure during 2018/19 was £30 million (£28 million general fund, £2 million HRA) which included £11 million slippage from the previous financial year. During the year further projects were added and removed from the council's Capital Programme, with only a slight revision to the approved limit for 2018/19.

**60.** Total capital expenditure in 2018/19 was £15 million (£15 million general fund, £0.2 million HRA) including, £2 million in harbour infrastructure, £1 million on vessels, £2 million in roads and transport, £4 million in community social services, £2 million in other services and £2 million on schools.

**61.** Capital slippage in 2018/19 amounted to £15 million due to weaknesses in forward planning arrangements. Capital projects which experienced slippage in 2018/19 include £3 million for refurbishment of Scapa Flow visitors centre and museum, £2 million social care facilities, £1 million education, £4 million for a new tug and £2 million social housing development.



#### Recommendation 4

**The council should ensure that slippage and re-profiling of capital projects does not have a significant impact on strategic priorities that are dependent on capital projects being completed on time.**

**62.** Funding of capital expenditure included £0.4 million from revenue, £9 million from government grants, £1 million from the sale of assets and other receipts, and £1 million from use of reserves. The council undertook no additional borrowing during the year based on the council's planned capital commitments.

**63.** The Interim Chief Executive Officer has commissioned Internal Audit to undertake a detailed review of the capital programme and the results of the audit are expected to be reported in November 2019. We will perform a review of the work of Internal Audit in this area and monitor the council's implementation of recommendations reported, providing comment in our 2019/20 reports.

## Treasury management

**64.** The Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 (the Code) has adopted a new financial reporting standard, IFRS 9 Financial Instruments. The objective of IFRS9 is to establish principles for the financial reporting of financial instruments that will present useful information for the users of the financial statements to assess the amounts, timing, and uncertainty of future cash flows.

**65.** A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The definition is broad and covers instruments used in the day-to-day treasury management activity of an authority, including the borrowing and lending of money and investment activity.

**66.** The main impact of IFRS 9 is in respect of the classification approach to financial assets and a new impairment model. The classification of investments has changed wherein the previous classifications of loans and receivables and available for sale have been replaced with three classifications based on both:

- the body's business model for managing the financial assets; and
- the contractual cash flow characteristics of the financial asset. Fair value through profit and loss represents those financial assets held principally for trading where the objective of the business model is to maximise gains from movements in the fair value of the underlying assets, that is, by other means than collecting contractual cashflows.

**67.** OIC has a significant portfolio of managed funds (£223 million at 31 March 2019). Consequently, the introduction of this new financial reporting standard has big implications for them, unlike most other councils. Officers anticipated this and reviewed their accounting treatment in good time, and for the prior year.

**68.** The council reviewed their business model for their investments in managed funds and confirmed that it is still appropriate to carry these financial assets at fair value through profit and loss, and we concur with their assessment. Therefore, the effect of adopting IFRS 9 is not significant. It does mean however that an element of upward movement in the council's harbour reserves relates to an *unrealised* gain and is not available (i.e. earmarked).

**69.** In 2018/19, the Strategic Reserve Fund managed funds increased to a total of £223 million, representing a gain of 5.7% on the year. The council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The council is unusual in that it holds a sizable portfolio of investments under active management, which is a higher risk activity for a local authority. The council maintains a diversified portfolio of investments as part of an agreed investment strategy to help mitigate this risk.

**70.** The value of the strategic reserve fund has increased over the last five years due to the performance of the council's investments. This level of performance is linked to market conditions and is therefore not guaranteed. The uncertainty surrounding Brexit increases the risk of a fall in the value of investments. The council needs to ensure it is prepared for any impact Brexit may bring.

## Budgetary process

**71.** The [Local Government in Scotland: Financial overview 2017/18](#) (November 2018) highlighted that the need for budgets and forecasts to reflect actual spending becomes increasingly important for councils with decreasing (or low levels) of usable reserves to rely on.

**72.** Members have a key role in agreeing the council budget each year and all members receive training on the budget process each year to ensure they fully

understand underlying assumptions and implications of the spending decisions they make.

**73.** Within the council the detailed scrutiny of financial performance is delegated to the Policy and Resources Committee which receives quarterly revenue and capital monitoring reports in addition to regular updates on financial monitoring. We have observed that the reports forecast out-turn position for the year and include good narrative explanations for significant variances against budget. They allow both members and officers to carry out scrutiny of the council's finances.

## Systems of internal control

**74.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that the council has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**75.** Our findings were included in our controls report that was presented to the Monitoring and Audit Committee in June 2019. We concluded that the key controls were operating effectively. No significant internal control weaknesses were identified which could affect the council's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

**76.** Our financial statements audit work included testing of 30 expense claims. We found a number of instances where insufficient checks had been carried out prior to approving claims. Some claim forms did not have receipts attached, four claims had credit card receipts attached instead of detailed receipts, and there were instances where it was unclear if expenditure represented value for money.



