

# Orkney Islands Council

Annual Audit Plan 2017/18



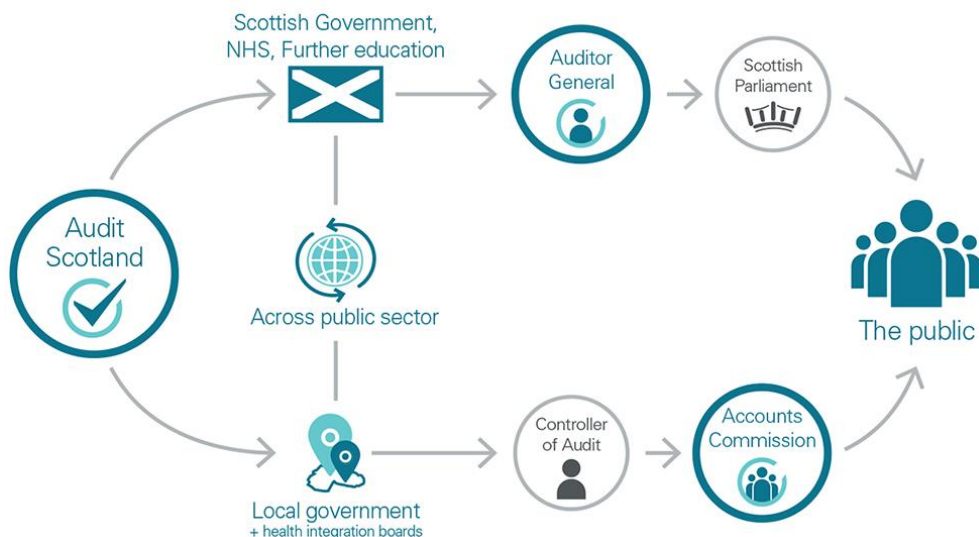
 AUDIT SCOTLAND

Prepared for Orkney Islands Council  
15 February 2018

## 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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# Risks and planned work

1. This annual audit plan contains an overview of the planned scope and timing of our audit and is carried out in accordance with International Standards on Auditing (ISAs), the Code of Audit Practice, and any other relevant guidance. This plan identifies our audit work to provide an opinion on the financial statements and related matters and meet the wider scope requirements of public sector audit including the new approach to Best Value.

2. The wider scope of public audit contributes to conclusions on the appropriateness, effectiveness and impact of corporate governance, financial management and financial sustainability, value for money and best value arrangements.

## Audit risks

3. Based on our discussions with staff, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for Orkney Islands Council. We have categorised these risks into financial risks and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in Exhibit 1.

## Exhibit 1

### 2017/18 Key audit risks

Audit Risk	Source of assurance	Planned audit work
<b>Financial statement issues and risks</b>		
<p><b>1 Risk of 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 in order to change the position disclosed in the financial statements.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance.</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>2 Risk of fraud over income</b></p> <p>Orkney Islands council receives a significant amount of income in addition to Scottish Government funding. The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud.</p>	<p>Effective budget monitoring and reporting by management.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>

Audit Risk	Source of assurance	Planned audit work
<p><b>3 Risk of fraud over expenditure</b></p> <p>The Financial Reporting Council's <a href="#">Practice Note 10</a> 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>Clear procedures in place for staff.</p> <p>Financial authorisation limits in place for authorising and approving expenditure.</p> <p>Budget monitoring and review with significant variances investigated and discussed with budget holders.</p>	<p>Audit work on the National Fraud Initiative matches.</p> <p>Assessing the high level key controls in areas of significant expenditure.</p> <p>Focused substantive testing of expenditure and housing benefit transactions.</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 subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Valuations carried out every 5 years for all assets (as part of rolling revaluation programme).</p> <p>Procurement and contract criteria ensure valuations are carried out by reputable valuers.</p> <p>Detailed discussions between valuers and Orkney Islands Council estates team.</p> <p>Detailed working papers retained to support asset reviews and impairments.</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 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>Wider dimension risks</b></p>		
<p><b>5 Financial Sustainability</b></p> <p>The council has not yet developed a longer term financial plan. Longer term financial planning would ensure the sustainability, feasibility and practicalities of current spending plans.</p>	<p>The Council aims to develop a long-term financial plan for the ten year period 2018-2028.</p> <p>The Council's success in its campaign to obtain fairer funding for its internal ferry services has significantly improved the financial sustainability of the authority in the short term</p>	<p>Monitor progress with preparing longer term financial plans providing comment in our annual audit report 2017/18.</p>
<p><b>6 Financial management</b></p> <p>The council has a history of slippage in its capital programme due to unrealistic timescales and budgets.</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</p>	<p>A new capital monitoring procedure has been implemented to identify potential slippage early in the financial year and take action to minimise its impact on individual projects or the programme as a whole.</p>	<p>Monitor capital slippage and assess any actions taken to reduce slippage providing comment in our annual audit report 2017/18.</p>

