

Orkney Islands Council

Annual Audit Plan 2021/22



 AUDIT SCOTLAND

Prepared for Orkney Islands Council
March 2022

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Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2021/22 external audit of Orkney Islands Council (the Council). The main elements of our work include:

- evaluation of the key controls within the main accounting systems
- an audit of the annual accounts, and provision of an Independent Auditor's Report
- an audit opinion on other statutory information published within the annual report and accounts including the Management Commentary, the Annual Governance Statement and the Remuneration Report
- consideration of arrangements in relation to the audit dimensions: financial management, financial sustainability, governance and transparency and value for money that frame the wider scope of public sector audit
- consideration of Best Value arrangements
- providing assurance on the Housing Benefit Subsidy Claim, Non-Domestic Rates Return and the Whole of Government Accounts (WGA) return
- review the Council's arrangements for preparing and publishing statutory performance information
- review the Council's participation in the National Fraud Initiative.

Impact of Covid-19

2. The coronavirus disease (Covid-19) pandemic has had a significant impact on public services and public finances, and the effects will be felt well into the future.

3. The Auditor General for Scotland, the Accounts Commission and Audit Scotland continue to assess the risks to public services and finances from Covid-19 across the full range of our audit work, including annual audits and the programme of performance audits. The well-being of audit teams and the delivery of high-quality audits remain paramount. Changes in our approach may be necessary and where this impacts on annual audits, revisions to this Annual Audit Plan may be required.

Adding value

4. We aim to add value to the Council through our external audit work by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we will help the Council promote improved standards of governance, better management and decision making and more effective use of resources. Additionally, we attend meetings of the Monitoring and Audit Committee and actively participate in discussions.

Respective responsibilities of the auditor and the Council

5. The [Code of Audit Practice \(2016\)](#) sets out in detail the respective responsibilities of the auditor and the Council. Key responsibilities are summarised below.

Auditor responsibilities

6. Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973 and the [Code of Audit Practice](#) (including [supplementary guidance](#)) and guided by the Financial Reporting Council's Ethical Standard.

7. Auditors in the public sector give an independent opinion on the financial statements and other information within the annual accounts. We also review and report on the arrangements within the audited body to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

The Council's responsibilities

8. The Council is responsible for maintaining accounting records and preparing financial statements that give a true and fair view.

9. Also, the Council has the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and legality that enable them to deliver their objectives.

Managing the transition to 2022/23 audits

10. Audit appointments are usually for five years but were extended to six years due to Covid-19. 2021/22 is the final year of the current appointment and we will work closely with our successors to ensure a well-managed transition.

Financial statements audit planning

Materiality

11. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. We are required to plan our audit to determine with reasonable confidence whether the financial statements are free from material misstatement. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.

Materiality levels for the 2021/22 audit

12. We assess materiality at different levels as described in [Exhibit 1](#). The materiality values for the Council and its group are set out below.

Exhibit 1

2021/22 Materiality levels for the Council

Materiality	Amount	Group
Planning materiality – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set at 1.5% of gross expenditure for the year ended 31 March 2022 based on the latest audited financial statements for 2020/21.	£2.5 million	£2.5 million
Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement, we have assessed performance materiality at 60% of planning materiality.	£1.5 million	£1.5 million
Reporting threshold (i.e. clearly trivial) – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.	£125 thousand	£125 thousand

Source: Audit Scotland

Significant risks of material misstatement to the financial statements

13. Our risk assessment draws on our cumulative knowledge of the Council, its major transaction streams, key systems of internal control and risk management processes. Also, it is informed by our discussions with management, meetings with internal audit, attendance at committees and a review of supporting information.

14. Based on our risk assessment process, we identified the following significant risks of material misstatement to the financial statements. These are risks which have the greatest impact on our planned audit procedures. [Exhibit 2](#) summarises the nature of the risk, the sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurance over the risk.