### Recommendation 5

**Management should ensure that officers expenses are processed and paid in accordance with agreed procedures.**

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## Internal audit

**77.** The council's internal audit function is carried out by the Internal Audit section of Orkney Islands Council. Each year we consider whether we can rely on internal audit work to avoid duplication of effort. When we plan to place reliance on internal audit work, we carry out an assessment of the internal audit function to ensure that it is sufficient in terms of documentations standards, reporting procedures and quality, and is performed in accordance with Public Sector Internal Audit Standards (PSIAS).

**78.** We reviewed the council's internal audit arrangements in accordance International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent we could rely on the work of internal audit. Overall, we concluded that we would place reliance on aspects of internal audit work in the following areas – cash collection, sundry creditors, sundry debtors, PARIS (Health and Social Care System).

## Standards of conduct for prevention and detection of fraud and error

**79.** The council has a range of established procedures for preventing and detecting fraud and irregularity including a whistleblowing policy, anti-fraud strategy and codes of conduct for members and officers. We assessed these to ensure that they

were appropriate, readily available to staff and are regularly reviewed to ensure they remain relevant and current.

**80.** We concluded that the council has appropriate arrangements in place for the prevention and detection of bribery and corruption. We are not aware of any specific issues we require to bring to your attention.

## National Fraud Initiative

**81.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity. NFI activity is summarised in [Exhibit 7](#).

### Exhibit 7 NFI activity



1262

Matches



22

Matches in progress



6

Completed/closed  
investigations

Source: NFI secure website: [www.nfi.gov.uk](http://www.nfi.gov.uk)

**82.** The council recognises that NFI is an important tool in allowing investigative resource to be targeted at risk areas. The council prioritises reviewing and investigating high risk matches.

**83.** Progress in reviewing matches has been slower in 2018/19 than in previous years due to lack of resources. However, the council expects that all high risk matches will be investigated, and outcomes reported to the Monitoring and Audit Committee, by the end of 2019.

## Dependency on key suppliers

**84.** The impact of a failure or collapse of a key supplier can be significant to an organisation and can result in either delays or non-completion of major contracts or, disruptions in the continued provision of vital services. This has brought into focus the risk of key supplier failure and the risk of underperformance in suppliers that are experiencing difficult trading conditions.

**85.** The council considers there is minimal risk in relation to supplier dependency as:

- there are few outsourced contracts
- care homes are all run by council staff.
- contingency arrangements are in place should any issues arise with the current contractor engaged on building maintenance works.

**86.** The only main supplier being monitored is an IT provider and no issues have been reported at present. Should any issue arise with the IT provider, this would be

a national issue for councils as the provider has contracts with most Scottish councils.

## ICT controls

**87.** The council's Digital Strategy (approved by the council in March 2017) has been reviewed to ensure that it continues to be appropriate in meeting the council's priorities and objectives. The review confirmed that the Digital Strategy 2018-20 remains sound with progress monitoring updates regularly provided to the Asset Management Sub-Committee.

**88.** The IT Service has completed their staffing plan resulting in all vacant posts now being filled which has helped deliver key projects including:

- improving stability, performance and security of the pension system
- stabilising and continuing to secure core local and wide area networks as well as improving security of external and internal firewalls
- updating and securing email arrangements as well as implementing protective marking protocols and fully implementing Skype for business.

**89.** The Public Services Network (PSN) is the UK government's high-performance network. Public bodies wishing to connect are required to submit a detailed application together with an independent ICT health check. If the submission meets the assessors' standard, then compliance is granted either unconditionally or conditionally with an action plan if the current level is close to meeting the standard. In August 2018, the council successfully obtained its PSN certification. The council has now applied for their 2019/20 certification and this was received on Thursday 12 September 2019. The council was also accredited with Cyber Essentials Plus in April 2019.

**90.** In addition, the council has been working with General Communication Inc (GCI) to develop cost options around a cloud-based disaster recovery solution. A report is being taken to the Information Services Programme Board in September 2019 and thereafter to the Policy and Resources Committee for final approval to enable implementation during 2020/21.

# Part 3

## Financial sustainability



### Main judgements

**The council and its group financial position, taking account of its reserve position, is sustainable in the foreseeable future although rising demand, increasing costs of services and constraints to central funding will continue to place a strain on the council's capacity to deliver services at the current levels.**

**There are long-term financial plans which highlight a range of funding gaps over a 10-year period. The council is forecasting the most likely case to be a funding gap of £65 million.**

Financial sustainability looks forward to the medium and long term to consider whether a body is planning effectively to continue to deliver its services or the way in which they should be delivered.

### Financial planning

**91.** It is important that long-term financial strategies (typically covering five to ten years) are in place which link spending to the council's strategies, and which reflect the impact of future pressures on the council. The Accounts Commission recommended that councils should plan for a range of scenarios, so that they are prepared for different future levels of funding and income.

**92.** The council has a long-term financial plan for the period 2018 to 2030 which was approved in February 2019. The plan was prepared in response to one of our recommendations included in our annual audit report 2017/18. It includes a range of cumulative funding gaps identified over a ten-year period, as follows:

- best case – £23.6 million.
- likely case – £65.7 million.
- worst case – £145.6 Million.

**93.** Going forward, the forecasts will be used for planning and identifying ways to plug the funding gaps.

### Changing landscape for public financial management and medium to long term financial planning

**94.** Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for some social security benefits. This provides the Scottish Parliament with more policy choices but also means that the Scottish budget is subject to greater uncertainty and complexity.

