

Orkney Islands Council

2017/18 Annual Audit Report



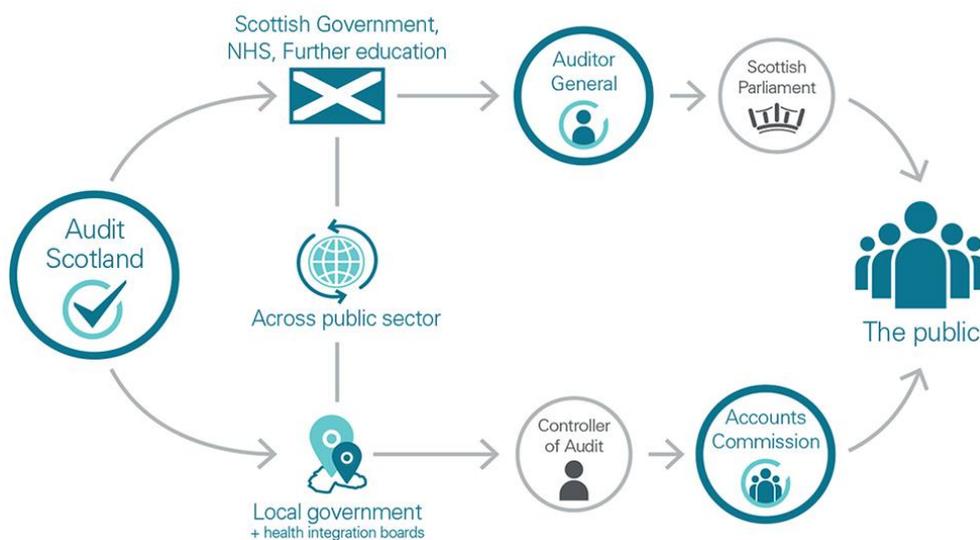
 AUDIT SCOTLAND

Prepared for the Members of Orkney Islands Council and the Controller of Audit
27 September 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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Key messages

2017/18 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 Charitable Trust administered by the Council are free from material misstatement.

Financial management

- 3 Financial management arrangements are broadly satisfactory.
- 4 The net cost of General Fund services in 2017/18 amounted to £84.62 million remaining in line with its overall budget of £84.94million.
- 5 The council has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

Financial sustainability

- 6 With its high level of usable reserves, there has been less need for the Council to respond to change in how it delivers services. However, it is becoming increasingly likely that the council will receive a decrease in core 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.
- 7 The Council has financial strategies and plans over the short and medium term and these are robust with linkages to wider Council initiatives. The council does not have a longer term financial plan.

Governance and transparency

- 8 The Council has satisfactory governance arrangements in place that support the scrutiny of decisions made by the Council.
- 9 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.
- 10 It will continue to be a challenge for the health and social care partnership to deliver commissioned services within the funding available. The three statutory bodies involved will have to work in close collaboration to meet their statutory obligations.

Value for money

- 11 A number of activities are underway in response to the Best Value Assurance Report published in December 2017. The Council will wish to ensure it can demonstrate what difference they are making in respect of improved outcomes and the realisation of efficiencies.

- 12** The Council has appropriate arrangements in place to follow the public pound with some room for improvement with respect to one ALEO, the Pickaquoy Trust.
- 13** Performance management arrangements are well developed. The Council Plan 2018-23, which has been agreed, has greater focus on how actions and agreed activities will impact on positive outcomes.

Introduction

1. This report summarises the findings arising from the 2017/18 audit of Orkney Islands Council and its group (the Council).
2. The scope of the audit was set out in our Annual Audit Plan presented to the March 2018 meeting of the Monitoring and Audit Committee. This report comprises the findings from:
 - an audit of the annual 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](#).

Exhibit 1

Audit dimensions



Source: *Code of Audit Practice 2016*

3. The main elements of our audit work in 2017/18 have been:
 - an audit of the Council and its group 2017/18 annual 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 2017/18 audit work covering the Council's arrangements for securing Best Value;
 - consideration of the four audit dimensions.