Audit Risk	Source of assurance	Planned audit work
<p>rely on capital projects being completed on time.</p>		
<p><b>7 PSN Compliance</b></p> <p>The council currently does not have a valid Public Sector Network (PSN) certificate. There is a risk that continued non-compliance with PSN could lead to financial loss and reputational damage for the council.</p>	<p>In 2017 steps were taken to mitigate the PSN risk by strengthening the council's approach to patch management, boundary protection and password policy controls.</p> <p>The council's boundary protection has been enhanced and strong password policy controls are now in place.</p> <p>A PSN health check is being undertaken and is expected to be completed by 31 March 2018.</p> <p>Work is now underway to procure the services of an external contractor to carry out the pre PSN penetration tests and to complete the Cyber Essentials basic accreditation.</p>	<p>Review the results of the PSN health check providing comment in our annual audit report 2017/18.</p>
<p><b>Governance and transparency</b></p>		
<p><b>8 Governance Statement assurances</b></p> <p>Internal audit have planned some reviews of key financial systems during 2017/18 but the reviews do not cover all the key financial systems.</p> <p>There is a risk that the council will have insufficient assurances for the governance statement for 2017/18.</p>	<p>Internal Audit plan to perform a financial systems health check of key financial systems as well as more in-depth review of the financial ledger and housing rents to provide assurance for the 2017/18 annual governance statement.</p>	<p>Liaise with Internal Audit early in the year.</p> <p>Review the work of internal audit and assess the adequacy of assurances provided to support the governance statement.</p>
<p><b>9 Financial ledger user access</b></p> <p>The general ledger records the council's financial transactions and is the primary source of information for compiling the annual accounts.</p> <p>A review of access rights to the financial management system found there to be a significant number of users with system administration/super user rights.</p> <p>There is a risk that erroneous or</p>	<p>Internal Audit plan to carry out a system review of the ledger in 2017/18 which will include the payment process used within the council and user access controls to ensure that only users who have a business need continue to have system access.</p>	<p>Review and assess the work of Internal Audit, and adjust our testing strategy for financial ledger transactions as appropriate.</p>

Audit Risk	Source of assurance	Planned audit work
fraudulent transactions are made as inappropriate or unauthorised access to the computer systems is not prevented.		
<p><b>10 Pickaquoy Centre Trust</b></p> <p>The Service Agreement for the Trust covered the period 1 April 2012 to 31 March 2015. A review of the agreement and the actual operating arrangements between the council and the Trust require to be carried out.</p> <p>There is a risk that the existing, expired agreement no longer meets the requirements of the council.</p>	<p>Management plans to review and agree the business objectives and the financial, performance and reporting requirements of the Trust.</p> <p>Capacity issues are hindering progress with the review.</p>	<p>Monitor progress in reviewing the service agreement between the council and the Trust providing comment in our annual audit report 2017/18.</p>

4. The Charities Accounts (Scotland) Regulations 2006 specify the accounting and auditing requirements for Scottish registered charities. The council administers one trust with charitable status. The council also prepares group accounts which incorporate three subsidiaries, one associate and one joint venture. We will perform the audit of the council's charitable trust and group accounts in parallel with the audit of Orkney Islands Council's financial statements. There are no specific risks for these audits which we require to bring to your attention.

## Reporting arrangements

5. Audit reporting is the visible output for the annual audit. All annual audit plans and the outputs as detailed in Exhibit 2, and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

6. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Management reports will be issued to the relevant officer(s) to confirm factual accuracy.

7. We will provide an independent auditor's report to Orkney Islands Council and to the Accounts Commission setting out our opinions on the annual accounts. We will provide the Accountable Officer and Accounts Commission with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.