**95.** A new Scottish budget process has been introduced, which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. As part of the new budget process, the Scottish Government publish a five-year Medium-Term

Financial Strategy (MTFS) which is updated every year. The five-year outlook for the Scottish budget, set out in the MTFS, provides useful context for bodies' financial planning.

**96.** The council uses the MTFS to help inform assumed changes to the future levels of Scottish Government funding settlement that are included in its financial plans.

## **EU withdrawal**

**97.** There remains significant uncertainty surrounding the terms of the UK's withdrawal from the European Union (EU). EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- workforce – the extent to which potential changes to migration are likely to affect the availability of the people and skills needed to deliver services.
- funding – the extent to which potential changes to existing EU funding programmes are likely to affect the finances of public bodies and the activity that such funding supports.
- regulation – the extent to which potential changes to EU regulations are likely to affect the activities of some public bodies.

**98.** The council has flagged the economic uncertainty in relation to Brexit as a risk, incorporating the risk and mitigating actions in its corporate risk register. A "Brexit preparedness group" has been established to take forward any related actions raised by the corporate management team.

**99.** The council is aware of its EU funding streams and has engaged with the Scottish Government to identify the impact of the loss of EU funding. The council has also identified its key suppliers and carried out a risk assessment focussing on workforce, supplier supplies and business continuity. No major issues were identified from this work considered by the Brexit preparedness group.

**100.** The council should ensure it closely monitors developments and has plans in place to mitigate any emerging operational risks.



# Part 4

## Governance and transparency



### Main Judgements

**The council has satisfactory and effective governance arrangements in place that support the scrutiny of decisions made by the council.**

**The council is open and transparent in the way it conducts its business and the public can attend meetings of the council and its standing committees.**

**Future leadership arrangements in the council are unclear. Appropriate governance arrangements should be put in place to resolve this in 2019/20.**

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

### Governance

**101.** We review the council's governance and accountability arrangements annually. This included:

- confirming that the governance framework and governance arrangements, including decision-making and scrutiny, are regularly reviewed and updated to ensure they remain effective. We found these arrangements to be satisfactory
- assessing the effectiveness of decision-making to ensure it is balanced by effective scrutiny and challenge by those independent of the body. We found sound processes in place surrounding decision making and effective scrutiny and challenge by Members during 2018/19
- confirming that there is effective scrutiny and challenge in place over policy decisions, service performance, and programme management. We observed, through attending various committees, effective scrutiny and challenge
- confirming that decision makers have the information they need to scrutinise, challenge and make transparent decisions. We found that decision makers were given appropriate information to make decisions
- ensuring that it is clear what decisions have been made, who made them and the rationale supporting those decisions. We found that documentation over decisions and rationale was clear and available.

**102.** Overall, we concluded that the council's governance arrangements are appropriate, effective and support good governance and accountability.

## Leadership and Management

**103.** The Chief Executive Officer has been on long term sick leave since February 2019. Between February and the end of June members of the senior management team stepped up to the role on a rotational basis to ensure there was no gap in leadership of the council.

**104.** An Interim Chief Executive was formally appointed at the end of June 2019, initially for four months until 31 October while the substantive Chief Executive Officer was absent from work on sick leave. The Council has proposed to extend the interim arrangements until 31 March 2020.

## Openness and transparency

**105.** Transparency means that the general public have access to understandable, relevant and timely information about how the council is taking decisions and how it is using resources such as money, people and assets.

**106.** There is evidence from several sources which demonstrate the council's commitment to transparency.

- members of the public can attend meetings of the full council and other committees and the agendas, papers and minutes of these committee meetings are readily available on the council's website
- the council's website allows the public to access a wide range of information including the register of members' interests, current consultations and how to make a complaint. The website also provides details of the Orkney Public Consultation Group. The group provides information and feedback on services as well as information on the needs of local communities
- the council makes its annual accounts available on its website. These include a management commentary which provides details of performance against budget, information on the use of reserves and risks and uncertainties facing the council.

**107.** Overall, we concluded that the council conducts its business in an open and transparent manner.

## Transparent reporting of financial performance

**108.** The management commentary that accompanies the financial statements should explain the results in simple terms and provide clarity to readers in order to help them understand clearly how the council and its group has performed against budget.

**109.** OIC have revised their management commentary over the last few years but there is scope for further refinement.



### Recommendation 6

**Management should revise the management commentary for the 2019/20 accounts to ensure it provides a clear, concise account of the performance of the council and its group for the year.**

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## Integration of health and social care

**110.** The Scottish Government's 2020 vision places greater emphasis on enabling people to stay in their homes, or another homely setting, where possible, sharing

their lives with their family and friends and doing the things that give life meaning and value. The integration of health and social care is a mechanism to achieve this.

**111.** The Orkney Integration Joint Board (IJB) is provided in partnership with NHS Orkney and became fully operational on 1 April 2016. The financial transactions of the IJB have been consolidated into the council's group accounts and we have audited these with satisfactory results

**112.** The Orkney IJB reported a year end surplus of £0.12 million. The surplus was in relation to funding received by NHS Orkney for specific services (primary care and alcohol and drugs partnership) which was not fully utilised and is held within earmarked reserves.