4. 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.
5. 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.
6. 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.
7. As public sector auditors we give independent opinions on the annual accounts. We also review and provide conclusions on the effectiveness of the Council's financial management arrangements, arrangements for securing financial sustainability, corporate governance and transparency, and arrangements for securing value for money. We also report on the Council's best value arrangements and in doing this we aim to support improvement and accountability.
8. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#).
9. 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.
10. Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and progress against these.
11. 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 2017/18 audit fee of £182,380 (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.

Adding value through the audit

12. Our aim is to add value to Orkney Islands Council by providing insight into, and offering foresight on, financial sustainability, risk and performance by identifying areas of improvement and recommending and encouraging good practice. In so doing, we aim to help the council promote improved standards of governance, better management and decision making and more effective use of resources.
13. 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.
14. We would like to thank all management and staff who have been involved in our work for their co-operation and assistance during the audit.

Part 1

Audit of 2017/18 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 General Charitable Trust administered by the Council are free from material misstatement.

Audit opinions on the annual accounts

15. The annual accounts for the Council and its group for the year ended 31 March 2018 were approved by the Monitoring and Audit Committee on 27 September 2018. We reported, within our independent auditor's report that, in our opinion:

- 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 guidance.

16. 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.

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 section 106 charities

17. 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.

18. 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.

19. 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 2017/18 financial statements.

Submission of the Council and its group annual accounts for audit

20. We received the unaudited annual accounts on 29 June 2018 in line with the audit timetable set out in our 2017/18 Annual Audit Plan.

21. 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.

Risk of material misstatement

22. [Appendix 2](#) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team and the wider audit dimension risks identified.

Materiality

23. 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. It is affected by our perception of the financial information needs of users of the financial statements.

24. Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit and is summarised in [Exhibit 2](#). With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

25. 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.

Exhibit 2

Materiality values

Materiality level	Amount
Overall materiality	£1.50 million
Performance materiality	£0.75 million
Reporting threshold	£15,000

Source: Audit Scotland, Annual Audit Plan 2017/18

How we evaluate misstatements

26. There was one material adjustment to the unaudited financial statements arising from our audit as set out in [exhibit 3, finding 1](#).

Significant findings from the audit in accordance with ISA 260

27. International Standard on Auditing 260 (UK) requires us to communicate significant findings from the audit to those charged with governance. These 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.

28. The findings include our views about significant qualitative aspects of the Council's accounting practices including:

- | | |
|---|---|
| • Accounting policies | • Accounting estimates and judgements |
| • Significant financial statements disclosures | • Timing of transactions and the period in which they are recorded |
| • The impact on the financial statements of any uncertainties | • The effect of any unusual transactions on the financial statements |
| • Misstatements in the annual accounts | • Disagreement over any accounting treatment or financial statements disclosure |

Exhibit 3

Significant findings from the audit of the financial statements

Finding	Resolution
<p>1. Pension Scheme Valuation</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 were lower than actual returns. This resulted in pension fund assets reported in the Council's balance sheet being understated by £11.80 million.</p>	<p>The accounts have been adjusted to reflect the Council's share of the pension fund assets based on the value at 31 March 2018. We have confirmed that the revised values are satisfactory.</p> <p> Recommendation 1 (refer appendix 1, action plan)</p>
<p>2. Net pension asset measurement</p> <p>Paragraph 64 of IAS 19 states that when an entity has a surplus in a defined benefit plan, it is required to measure the net defined benefit asset at the lower of:</p> <p>(a) the surplus in the defined benefit plan; and</p>	<p>For 2017/18 we are content that the surplus has been recognised on the basis that economic benefits will be available to the authority over the life of the plan in the form of reduced Employer contributions, and so there is no modification required to our audit opinion.</p> <p>In future periods, where it is likely that OIC will have an IAS 19 asset, the council should consider the</p>