Exhibit 2

2021/22 Significant risks of material misstatement to the financial statements

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p>1. Risk of material misstatement due to fraud caused by the management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance</p>	<ul style="list-style-type: none"> • Assess the design and implementation of controls over journal entry processing. • Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments. • Test journals at the year-end and post-closing entries and focus on significant risk areas. • Consider the need to test journal entries and other adjustments during the period. • Evaluate significant transactions outside the normal course of business. • Assess the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements. • We will assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Focussed testing of accounting accruals and prepayments.
<p>2. Estimation in the valuation of</p>	<p>Asset valuation reports.</p>	<ul style="list-style-type: none"> • Review the information provided to the external valuer to assess for completeness.

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p>non-current assets.</p> <p>There is a significant degree of subjectivity in the valuation of land and buildings. Valuations are based on specialist and management assumptions and changes in these can result in material changes to valuations.</p> <p>All non-current assets are revalued on a five-year rolling basis. Values may also change year on year, and it is important that the Council ensures the financial statements accurately reflect the value of the land and buildings.</p>	<p>Feedback from client services, and property and estates teams in respect of change in use, general condition, and impairment of non-current assets.</p> <p>Feedback from asset valuers in respect of material changes in market conditions.</p>	<ul style="list-style-type: none"> • Review the minute of the discussions between valuers and the Council. • Review detailed working papers to support asset reviews and impairments. • Evaluate the competence, capabilities, and objectivity of the professional valuer. • Obtain an understanding of the management's involvement in the valuation process to assess if appropriate oversight has occurred. • Critically assess the approach the Council has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach. • Challenge management's assessment of why it considers that the land and buildings not revalued in 2021-22 are not materially misstated. We will critically assess the appropriateness of any assumptions. • Test the reconciliation between the financial ledger and the property asset register. • Critically assess the adequacy of the Council disclosures regarding the assumptions in relation to the valuation of land and buildings.
<p>3. Estimation in the valuation of Level 3 investments</p> <p>The Council has a significant portfolio of level 3 investments, for example unquoted equities, where valuations involve the application of a variety of estimates in determining appropriate valuations. This subjectivity gives rise to a significant risk of misstatement</p>	<p>Regular managed funds investment performance monitoring reports prepared by the Council's appointed investment consultants, including a current rating of each fund managers' competency and capabilities.</p> <p>Review of annual accounts, independent valuation reports</p>	<ul style="list-style-type: none"> • Evaluate the competence, capabilities, and objectivity of the fund manager. • Confirmation of year-end values to valuation reports and other supporting documentation. • Review the relevant investment manager service auditor reports for qualifications. • Review arrangements at the Council to assess the reasonableness of values provided by the fund manager. • Review the accounts to ensure there is adequate disclosure on the sources of uncertainty and the key estimates and judgements associated with level 3 assets.

Significant risk of material misstatement	Sources of assurance	Planned audit response
in the financial statements.	and internal control reports for each fund manager.	

Source: Audit Scotland

15. As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statement*, there is a presumed risk of fraud over the recognition of revenue. There is a risk that revenue may be misstated resulting in a material misstatement in the financial statements. We have rebutted this risk as funding received from the Scottish Government is clearly communicated and can readily be agreed to third party confirmations. In addition, the Council's other income streams comprise of a high volume of low value transactions which are unlikely to result in a material manipulation of the financial statements.

16. In line with Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom*, as most public-sector bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk relating to revenue recognition. We have considered expenditure streams including payroll and depreciation and consider that these items can be readily forecast based on a predictable pattern of expenditure. We have concluded that opportunity for fraudulent manipulation is deemed to be limited. The Council's other expenditure is made up of a high volume of low value items and therefore the risk of a material misstatement is deemed to be low.

17. We have not, therefore, incorporated specific work into our audit plan in these areas over and above our standard audit procedures.

Other areas of audit focus

18. As part of our assessment of audit risks, we have identified other areas where we consider there are also risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we do not consider these to represent significant risks. We will keep these areas under review as our audit progresses. If our assessment of risk changes and we consider these risks to be significant, we will communicate this to management and those charged with governance and revise our planned audit approach accordingly.

19. The areas of specific audit focus are:

- Estimation in the valuation of the IAS19 pension liability: The actuarial valuation depends on a range of financial and demographic estimations about the future. The subjectivity around these estimates gives rise to a risk of material misstatement in the financial statements.