**113.** During the year the original budget for 2018/19 was supplemented by additional funding from the partners of the IJB, with NHS Orkney providing an additional £1.0 million for delegated services, as well as £8.0 million for set-aside services. OIC provided additional funding of £0.9 million during the year and a further £0.3 million at the end of the year to ensure a break-even position. Of the additional funding provided by the council, £0.8 million was in respect of high cost residential childcare places whilst, £0.1 million was to cover agreed budget savings for new charging proposals that were not implemented by the service. A separate 2018/19 annual audit report for Orkney IJB was presented to the Orkney IJB Audit Committee on 29 August 2019.

# Part 5

## Value for money



### Main judgements

The council continues to demonstrate progress in a number of areas in response to the Best Value Assurance Report published in December 2017.

Performance management arrangements are well developed. The Council Plan 2018-23, which has been agreed, and has greater focus on how actions and agreed activities will impact on positive outcomes.

The Change Programme is intended to drive an evaluation of key business processes, including a review of options for modernising and delivering frontline services more efficiently. However, the programme has proved difficult to manage and there has been a delay in delivering the intended outcomes.

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

### Best value

**114.** Best value is assessed over the five-year audit appointment, as part of the annual audit work. In addition, a Best Value Assurance Report (BVAR) for each council will be considered by the Accounts Commission at least once in this five-year period. The BVAR report for Orkney Islands Council was published in December 2017 and included an action plan setting out our recommendations for improvement.

**115.** Orkney Islands Council is the smallest council in Scotland with a complex and challenging local context. The council has a very good understanding of the area and its communities and has clear priorities and ambition for the islands that reflect these.

**116.** The council's response to the Accounts Commission's recommendations, in the form of the Best Value Response Plan, was approved in April 2018. We have followed up the council's progress in implementing our recommendations. [Exhibit 8](#) details the recommendations for improvement and progress reported by the council to date.

**117.** Overall, the council is progressing a number of activities in response to the BVAR recommendations.

## Exhibit 8

### Progress in implementing best value recommendations

BVAR Recommendation	Progress in implementing each recommendation
<p>The council must maintain the current pace of improvement and ensure it makes progress with the following:</p>	
<p>Developing a detailed workforce plan</p>	<p>The council's Corporate Workforce Plan was approved by the Policy and Resources Committee on 23 April 2019. Individual Service Plans for 2019-22 are being presented for approval to the relevant committees in September 2019 and these will include service-specific workforce actions linked to the overarching council Workforce Plan.</p>
<p>Managing capital projects effectively to avoid slippage and the negative impact on delivering strategic priorities.</p>	<p>Concerto is now a live system within asset and property management and is fully integrated with the council's financial system Integra.</p> <p>Updated guidance on the operation of the Capital Project Appraisal process has been developed and revised, and was presented to the Senior Management Team in 2018. In 2019/20, further guidance is being developed in association with finance colleagues which should link into the planned agreement of long-term capital programme priorities and the sequence of delivery.</p>
<p>Longer term financial planning to ensure the sustainability, feasibility and practicalities of current spending plans. This should be done with reference, also, to the Strategic Reserve Fund.</p>	<p>A long-term Financial Plan for 2018/19 to 2029/30 was approved in February 2019.</p>
<p>The council must ensure it makes progress with the implementation of the IT Strategy and Digital Strategy, including the associated capital programme and completion of the review of capacity.</p>	<p>The council is making positive progress with the Digital Strategy Delivery Plan (2018-2020). Majority of actions complete with 10 actions still to progress. The Council is also making progress with the IT Strategy Delivery Plan, with 14 of the 31 actions complete.</p>
<p>To support a culture of improvement, the council should build on the self-evaluation work already in place in services and further develop a corporate approach</p>	<p>A revised approach to the How Good is Our Council? self-assessment model was approved by the Monitoring and Audit Committee in November 2018. This has been rolled out at service level during 2019 and used to inform the corporate level self-assessments undertaken in August 2019, as well as contributing to the development of Service Plans for 2019-22.</p>
<p>The council should build on its good examples of community engagement and participation to improve consistency of approach across all the communities, including those that are 'hard to reach'</p>	<p>In recent years the third sector has been commissioned to carry out "place standard" consultation in the isles to inform the council's first Locality Plan and has conducted two participatory budgeting exercises to distribute Community Choices funding under the banner "Your Island Your Choice"</p>

BVAR Recommendation	Progress in implementing each recommendation
	A further 5 surveys have been issued in respect of the Orkney Opinions pilot with good response rates and positive feedback from managers. Funding has been found to maintain Orkney Opinions during 2019/20.
The council should set out how its activities will contribute to improved outcomes for communities so that it can evidence and monitor the impact.	The Council Plan 2018-23 sets out the intended outcomes for each strategic priority and for each individual action. Completion of refreshed service plans is timed for completion in September 2019.
The council and its community planning partners should ensure clear performance management arrangements are in place to demonstrate that they are making progress towards delivering positive outcomes for the community.	The SMT has agreed a revised Strategic Planning and Performance Framework and this is being presented to the Monitoring and Audit committee in September 2019. The Local Government Benchmarking Framework Indicators were reported to Service Committees in April 2019 for Elected Member scrutiny.
The council should consider how it can enhance its councillor training and development programme and encourage better uptake by councillors of personal development opportunities.	A review of the councillors Induction Programme was undertaken in October 2018. Feedback has been collated and a programme is in development, due to commence in Autumn 2019.