Finding	Resolution
<p>(b) the asset ceiling, determined using the discount rate specified in paragraph 83 of IAS 19.</p> <p>OIC are showing a net pension asset of £15.16 million on their balance sheet but the council's actuaries, Hymen Robertson, have not calculated the asset ceiling.</p>	<p>need to calculate the asset ceiling during their discussions with the actuary.</p> <p> Recommendation 2 (refer appendix 1, action plan)</p>
<p>3. Note 29 (Application of the current Code)</p> <p>The draft accounts included Note 29 (Amounts reported for resource allocation Decision) based on CIPFA's Service Reporting Code of Practice (SeRCOP). Since 2016/17 the Code no longer requires disclosure of SeRCOP.</p> <p>Note 29 is not required to be included in the notes to the accounts.</p>	<p>The finding was discussed with management who agreed to remove Note 29.</p> <p>The final version of the accounts has been amended accordingly.</p>
<p>4. Non-current assets</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 a number of years. As a result, many of the infrastructure assets are recorded with short useful lives.</p> <p>From the audit work we have carried out, we are assured that revising the asset lives would not have a material impact on the Comprehensive Income and Expenditure Statement.</p>	<p>The finding was discussed with management who agreed to put a process in place to ensure the useful lives of infrastructure assets would be considered annually going forward.</p> <p> Recommendation 3 (refer appendix 1, action plan)</p>
<p>5. Transfer of assets</p> <p>OIC transferred two assets to Orkney Research and Innovation Campus (ORIC), a newly formed joint venture between Orkney Islands Council & Highlands and Islands Enterprise, in which both parties have an equal share. The assets transferred comprised the Old Stromness Primary School and the Old Stromness Academy. The Old Stromness Primary School was no longer required by OIC due to the building of a new primary school in Stromness while the Old Stromness Academy was in need of a major overhaul.</p> <p>The draft accounts show a loss on sale of these assets of £1.67m in the CIES (shown under Other Operating Expenditure). The CIES also shows a corresponding gain within 'Surplus on revaluation of available for sale financial assets'.</p>	<p>OIC initially felt that this accounting treatment was the best way to account for the transfer of the two assets into ORIC because no cash payment took place. However, upon further reflection OIC felt that the transfer of the assets should be shown with no profit or loss on sale of the assets to better reflect that the transfer occurred at fair value. Audit Scotland concur with the amended accounting treatment as it better reflects the economic reality of the transfer of the assets. The net impact of the revised accounting treatment on CIES is to remove both the loss of £1.67m shown under Other Operating Expenditure and the gain shown as surplus on revaluation of available for sale financial assets.</p> <p>There is no change to the balance sheet where the assets are removed from Non-Current Assets and the investment in ORIC is shown as an asset within financial instruments.</p>
<p>6. Provision for bad debts</p> <p>The percentages used to calculate the provision for bad debts have remained unchanged for a number of years and have not been subject to review.</p>	<p>The finding was discussed with management who agreed to review the percentages for the calculation prior to 31 March 2019.</p>

Finding	Resolution
<p>7. Reserves - consistency between External Funding Analysis (EFA) and Movement in Reserves Statement (MIRS)</p> <p>The figures in the right hand column of the EFA could not be agreed to figures in the MIRS relating to the surplus/deficit on provision of services.</p>	<p>Management revised the MIRS to split the figures between the surplus/deficit on the provision of services and other comprehensive income and expenditure to clearly show the adjustments below the line which are detailed on the comprehensive income and expenditure statement.</p> <p>The revised MIRS was reviewed and assessed as satisfactory, and consistent with the EFA.</p>
<p>8. Provisions</p> <p>A provision of £2.80 million has been identified in respect of the council's section 75 debt in respect of the Merchant Navy Officers Pension Fund – Post 78 section. A debt was triggered when the last active member retired and no active members of the pension fund were directly employed by the council.</p> <p>The provision was set up a number of years ago and there is uncertainty over the accuracy of the value included in the accounts.</p>	<p>Management have agreed to obtain an up to date valuation of the provision prior to 31 March 2019.</p>

Good practice in financial reporting

29. The revised audited annual report and accounts reflect good practice as set out in Audit Scotland on '[Improving the quality of local authority accounts – expenditure and funding analysis](#)'.

Follow up of prior year recommendations

30. We have followed up actions previously reported and assessed progress with implementation. These are reported in [Appendix 1](#) and identified by the prefix b/f (brought forward).

31. In total, 6 agreed actions were raised in 2016/17. Of these:

- 2 have been fully implemented
- 1 action in relation to reviewing user access to the financial ledger is progressing
- 3 actions remain outstanding and have been carried forward and included in the current action plan.