## Exhibit 2

### 2017/18 Audit outputs

Audit Output	Monitoring and Audit Committee Date
Annual Audit Plan	29 March 2018
Interim Audit Report	7 June 2018
Annual Audit Report including ISA 260 requirements	27 September 2018

Audit Output	Monitoring and Audit Committee Date
Signed Independent Auditor's Report	27 September 2018

## Audit fee

8. The audit fee for the 2017/18 audit of Orkney Islands Council is £182,380 (2016/17: £181,590). Included in the fee is the sum of £1,000 (2016/17: £1,000) for the audit of Orkney Islands Council General Charitable Trust. In determining the audit fee we have taken account of the risk exposure of Orkney Islands Council, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the unaudited financial statements, with a complete working papers package on 29 June 2018.

9. Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements 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 outwith our planned audit activity.

## Responsibilities

### Monitoring and Audit Committee and Accountable Officer

10. Audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives.

11. The audit of the financial statements does not relieve management or the Monitoring and Audit Committee as those charged with governance, of their responsibilities.

### Appointed auditor

12. Our responsibilities as independent auditor are established by the Local Government (Scotland) 1973 Act and the Code of Audit Practice (including supplementary guidance) and guided by the auditing profession's ethical guidance.

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



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# Audit scope and timing

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## Financial statements

**14.** The statutory financial statements audit will be the foundation and source for the majority of the audit work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding the business of Orkney Islands Council and the associated risks which could impact on the financial statements
- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how Orkney Islands Council will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free of material misstatement.

**15.** We will give an opinion on the financial statements as to:

- whether they give a true and fair view of the financial position of council and its group as at 31 March 2018 and its expenditure and income for the year then ended
- the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2017/18 Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

## Materiality

**16.** We apply the concept of materiality in planning and performing the audit. It is used in evaluating the effect of identified misstatements on the audit, and of any uncorrected misstatements, on the financial statements and in forming our opinion in the auditor's report.

**17.** We calculate materiality at different levels as described below. The calculated materiality values for Orkney Islands Council are set out in Exhibit 3.

## Exhibit 3

### Materiality values

Materiality level	Amount
<b>Planning materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It has been set at 1% of gross expenditure for the year ended 31 March 17 based on the latest audited accounts for 2016/17.	£1.390 million
<b>Performance materiality</b> – 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 calculated performance materiality at 50% of planning materiality.	£0.695 million
<b>Reporting threshold (i.e. clearly trivial)</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of planning materiality.	£0.014 million

Source: Orkney Islands Council Annual Report and Accounts 2016/17



**18.** We review and report on other information published with the financial statements including the management commentary, annual governance report and the remuneration report. Any issue identified will be reported to the Monitoring and Audit Committee.

#### Timetable

**19.** To support the efficient use of resources it is critical that a financial statements timetable is agreed with us for the production of the unaudited accounts. An agreed timetable is included at Exhibit 4 which takes account of submission requirements and planned Monitoring and Audit Committee dates.

## Exhibit 4

### Financial statements timetable

 Key stage	 Date
Consideration of unaudited financial statements by those charged with governance	31 August 2018
Latest submission date of unaudited annual accounts with complete working papers package	29 June 2018
Latest date for final clearance meeting with Head of Finance	31 August 2018
Agreement of audited unsigned annual accounts and issue of Annual Audit Report including ISA 260 report to those charged with governance	17 September 2018
Independent auditor's report signed	27 September 2018

## Internal audit

**20.** Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an assessment of the internal audit function. Internal audit is provided by the Internal Audit section of Orkney Islands Council overseen by a Chief Internal Auditor.

### Adequacy of Internal Audit

**21.** In previous years we have concluded that overall the Internal Audit service operates in accordance with Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place. We will review this again as part of the 2017/18 audit.

### Areas of Internal Audit reliance

**22.** To support our audit opinion on the financial statements we plan to place formal reliance on the following planned internal audit reviews:

- Housing Rents
- Financial Health Check
- Nominal Ledger.

**23.** In respect of our wider dimension audit responsibilities we also plan to consider other areas of internal audit work including:

- Corporate Governance / Risk Management
- Complaints handling
- Computer audit
- Statutory Performance Indicators
- Stock checks.

## Audit dimensions

**24.** Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in Exhibit 5.

## Exhibit 5

### Audit dimensions



Source: Code of Audit Practice

**25.** In the local government sector, the appointed auditor's annual conclusions on these four dimensions will help contribute to an overall assessment and assurance on best value.

#### Financial sustainability

**26.** 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 the body's financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years) sustainability. We will carry out work and conclude on:

- the effectiveness of financial planning in identifying and addressing risks to financial sustainability in the short, medium and long term
- the appropriateness and effectiveness of arrangements in place to address any identified funding gaps
- whether Orkney Islands Council can demonstrate the affordability and effectiveness of funding and investment decisions it has made.