**118.** The council has a Change Programme to help underpin a number of the BVAR response plan actions. The Change Programme is intended to drive an evaluation of key business processes, including a review of options for modernising and delivering frontline services more efficiently. The Change Programme, which has been in place since 2011, has proved difficult to manage and there has been a delay in delivering the intended outcomes.



### Recommendation 7

**The council should ensure the change programme sets out realistic plans and savings targets, and that appropriate management arrangements in place to ensure delivery of the programme.**

### Following the public pound

**119.** Local authorities have a statutory responsibility to comply with the Accounts Commission / COSLA Code of Guidance on funding external bodies and following the public pound (FPP).

**120.** The council's financial regulations contain a specific section on following the public pound. These emphasise that services must adhere to the council's guidance for allocating funds to external organisations. The guidance applies where funding is provided, or transferred, to arm's-length bodies such as companies, trusts and voluntary organisations.

**121.** The following companies are regarded as arm's length organisations through their association with the council:

- the council holds 100% of the shares in 2 Companies: Orkney Towage Company Limited and Orkney Ferries Limited.
- the Pickaquoy Centre Trust is a charitable trust formed in 1999 and is registered in Scotland. The Trust provides leisure facilities within Orkney Islands Council's area to the general public. Internal Audit carried out a review of the Pickaquoy Centre Trust in relation to the FPP code and noted within their annual report that generally the principles of the Code of Practice of Following the Public Pound were being followed within the Service Agreement and that areas of good practice were evident. Areas where improvements could be made were also identified, both regarding the content of the Service Agreement and the actual operating arrangements between the council and the Trust.
- Orkney Islands Council provides further and higher education provision through Orkney College using a devolved Board of Management arrangement. Orkney College is funded by direct grant from the Scottish Funding Council (SFC). The trading position from these activities is reflected within the council's comprehensive income and expenditure statement as part of financing and investment expenditure. In 2018/19 the net effect of Orkney College activities resulted in a deficit of £0.621 million. The college applied most of its useable reserves to achieve a break-even position for the year.

**122.** We concluded that the council has appropriate arrangements for ensuring compliance with the Code of Guidance on funding external bodies and following the public pound.

## Performance management

**123.** The council's performance management arrangements were considered in our BVAR issued in December 2017. We identified that the council has an established performance management framework that managers and councillors clearly understand, and that this provides a sound basis for improvement.

**124.** There is a clear corporate planning framework. The Council Plan 2018-23, which has been agreed, has greater focus on how actions and agreed activities will impact on positive outcomes. Service Plans for 2019-22, which are currently being developed, will include service-specific workforce actions linking to the overarching Council Workforce Plan. Councillors have ownership of the council plan and monitor progress against actions every six months.

**125.** Services also report performance to their respective management teams and service committees on a six-monthly basis. Performance reports are sufficiently detailed to support scrutiny.

**126.** The council publishes an annual performance report which is available on its website. The annual performance report shows the council's performance towards meeting the targets set out in its council plan. It also outlines how well the council performed against the national Local Government Benchmarking Framework indicators.

## Overview of performance targets

**127.** The council participates in the [Local Government Benchmarking Framework](#) (LGBF). The framework aims to bring together a wide range of information about how all Scottish Councils perform in delivering better services to local communities, including the cost of services and how satisfied citizens are with them.

**128.** The most recent [National Benchmarking Overview Report 2017/18](#) by the Improvement Service was submitted to the Policy and Resources Committee in April 2019. The overall conclusion was that the council performed well in



comparison to other councils. However, areas where council performance was below the Scottish average include:

- the cost per dwelling of collecting council tax in Orkney was £16.93 compared to the Scottish average of £7.35.
- an average of 8.66 days per teacher were lost due to sickness absence in Orkney compared to the Scottish average of 5.93 days.
- 81.1% of invoices to the council were paid within 30 days compared to the Scottish average of 93.19%.

**129.** The Policy and Resources Committee receives regular performance reports throughout the year and an annual performance report. These reports monitor progress against the council's key priorities in respect of the targets within the Council Delivery Plan. The council uses red/amber/green ratings to show which indicators are below, near or on target. Based on the most recent report submitted to the committee in June 2019 several positives were highlighted including:

- 56 indicators are rated green, 8 amber and 12 red
- Occupational therapy input continues to support the reablement approach within home care
- The Employment Service continues to perform with 44 per cent of participants in paid hours of work as well as supporting unpaid work experience / volunteering / befriending
- Agreements are in place for formally managing the relationship between the council and the Pickaquoy Centre Trust.

## Statutory performance indicators (SPIs)

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

**131.** For 2018/19 two SPIs were prescribed:

- SPI 1: covering a range of information relating to areas of performance such as improving local public services, improving local outcomes, engaging with communities and achieving best value
- SPI 2: relates to the reporting of performance information as required by the [Local Government Benchmarking Framework](#).