32. Overall the Council is progressing in implementing these actions. For those actions not yet implemented, revised responses and timescales have been agreed with management as set out in [Appendix 1](#).

Other findings

33. Our audit identified several presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited annual accounts.

Objections

34. 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 broadly satisfactory.

The net cost of General Fund services in 2017/18 amounted to £84.62 million remaining in line with its overall budget of £84.94million.

The council has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

Financial performance in 2017/18

- 35.** In February 2017 the Council approved a budget of £81.98 million for 2017/18. The budget included a transfer from reserve funds of £7.03 million.
- 36.** Following confirmation of Scottish Government funding and a further contribution from reserve funds of £0.33 million, a revised General Fund Revenue Budget for 2017/18 of £82.44 million was approved at the Policy and Resources Committee on 20 June 2017. Since that date, additional revenue grant of £0.66 million was received from the Scottish Government and a further £1.84 million was transferred from reserves to give a final budget for the year of £84.94 million.
- 37.** The net cost of General Fund services in 2017/18 amounted to £84.62 million, while sources of finance were realised at £84.86 million including a total contribution from reserves of £9.29 million of which £0.09 million was for non-General Fund services. While the Council's spending has remained in line with its overall budget, there are a number of variations across individual expenditure budgets, two of which are significant, as summarised in [Exhibit 4](#).

Exhibit 4

Summary of significant under / overspends against budget

Area	Under/over spend (£m)	Reason for variance
Underspends		
Harbour Authority	£1.32	Reduced spend on repairs and maintenance along with an increase in respect of harbour dues income.
Overspends		

Area	Under/over spend (£m)	Reason for variance
Other Income and Expenditure	£7.25	Financing and investment income has decreased due to reduced income from investing activities. The council has a treasury management policy of ensuring investments are as risk free as possible. Returns this year reflect the market.

Source: Orkney Islands Council 2017/18 Annual Accounts

Housing revenue account

38. The Council is required by legislation to maintain a separate housing revenue account and to ensure that rents are set to at least cover the costs of its social housing provision. Rent levels are therefore a direct consequence of the budget set for the year.

39. The HRA returned a deficit on its operations of £0.09million for 2017/18 (gain £2.13million for 2016/17). The gain on operations in 2016/17 was unusual. There was a revaluation of housing stock in 2016/17 which resulted in a revised increase in value of £12.77 million for housing stock and a write back of £5.74 million of depreciation.

Efficiency savings

40. With reduced funding from government and increased demand for financial services, efficiency savings are an important means of bridging the gap between funding received and spending commitments.

41. 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.

42. The 2017/18 annual return to the Scottish Government indicated that £0.8 million of savings were planned. The Council achieved actual savings of £0.9 million. Going forward the Council recognises that achievement of further savings will prove challenging.

Capital programme 2017/18

43. The original approved limit for capital expenditure during 2017/18 was £21.3 million which included £1.5 million slippage from the previous financial year. During the year further projects were added and removed from the Council's Capital Programme, resulting in a revised limit of £26 million.