- Valuation of level 1 and level 2 assets: Investments held by the Council are subject to market price fluctuations and a degree of estimation. The Council holds material level 1 and level 2 investments (where the valuation is based on quoted market price or where the fair value is determined using valuation techniques based on market prices). Due to the material amounts and in particular, the degree of subjectivity and complexity in the valuation of level 2 assets, this gives rise to a risk of material misstatement in the financial statements.
- Finance team capacity: There has been significant change and within the finance team in 2021/22. With this level of change there is an increased risk of error in the financial statements both in the figures reported and the disclosures.
- Covid 19 funding – the Scottish Government has provided a significant amount of additional funding for Covid-19 support schemes. The Council is required to assess the nature of the transactions that are taking place to establish the appropriate accounting treatment. Where the council is acting as an intermediary for the Scottish Government the transactions should be recorded as agency in the accounts. Due to the volume and high value of grants this increases the risk of material misstatement.

Group Consideration

20. As group auditors, we are required under International Standard on Auditing (UK) 600: *Audits of group financial statements (including the work of component auditors)* to obtain sufficient appropriate audit evidence on which to base our audit opinion on the group financial statements.

21. The Council has a group which comprises component entities, including subsidiaries, associates and joint ventures. The audits of the financial information of some of the components are performed by other auditors. We plan to place reliance on the work of the component auditors. We will obtain sufficient appropriate audit evidence in relation to the consolidation process and the financial information of the components on which to base our group audit opinion.

Audit of the trusts registered as Scottish charities

22. The 2006 Regulations require charities to prepare annual accounts and require an accompanying auditor's report where any legislation requires an audit. The Local Government (Scotland) Act 1973 specifies the audit requirements for any trust fund where some or all members of a council are the sole trustees. Therefore, a full and separate audit and independent auditor's report is required for each registered charity where members of the Council are sole trustees, irrespective of the size of the charity.

23. Members of the Council are sole trustees for one trust registered as Scottish charities, with total assets of £0.05 million as at 31 March 2021. The preparation and audit of financial statements of registered charities is regulated by the Charities and Trustee Investment (Scotland) Act 2005 and the Charities Accounts (Scotland) Regulations 2006.

24. Other than a risk of management override of controls which has also been identified as risks in respect of the council's annual accounts, no specific planning risks were identified in respect of the charity's accounts

25. The charity administers educational grants and we recognised in 2020/21 the level of activity within the trust was low. There is a risk that the trust is not meeting its charitable objectives and is failing to provide appropriate public benefit. We will review and provide and update in our 2021/22 Annual Audit Report.

Materiality levels for the 2021/22 audit of trusts registered as Scottish charities

26. Materiality levels for the various trusts are set out in [Exhibit 3](#).

Exhibit 3

2021/22 Materiality levels for the charitable trust

Charitable trust	Planning Materiality	Performance Materiality	Reporting Threshold
General Charitable Trust	£1,000 (Based on 1.5% of audited 2020/21 net asset value)	£750 (Based on 75% of planning materiality)	£50

Source: Audit Scotland

Audit risk assessment process

27. Audit risk assessment is an iterative and dynamic process. Our assessment of risks set out in this plan may change as more information and evidence becomes available during the progress of the audit. Where such changes occur, we will advise management and where relevant, report them to those charged with governance.

Audit dimensions and Best Value

Introduction

28. The [Code of Audit Practice](#) sets out the four dimensions that frame the wider scope of public sector audit. The Code of Audit Practice requires auditors to consider the adequacy of the arrangements in place for the audit dimensions in audited bodies.

Audit dimensions

29. The four dimensions that frame our audit work are shown in [Exhibit 4](#).

Exhibit 4

Audit dimensions



Source: Code of Audit Practice

30. In summary, the four dimensions cover the following:

- **Financial management** – financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Financial sustainability** – as auditors, we consider the appropriateness of the use of the going concern basis of accounting as part of the annual

audit. We will also comment on financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years).

- **Governance and transparency** – 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.
- **Value for money** – value for money refers to using resources effectively and continually improving services.