**132.** Overall, we placed reliance on the work of Internal Audit and concluded that the council's arrangements for publication are satisfactory.

## National performance audit reports

**133.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2018/19, Audit Scotland published a number of reports which are of direct interest to the council. These are outlined in [Appendix 4](#).

**134.** Relevant national reports continue to be routinely presented to the Policy and Resources Committee throughout the year. The council has well established and effective arrangements in place to ensure that our national reports and their impact on the council are considered by members.



# Appendix 1

## Action plan 2018/19



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Annual Budget</b></p> <p>The council continues to approve contributions from the SRF to supplement its funding from the Scottish Government and local taxes raised through council tax and non-domestic rates.</p> <p><b>Risk</b> - over-reliance on the SRF as a means of balancing the General Fund budget as part of a long-term financial strategy is not considered good practice, particularly given the levels of volatility that may continue to impact adversely on investment returns.</p>	<p>The council needs to consider reducing the level of General Fund expenditure to bring it into line with the financial support received (<a href="#">refer paragraph 40</a>).</p>	<p>The Council will be given the opportunity to reduce the level of General Fund expenditure in the budget setting process for 2020/21 to 2022/23.</p> <p>The Council will need to balance the risks of reducing essential services against the sustainability of balancing the General Fund budget with contributions from the SRF</p> <p>Head of Finance February 2020</p>
2	<p><b>Harbour Authority ear-marked balance</b></p> <p>The council is clear that responsibility for decommissioning costs of the Flotta Oil Terminal rests with the operator, Repsol, but has earmarked a proportion of the General Fund balance to ensure it can meet the cost of any unexpected events. The sum which has been earmarked is based on a report prepared by consultants in 1997, uprated for inflation.</p> <p><b>Risk</b> - Economic conditions and oil terminal operations have changed significantly since the consultants provided their initial estimate of costs, therefore the sum set aside may not be enough to meet the cost of any unexpected event.</p>	<p>The council should obtain an up to date estimate of the decommissioning costs and ensure the sum set aside to meet any unexpected events is fair and reasonable (<a href="#">refer paragraph 50</a>).</p>	<p>An up to date estimate of the decommissioning costs will be sought during the next year.</p> <p>Executive Director of Development and Infrastructure July 2020</p>
3	<p><b>Longer term financial planning -Strategic Reserve Fund</b></p> <p>The high level of reserves supports the need for long term</p>	<p>The Council should prioritise the preparation of a longer term (five to ten year)</p>	<p>We will extend the planning period for the strategic reserve fund over a longer term (five to ten years).</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>financial planning to ensure the funds will be used to achieve strategic aims and benefit the people of Orkney. The council has made progress in agreeing a medium-term financial plan for the strategic reserve fund covering the period 2018/19 to 2021/22.</p> <p><b>Risk</b> – the reserve balances may not support strategic aims.</p>	<p>financial plan for the strategic reserve fund.</p> <p><a href="#">(refer paragraph 51)</a></p>	<p>Head of Finance February 2020.</p>
4	<p><b>Capital slippage</b></p> <p>The original approved limit for capital expenditure during 2018/19 was £30 million which included £11 million slippage from the previous financial year. capital slippage in 2018/19 amounted to £15 million due to weaknesses in forward planning arrangements.</p> <p><b>Risk</b> – capital slippage might impact on strategic priorities that are dependent on capital projects being completed on time.</p>	<p>The council should ensure that slippage and re-profiling of capital projects does not have a significant impact on strategic priorities that are dependent on capital projects being completed on time <a href="#">(refer paragraph 61)</a>.</p>	<p>Action on reviewing the Capital Programme is already underway to try and minimise slippage. The programme delivery has suffered from over ambitious timescales and limited capacity.</p> <p>Chief Executive June 2020</p>
5	<p><b>Expenses</b></p> <p>Our financial statements audit work included testing of 30 officers' expense claims. We found a number of instances where insufficient checks had been carried out prior to approving claims. Some claim forms did not have receipts attached, four claims had credit card receipts attached instead of detailed receipts, and there were instances where it was unclear if expenditure represented value for money.</p> <p><b>Risk</b> – Expenses claimed may not comply with agreed procedures.</p>	<p>All claims should include detailed receipts to support items of expenditure <a href="#">(refer paragraph 76)</a>.</p>	<p>The requirement to attach receipts to expenses claims and provide detailed receipts to support credit card receipts is included in existing guidelines. A reminder of the procedures to be followed when claiming expenses will be issued to all staff.</p> <p>Head of Finance December 2019</p>
6	<p><b>Management commentary</b></p> <p>The management commentary that accompanies the financial statements should explain the results in simple terms and provide clarity to readers in order to help them understand clearly how the council and its group has performed against budget.</p>	<p>Management should revise the management commentary for the 2019/20 accounts to ensure it provides a clear, concise account of the performance of the council and its group for the year. <a href="#">(refer paragraph 109)</a></p>	<p>The management commentary in its current form has evolved over the years with changes made to reflect improvements suggested through the audit process that have invariably increased the length of the commentary. The suggestion</p>


**No. Issue/risk**
**Recommendation**
**Agreed management action/timing**

OIC have revised their management commentary over the last few years but there is scope for further refinement.