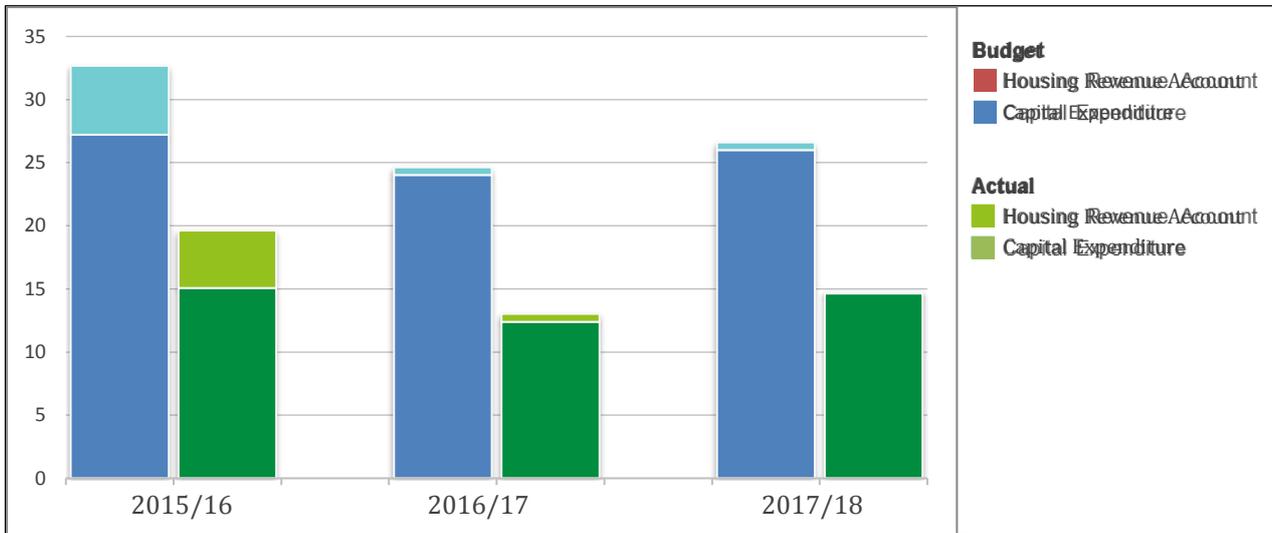
44. Total capital expenditure in 2017/18 was £14.8 million including £4 million on schools and £3.7 million on roads. Capital slippage in 2017/18 amounted to £11.2 million.

45. The Council has a history of slippage in its capital programme as outlined in [Exhibit 5](#).

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

Exhibit 5

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



Source: OIC Annual Accounts

46. During the year delays were identified in the delivery of the approved programme of capital works for financial year 2017/18, including for example late revisions to project specification and design together with unrealistic timescales. This resulted in some projects being referred back to the relevant Service Committee for further consideration. As a result, £10.05 million was re-profiled into 2018/19, reducing the approved limit for 2017/18 to £15.94million.

47. The significant slippages relate to:

- St. Peters House replacement - £2.24 million
- Gill Pier Refurbishment - £1.35 million
- Pilot Vessel - £0.99 million
- Replacement Tug - £3.35 million.

48. The Council recognises that the capital programme for financial year 2017/18 was ambitious and not deliverable due to weaknesses in forward planning arrangements.

49. The Council should ensure that slippage and rescheduling of general fund capital projects does not have a significant impact on strategic priorities that are dependent on capital projects being completed on time.



[Recommendation 4 \(refer appendix 1, action plan\)](#)

Borrowing in 2017/18

50. The Council's outstanding short and long term loans at 31 March 2018 totalled £30.63 million representing a decrease of £5.08 million on the previous year. The Council undertook no additional borrowing during 2017/18.

Budget monitoring process

51. 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.

52. 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

53. 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.

54. Our findings are included in our management report that was presented to the Monitoring and Audit Committee in May 2018. Apart from a few control weaknesses which were identified, we concluded that the council has satisfactory systems of internal control and we have been able to take planned assurance for the audit of the financial statements.

ICT controls

55. The Council's first Digital Strategy was approved by the Council in March 2017. A digital strategy delivery plan has been developed and progress monitoring updates are regularly provided to the Asset Management Sub-Committee. The IT Service has successfully recruited staff to enhance capacity and help deliver key projects including:

- joint working with NHS Orkney to provide secure physical access to OIC infrastructure around Kirkwall
- stabilising and continuing to securely share the PARIS case-management system with OHAC staff employed by both OIC and NHS Orkney.
- installing Office 2016 upgrades and completing Office 365 email migrations to the Cloud for all available accounts.

56. 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 was also accredited with Cyber Essentials Basic in February 2018 and is working towards Cyber Essentials Plus, with a target date of early 2019

Part 3

Financial sustainability



Main judgements

With its high level of usable reserves, there has been less need for the Council to respond to change in how it delivers services. The Council received an extra £5.5 million towards internal ferry services for 2018/19 and there is a high expectation that the Government will honour its commitment to fair funding with a continuation of funding the full operational costs of the ferry services. However, it is becoming increasingly likely that the council will receive a decrease in core 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.

Long term financial plans are essential to ensure that funds are used to deliver the priorities of the Council and that reserves continue to provide benefit for the people of Orkney in the way intended. The council does not have a longer term financial plan.