#### Financial management

**27.** Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. We will review, conclude and report on:

- whether Orkney Islands Council has arrangements in place to ensure systems of internal control are operating effectively
- whether Orkney Islands Council can demonstrate the effectiveness of budgetary control system in communicating accurate and timely financial performance
- how Orkney Islands Council has assured itself that its financial capacity and skills are appropriate

- whether Orkney Islands Council has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

### Governance and transparency

**28.** 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. We will review, conclude and report on:

- whether Orkney Islands Council can demonstrate that the governance arrangements in place are appropriate and operating effectively (including risk management and services delivered by, or in partnership with, others such as ALEOs).
- whether there is effective scrutiny, challenge and transparency on the decision-making and finance and performance reports.
- the quality and timeliness of financial and performance reporting.

### Value for money

**29.** Value for money refers to using resources effectively and continually improving services. We will review, conclude and report on whether:

- Orkney Islands Council can provide evidence that it is demonstrating value for money in the use of its resources.
- Orkney Islands Council can demonstrate that there is a clear link between money spent, output and outcomes delivered.
- Orkney Islands Council can demonstrate that outcomes are improving.
- There is sufficient focus on improvement and the pace of it.

### Best Value

**30.** The Accounts Commission agreed the overall framework for a new approach to auditing Best Value in June 2016. A key feature of the new approach is that it integrates Best Value into the wider scope annual audit, which will influence audit planning and reporting.

**31.** Orkney Islands Council received a Best Value Assurance Report in December 2017. Key messages in the Best Value Assurance Report include:

- 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. The council has stable, effective leadership with a strong focus on doing what is right for the communities of Orkney.
- Since our 2008 Best Value report the council has improved its planning framework, performance management, its use of self-evaluation and the way it engages with communities. The pace of improvement in the council has increased over the past three years since it has focused its improvement work around a change programme and its medium-term financial planning.
- The council has benefited from a strong financial position for many years. This has meant the council has been able to supplement local government funding, to some extent, to help protect front line services. Nevertheless, certain cost saving decisions have been taken and, for instance, the senior management team has been halved in size.

- The council has been slow to develop some of the other essential tools for using resources efficiently. Examples include workforce planning, medium to long-term financial plans, asset management planning and digital and IT arrangements. The pace of progress has, however, picked up in recent years and it is important that the council maintains this increased pace to ensure it makes best use of public money. The council should prepare longer term financial plans to ensure the sustainability, feasibility and practicalities of current spending plans, and to demonstrate that dependency on the Strategic Reserve Fund, to subsidise service delivery, is limited to the short term.
- Orkney residents show very high levels of satisfaction with council services, including some of the highest levels across Scotland. In addition, external service inspections have been positive, especially within the education service
- The council works well with its partners and local communities, with some examples of good community engagement and progress in empowering communities. However, the council and the Orkney Community Planning Partnership do not yet measure, monitor and report sufficient evidence to demonstrate how effectively they are making progress towards delivering their outcome priorities for the community.

**32.** The work planned in Orkney Islands Council this year will focus on a follow-up of the Best Value Assurance Report approved by the Accounts Commission on 7 December 2017. It will involve us gaining an understanding of how effective the council's self evaluation processes are in driving improvement across the council. The results of this work will be reported in the Annual Audit Report.

## Independence and objectivity

**33.** Auditors appointed by the Accounts Commission or Auditor General 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 in place robust arrangements to ensure compliance with these standards including an annual “fit and proper” declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland’s Ethics Partner.

**34.** The engagement lead and appointed auditor for Orkney Islands Council is Gillian Woolman, Assistant Director. 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 Orkney Islands Council.

## Quality control

**35.** International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is 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.

**36.** 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 relevant 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, internal quality reviews and has recently secured arrangements for external quality reviews.

**37.** 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.

### **Adding Value**

**38.** Through our audit work we aim to add value to Orkney Islands Council. We will do this by ensuring our Annual Audit Report provides a summary of the audit work done in the year together with clear judgements and conclusions on how well Orkney Islands Council has discharged its responsibilities and how well it has demonstrated the effectiveness of its arrangements. Where it is appropriate we will recommend actions that support continuous improvement and summarise areas of good practice identified from our audit work.

# Orkney Islands Council

## Annual Audit Plan 2017/18

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