**Risk** - the performance of the council and its group may not be transparent, and the reader may not fully understand key messages.

to simplify the management commentary is welcome

Head of Finance

June 2020

**7 Change programme**

The Change Programme is intended to drive an evaluation of key business processes, including a review of options for modernising and delivering frontline services more efficiently. The Change Programme, which has been in place since 2011, has proved difficult to manage and there has been a delay in delivering the intended outcomes.

**Risk** - the programme may not deliver planned changes and efficiencies.

The council should ensure the change programme sets out realistic plans and savings targets and that appropriate management arrangements in place to ensure delivery of the programme. ([refer paragraph 118](#))

The Council's Senior Management Team have been reviewing the Change Programme activities and projects to refocus the efforts of the team and deliver results.

Head of Executive Support

Ongoing.

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p><b>Satisfactory</b></p> <p>Audit testing was satisfactory, and no fraud concerns were identified in respect of management override of controls.</p>
<p><b>2 Risk of Fraud over income</b></p> <p>Orkney Islands Council receives a significant amount of income in addition to Scottish Government funding.</p> <p>The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>	<p><b>Satisfactory</b></p> <p>Audit testing was satisfactory, and no concerns were identified.</p>
<p><b>3 Risk of Fraud over expenditure</b></p> <p>The Financial Reporting Council's <i>Practice Note 10</i> requires consideration of the risk of fraud over expenditure. The extent and nature of expenditure, for example, welfare benefits, social care payments and grants means that there is an inherent risk of fraud.</p>	<p>Review of work performed on the National Fraud Initiative matches.</p> <p>Assess the high level key controls in areas of significant expenditure.</p> <p>Focused substantive testing of expenditure and housing benefit transactions.</p>	<p><b>Satisfactory</b></p> <p>Audit testing was satisfactory, and no concerns were identified.</p>
<p><b>4 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of non-current assets and provisions. This</p>	<p>Review and comment on the appropriateness of the Council's policy with regard to useful lives.</p> <p>Completion of 'review of the work of an expert' in</p>	<p><b>Satisfactory</b></p> <p>We found the estimates and judgements (where applied) were appropriate.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>accordance with ISA500 for the professional valuer.</p> <p>Focused substantive testing of asset valuations and asset useful lives.</p> <p>Focused substantive testing of provisions.</p>	
<p><b>5 Value of Investments</b></p> <p>The Council requires to adopt the new standard IFRS 9 – Financial Instruments during 2018/19. Preparatory work should be undertaken to ensure full compliance with the new standard and reduce the risk of a material error within the balance sheet.</p>	<p>Review of the approach adopted by management to ensure compliance with IFRS 9.</p> <p>Substantive testing of investment values at year end to ensure fairly stated.</p> <p>Review of financial instruments' disclosures.</p>	<p><b>Satisfactory</b></p> <p>We identified a number of disclosure changes (as detailed in the audit finding in <a href="#">Exhibit 3</a>. The accounts were updated to reflect the changes and confirmed as satisfactory.</p>
<p><b>6 Pension Scheme Valuation</b></p> <p>The Council accounts for its share of Orkney Islands Council Pension Fund in accordance with International Accounting Standard 19 Employee Benefits (IAS19). This relies on valuations of pension fund assets and liabilities by the actuary. The timing of actuarial reports means that actuaries produce their IAS 19 reports using estimated data for the final part of the year. Asset returns estimated by the actuary for the final part of the year can be significantly higher or lower than actual returns.</p> <p>The Council should ensure that asset values reported are as accurate as possible and that any potential differences due to timing of information are adequately considered.</p>	<p>Review of actuarial report which supports pension assets and liabilities, as accounted for at year end in the balance sheet and the movements in the comprehensive income and expenditure statement, and all associated disclosures.</p>	<p><b>Satisfactory</b></p> <p>The council obtained an up to date valuation prior to preparing the annual accounts.</p>
<p><b>7 Net pension asset measurement</b></p> <p>Where the Council reports a net pension asset on their balance sheet we advised, last year, that consideration should be given to working with the actuary to establish an asset ceiling.</p> <p>There is a risk that the accounts could be materially misstated if it is decided that an asset ceiling would be</p>	<p>Review of year end transactions and balances in the primary financial statements where the need for an asset ceiling has been established.</p> <p>Review of associated IAS 19 disclosures.</p>	<p><b>Satisfactory</b></p> <p>No net pension asset disclosed on the balance sheet for 2018/19. Therefore, no asset ceiling required.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>appropriate, and it has not been established.</p>		
<p><b>8 Non-current assets</b></p> <p>The Code requires councils to consider the appropriateness of remaining useful lives of all their assets on an annual basis.</p> <p>It was noted that many of the council's historic cost assets such as infrastructure assets are being revalued on a regular basis but that the useful lives have not been reviewed for several years. As a result, many of the infrastructure assets are recorded with short useful lives.</p> <p>There is a risk that the accounts could be materially misstated if assets are recorded with incorrect useful lives.</p>	<p>Focused substantive testing of non-current asset values to ensure updated asset lives have been applied.</p>	<p><b>Satisfactory</b></p> <p>Audit testing was satisfactory, and no concerns were identified.</p>
<p><b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b></p>		
<p><b>9 Financial sustainability</b></p> <p>The council has not yet developed a longer-term financial plan. Longer term financial planning would improve the sustainability, feasibility and practicalities of current spending plans.</p>	<p>Monitor progress with preparing longer term financial plans providing comment in our annual audit report 2018/19.</p>	<p><b>Satisfactory</b></p> <p>A long- term financial plan (2018/19 to 2030) was approved by the Policy and Resources Committee in February 2019 (<a href="#">refer to paragraph 92</a>).</p>
<p><b>10 Financial management</b></p> <p>The council has a history of slippage in its capital programme due to unrealistic timescales and budgets. The original approved limit for capital expenditure during 2018/19 was £30 million, however, capital expenditure in 2018/19 was £15 million resulting in an underspend of £15 million.</p> <p>There is a risk that ineffective direction and control of the capital investment programme may lead to rescheduling of general fund capital projects which could have a significant impact on strategic priorities that rely on capital projects being completed on time.</p>	<p>Monitor capital slippage and assess any actions taken to reduce slippage providing comment in our annual audit report 2018/19.</p>	<p><b>Unsatisfactory</b></p> <p>Refer to <a href="#">paragraphs 61</a> and <a href="#">appendix 1, action plan point 4</a>.</p>