Financial planning

57. The council is facing several challenges in maintaining a sustainable financial position in the future. These include rising demands for services, increasing cost of services and the potential of less local government funding.

58. 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. Although councillors only approve the budget for a single year, this should be supported by indicative future spending plans (covering three years at least) that forecast the impact of relevant pressures on the Council.

59. The Council agrees that longer term financial plans are essential to ensure that funds are used to deliver the priorities of the Council and that reserves continue to provide benefit for the people of Orkney in the way intended. The council does not currently have a longer term financial plan. Management have advised that work is underway to identify good examples to assist the council in developing its longer term financial plan.



Recommendation 5 (refer appendix 1, action plan)

60. The Accounts Commission recommends that when future Scottish Government funding is not known, councils should plan for a range of scenarios, so they are prepared for different levels of funding and income.

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

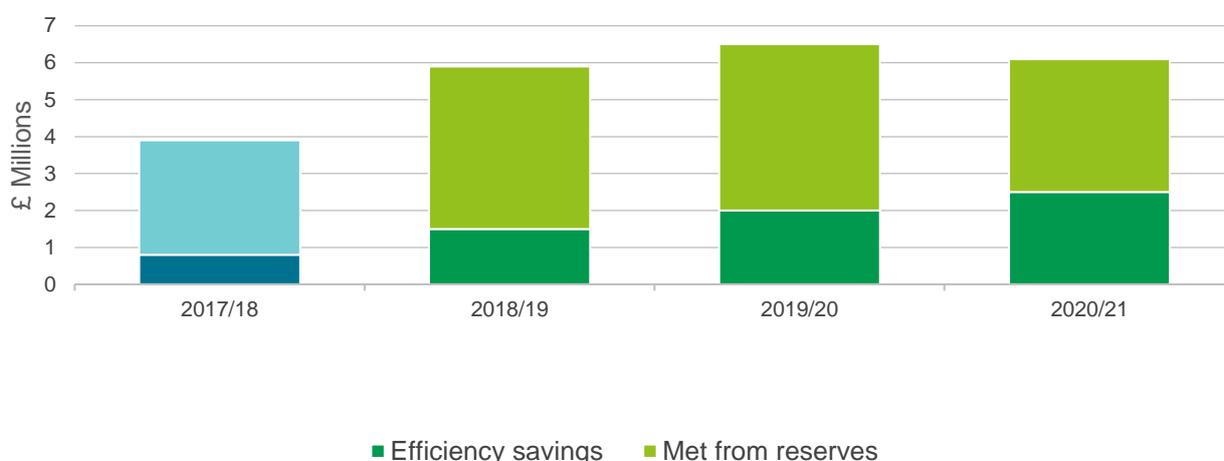
Funding position

61. The Council approved its 2017/18 budget in February 2017. The budget was set at £84.94 million with a funding gap of £7.9 million. Plans to address this gap included £0.9 million of savings and a transfer of £7 million from reserves.

62. Looking at the Council's budget information/financial projections for 2019/20 and 2020/21, it is forecasting funding gaps of £6.5 million and £6.1 million respectively. The Council plans to bridge these gaps mostly by the transfer of reserves and efficiency savings as illustrated in [Exhibit 6](#).

Exhibit 6

Identified funding gaps 2017/18 – 2020/21



Source: OIC Medium Term Financial Strategy

63. The council has an agreed policy to top up funding for the cost of provision of services from the strategic reserve fund which accounts for £185.18 million, 71 percent of usable reserves. With its high level of usable reserves, £261.30 million at 31 March 2018, there has been less need for the Council to respond to change in how it delivers services. However, 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. The budget paper presented to Policy and Resources committee in February 2018 reported that it is not prudent for reserves to be deployed to finance recurrent expenditure.



[Recommendation 6 \(refer appendix 1, action plan\)](#)

Reserves

64. 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 £260.85 million in 2016/17 to £261.63 million in 2017/18 as illustrated in [Exhibit 7](#).

65. Around 71 percent of the value of useable reserves, (£185.18 million at 31 March 2018) 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 the Flotta Oil Terminal operators.

66. The purpose of the SRF is to provide for the benefit of Orkney and its inhabitants. 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. SRF investments have performed well with an overall increasing trend in value. In recent years, 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.