Best Value

31. 2021/22 is the final year of the extended six-year approach to auditing Best Value in councils. Best Value work is integrated within the annual audit. It is to be assessed comprehensively over the period of the audit appointment, both through ongoing annual audit work and through discrete packages of work focussing on specific issues. Conclusions and judgements on Best Value will be reported through:

- the Annual Audit Report for each council that will provide a rounded picture of the council overall.
- an Annual Assurance and Risks Report that the Controller of Audit will provide to the Accounts Commission that will highlight issues from across all 32 council annual audit reports.
- a Best Value Assurance Report (BVAR) for each council that will be considered by the Accounts Commission at least once over the period of the audit appointment.

32. BVARs will be considered by the Accounts Commission between February and September 2022 on the councils listed in [Exhibit 5](#).

Exhibit 5 2022 Best Value Assurance Reports



Comhairle nan Eilean Siar

Shetland Island Council

Angus Council

Moray follow-up

33. The Best Value work planned at the Council this year will focus on the follow-up on the findings reported in the council's BVAR which was published in December 2017. We will assess progress on the pace and depth of continuous improvement. Our findings will be reported through our Annual Audit Report.

Audit dimension risks

34. We have identified audit risks in the areas set out in [Exhibit 6](#). This exhibit sets out the risks, sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurances over the risks.

Exhibit 6

2021/22 Audit dimension risks

Description of risk	Sources of assurance	Planned audit response
<p>1. Financial sustainability</p> <p>Councils continue to face significant financial pressures on funding and increasing demand on services.</p> <p>The Council developed a long-term financial strategy identifying a cumulative funding gap of £65.7 million. However, there are currently no options developed to allow the council to close the gap and it does not take into account the impact of Covid.</p> <p>There is a risk that the Council is reliant on reserves to deliver services over the longer term.</p>	<p>The Council continues to make good progress in developing several strategic projects aimed at supporting the local economy into the longer-term including the Islands Deal, a number of community wind farm projects and Phase 1 of the Harbours Masterplan. If successful, these projects have the potential to generate additional income streams to the Council over the longer term and thereby helping to demonstrate that the Council's use of reserves is sustainable. This will also help to inform the development of longer-term financial plans for the Council going forward.</p>	<ul style="list-style-type: none"> • Review and comment on the appropriateness of process implemented to generate the council's option appraisals. • Review and comment on the operation and delivery outcomes of the Improvement Support Team. • We will review emerging long-term financial strategies to see how a balanced budget is to be achieved.
<p>2. Financial management</p> <p>The council has a history of slippage in its capital programme.</p> <p>The original approved limit for capital</p>	<p>The Council continues to monitor progress in the delivery of the capital programme and reports through the Policy and Resources Committee. Comments on reasons for the slippage and any</p>	<ul style="list-style-type: none"> • Review the capital investment strategy in place at the Council. • Consider the Council's approach to capital monitoring. • Review actions taken by the Council to reduce slippage.

Description of risk	Sources of assurance	Planned audit response
<p>expenditure during 2021/22 was £27.8 million and an underspend of £5.2 million is expected at 31 March 2022.</p> <p>There is a risk that slippage in capital projects will result in increased costs for the council and delays in delivering key services.</p>	<p>actions to mitigate are included in the committee reports.</p> <p>This includes re-profiling the approved capital programme during the year and re-assessing a number of capital project appraisals in light of the impact that delays in the supply chain have had both on the availability and cost of materials.</p>	
<p>3. Senior management restructuring</p> <p>Interim senior management team arrangements were introduced in the summer of 2021.</p> <p>A review of the Council operating model and leadership commenced in 2021/22 with the first phase considering the Corporate Management Structure</p> <p>Changes of this nature bring risks over the governance and transparency of decision making processes and stability of operations.</p>	<p>Phase 1 of the Corporate Management Restructure was approved by Council on the 7 December 2021. This included the establishment of new leadership principles and an Our People Our Plan programme to address seven key Council priorities.</p>	<ul style="list-style-type: none"> • We will review the governance processes for approval of the revised operating model. • We will consider the impact of any changes on the interactions between the Executive Team and those charged with governance.

Source: Audit Scotland

Reporting arrangements, timetable, and audit fee

Reporting arrangements

35. Audit reporting is the visible output for the annual audit. All Annual Audit Plans and the outputs, as detailed in [Exhibit 7](#), and any other outputs on matters of public interest will be published on our website: www.audit-scotland.gov.uk.

36. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officers to confirm factual accuracy.

37. We will provide an independent auditor's report to the Council and the Accounts Commission setting out our opinions on the annual report and accounts. We will provide the Council and the Accounts Commission with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

38. [Exhibit 7](#) outlines the target dates for our audit outputs. We acknowledge this will be challenging due to the ongoing pressures and uncertainties caused by Covid-19.

Exhibit 7 2020/21 Audit outputs

Audit Output	Target Audit and Risk Committee Date
Annual Audit Plan	9 June 2022
Independent Auditor's Report	10 November 2022
Annual Audit Report	10 November 2022

Source: Audit Scotland



Timetable

39. To support an efficient audit, it is critical that the timetable for producing the annual report and accounts for audit is achieved. We have included a proposed timetable for the audit at [Exhibit 8](#) that has been discussed with management.

40. Covid-19 has had a considerable impact on the conduct and timeliness of the audit. We recognise that it is in the best interests of public accountability to get the reporting of audited accounts back to pre-pandemic timelines. We are identifying ways to work more efficiently to expedite the 2021/22 audits whilst at the same time maintaining high standards of quality.

41. We will continue to work in close partnership with management with clarity over timescales and the requirement for high quality unaudited accounts and supporting working papers. Progress will be discussed with management and finance officers over the course of the audit.

Exhibit 8 Proposed annual report and accounts timetable

 Key stage	 Provisional Date
Consideration of the unaudited annual report and accounts by those charged with governance	30 June 2022
Latest submission date for the receipt of the unaudited annual report and accounts with complete working papers package.	30 June 2022
Latest date for final clearance meeting with the Director of Finance (or equivalent)	16 September 2022
Issue of Letter of Representation and proposed Independent Auditor's Report	30 September 2022
Agreement of audited and unsigned annual report and accounts	30 September 2022
Issue of Annual Audit Report to those charged with governance.	30 September 2022
Signed Independent Auditor's Report	10 November 2022
Latest date for WGA assurance	To be confirmed

Source: Audit Scotland

Audit fee

42. The proposed audit fee for the 2021/22 audit of the Council is £199,730 and the General Charitable Trust is £1,000 (2020/21: £196,350 and £1,000 respectively). In determining the audit fee, we have taken account of the risk exposure of the Council, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit.

43. Where our audit cannot proceed as planned through, for example, late receipt of unaudited annual report and accounts, the absence of adequate supporting working papers or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required

in relation to any work or other significant exercises out with our planned audit activity.

Other matters

Internal audit

44. International standards on Auditing (UK) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect on external audit procedures;
- obtain an understanding of internal audit activities to inform our planning and develop an effective audit approach that avoids duplication of effort;
- perform a preliminary assessment of the internal audit function when there is scope for relying on internal audit work which is relevant to our financial statements' responsibilities; and
- evaluate and test the work of internal audit, where use is made of that work for our financial statements responsibilities to confirm its adequacy for our purposes.

45. From our initial review of the internal audit plans, we do not plan to place formal reliance on internal audit's work for our financial statements' responsibilities. We will consider the findings of Internal Audit where it is relevant to our audit.

Independence and objectivity

46. Auditors appointed by the Auditor General for Scotland or Accounts Commission must comply with the [Code of Audit Practice](#) and relevant supporting guidance. When auditing the financial statements, auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual *'fit and proper'* declaration for all members of staff. The arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

47. The engagement lead (i.e. appointed auditor) for the Council and its group is Gillian Woolman, Audit Director. The engagement lead for the General Charitable Trust is Claire Gardiner, Senior Audit Manager. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of the Council, its group bodies or the General Charitable Trust.

Quality control

48. International Standard on Quality Control (UK) 1 (ISQC1) requires a system of quality control to be established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

49. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the [Code of Audit Practice](#) (and supporting guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews. Additionally, the Institute of Chartered Accountants of Scotland (ICAS) have been commissioned to carry out external quality reviews.

50. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time, and this may be directed to the engagement lead.

Orkney Islands Council

Annual Audit Plan 2021/22

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