Audit risk	Assurance procedure	Results and conclusions
<p><b>11 Annual Budget</b></p> <p>It is becoming increasingly likely that the council will receive a decrease in grant funding in the short to medium term and it therefore needs to consider reducing the level of General Fund expenditure to bring it into line with the financial support received.</p>	<p>Monitor progress providing comment in our annual audit report 2018/19.</p>	<p>The council continues to support service cost expenditure through transfers from reserves (<a href="#">refer appendix 1, action plan point 1.</a>)</p>
<p><b>12 Change of Chief Internal Auditor</b></p> <p>The Chief Internal Auditor left her post to take up the position of Payments Manager with effect from 16 November 2018.</p> <p>Until a replacement is in post, there is a risk that the council may not be able to demonstrate full compliance with PSIAS nor complete the operational audit plan.</p>	<p>Personnel arrangements and completion of the operational audit plan will be monitored, providing comment in our annual audit report 2018/19.</p>	<p><b>Satisfactory</b></p> <p>A new Chief Internal Auditor commenced with the council in February 2019 and the operational audit plan 2018/19 was completed.</p>
<p><b>13 Governance and transparency - Pickaquooy Centre Trust</b></p> <p>The Service Agreement for the Trust expired in March 2015. Arrangements have rolled forward but the council had intended to review the agreement and operating arrangements between the council and the Trust. Capacity issues are hindering progress with the review.</p> <p>There is a risk that the existing, agreement no longer meets the requirements of the council.</p>	<p>Monitor progress in reviewing the service agreement between the council and the Trust, providing comment in our annual audit report 2018/19.</p>	<p><b>Satisfactory</b></p> <p>The amended SLA has been agreed by the Pickaquooy Trust and approved by the Education, Leisure and Housing Committee in June 2019.</p> <p>The SLA was formally signed by all parties in August 2019.</p>
<p><b>14 Change Programme</b></p> <p>The council's Change Programme aims to deliver significant savings of £3.8 million between 2017/18 and 2021/22. To date £1.5 million baseline savings have been approved. However, £2.3 million savings have yet to be identified.</p> <p>Risk: There is a risk that the planned savings will not be achieved by 2021/22.</p>	<p>Monitor progress with identifying and achieving savings, providing comment in our annual audit report 2018/19.</p>	<p>The council is experiencing some difficulty in managing the change programme (<a href="#">refer paragraph 118</a>).</p>



# Appendix 3

## Summary of national performance reports 2018/19

		 <b>2018/19 Reports</b>	
Local government in Scotland: Challenges and performance 2018		<b>Apr</b>	
Councils' use of arm's-length organisations		<b>May</b>	 Scottish Fire and Rescue Service: an update
Scotland's colleges 2018		<b>Jun</b>	
		<b>Jul</b>	 The National Fraud Initiative in Scotland 2016/17
Forth Replacement Crossing		<b>Aug</b>	 Major project and procurement lessons
Children and young people's mental health		<b>Sept</b>	 Superfast broadband for Scotland: further progress update
NHS in Scotland 2018		<b>Oct</b>	
Health and social care integration: update on progress		<b>Nov</b>	 Local government in Scotland: Financial overview 2017/18
		Dec	
		Jan	
		Feb	
		<b>Mar</b>	 Local government in Scotland: Challenges and performance 2019

### Local government relevant reports

[Local government in Scotland: Challenges and performance 2018](#) – April 2018

[Councils' use of arm's-length organisations](#) – May 2018

[Health and social care integration: update on progress](#) – November 2018

[Local government in Scotland: Financial overview 2017/18](#) – November 2018

[Local government in Scotland: Challenges and performance 2019](#) – March 2019



# Orkney Islands Council

## 2018/19 Annual Audit Report

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