67. The high level of reserves further 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.

68. The general fund reserve has no restrictions on its use. Its main purpose is to provide a contingency fund to meet unexpected expenditure and as a working balance to help cushion the impact of uneven cash flows. The General Fund Reserve has a balance of £15.09 million at 31 March 2018, £10.06 million of the balance is earmarked for specific purposes.

69. [Exhibit 7](#) provides an analysis of the allocation of reserve balances over the last five years and details the value of useable reserves earmarked for specific purposes. The table highlights that the general fund balance accounts for 5.73% of total useable reserves which is significantly less than in 2012/13 when the general fund balance accounted for 11% of useable reserves. 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.

70. Investment income totalled £2.74 million in 2017/18 compared to £26.93 million in 2017/18. We are satisfied that due consideration was given to investment performance during the year and that investments were made in accordance with the council's treasury management policy. The significant increase in unusable reserves is a result of the actuarial valuation of the pension assets ([exhibit 3 point 1.](#))

Exhibit 7

Analysis of allocation of reserve balances over the last five years

Area	2013/14	2014/15	2015/16	2016/17	2017/18
	£ Millions				
Strategic reserve fund	139.84	156.31	151.62	178.95	185.18
General fund	23.76	18.52	21.18	15.78	15.09
Housing revenue reserve	0	0	0.47	0.17	0.24
Repair and renewal fund	2.92	3.81	4.78	7.38	8.08
Capital receipts reserve	0.02	0.02	0.02	0.53	2.61
Other statutory funds	0.51	0.51	0.51	0.53	0.53
Other reserves including £53.24 million of earmarked Harbour reserves.	56.95	57.94	56.22	57.50	51.57
Total usable reserves	224.00	237.11	234.80	260.84	263.30

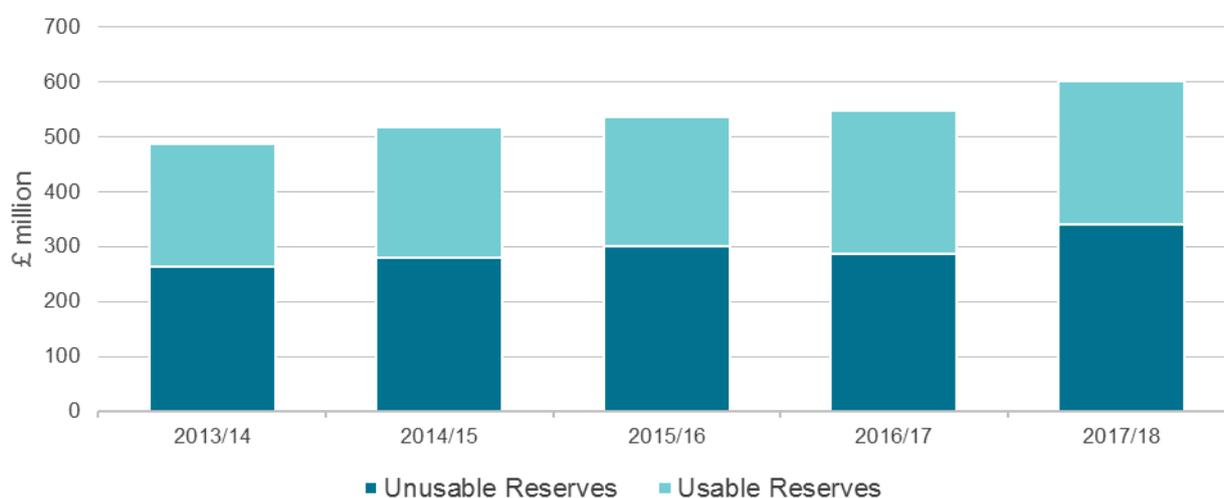
Area	2013/14	2014/15	2015/16	2016/17	2017/18
Unusable reserves	263.56	258.91	301.49	286.38	349.25

Source: OIC 2017/18 Accounts

71. [Exhibit 8](#) provides an analysis of the Council's total reserves over the last five years split between usable and unusable reserves. This shows a steady increase in net worth over the five years and slight fluctuations in useable reserves over the period with an overall increase of £39.3 million since 2013/14.

Exhibit 8

Analysis of Council reserves over last five years



Source: OIC Annual accounts

72. The Council has an investment strategy which is updated on an annual basis. The investment management agreements between the Council and the fund managers additionally stipulate guidelines and duration and other limits in order to contain and control risk.

73. The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The performance of the managed funds for the SRF are measured on a rolling 3 year average.

New Financial Powers

74. Proposals have been made for changes to the Scottish Budget process, with these likely to be introduced for the 2019/20 budget.

75. Overall, we concluded that the Council is facing a challenging situation in the short term. Rising costs, ending of the public sector pay cap combined with small decreases in funding and dependency on efficiency savings will make it difficult to achieve financial balance within the funding awarded annually.

76. The medium to longer term financial position is difficult to predict given the uncertainty around EU withdrawal and New Financial Powers and future funding settlements. The Council welfare reform and social security group which meets on a regular basis is considering and planning for the potential impact of these events.

EU withdrawal

77. There remains significant uncertainty about the detailed implications of EU withdrawal (i.e. Brexit). 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 changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour.
- Funding – the extent to which potential changes to funding flows are likely to affect the finances of the organisation and the activity that such funding supports.
- Regulation – the extent to which potential changes to regulation across a broad range of areas overseen at an EU level are likely to affect the activities of the organisation.

78. Orkney's economy may also feel the impact of the decision to leave the EU. Key sectors of Orkney's economy; farming, fishing, harbours and tourism could be negatively impacted by 'Brexit' through loss of EU subsidies, changes in trade agreements and negative changes in currency values. The Council has flagged the economic uncertainty in relation to Brexit as a challenge within its risk register which is reviewed and updated on a regular basis. It will be important for the Council to develop plans to mitigate the risks identified, where appropriate.

Part 4

Governance and transparency



Main Judgements

The Council has satisfactory 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.

It will continue to be a challenge for the health and social care partnership to deliver commissioned services within the funding available. The three statutory bodies involved will have to work in close collaboration to meet their statutory obligations.

Governance arrangements

79. The council's governance arrangements provide an appropriate framework for decision making and scrutiny.

80. The council conducts its business in an open and transparent manner. Councillors have good access to officers and are of the view that conversations they have do not impact on the transparency of full discussion and challenge in public forums.

81. The Council audio casts committee meetings via its website offering a listen live and listen again service to its stakeholders, improving the transparency of decision making. Committee agendas, reports, minutes and audio files are available on the OIC website.

82. The standard of member scrutiny is generally good with some areas for improvement.

83. Following the council elections in May last year, a comprehensive programme of member induction was provided to support new members in discharging their governance and scrutiny role.

84. The quality of reports to council/committee is in the main good with some exceptions where further information has been required. Councillors indicate they are broadly happy with the quality and range of information provided to them.

Transparency

85. 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.

86. There is evidence from several sources which demonstrate the Council's commitment to transparency. Members of the public can attend meetings of the full

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.

Council, executive and other committees. Minutes of these committee meetings and supporting papers are readily available on the Council's website.

87. The Council's website allows the public to access a wide range of information including the register of members' interests, current consultations and surveys and how to make a complaint. In addition, the website 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.

88. 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.

89. Overall, we concluded that the Council conducts its business in an open and transparent manner.

Internal audit

90. 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).

91. 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 – nominal ledger, financial healthcheck, and housing rents for our financial statements responsibilities.

Management commentary, annual governance statement and remuneration report

92. The Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 requires councils to prepare and publish, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. The management commentary should be fair, balanced and understandable and clearly address the longer-term financial sustainability of the body.

93. Based on our knowledge and work performed, we concluded that the management commentary, annual governance statement and remuneration report are consistent with the financial statements.

National Fraud Initiative

94. 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 9](#).

Exhibit 9

NFI activity



1,425

Matches



315

Recommended for
investigation



468

Completed/closed
investigations

Source: NFI secure website: www.nfi.gov.uk

95. The council were only required to undertake review of the recommended matches, which they have completed. The council has also completed an additional 153 other matches with only 2 errors identified totalling £2,789 of which £1,332 was recoverable.

96. The outcome of the Council's work on fraud prevention, detection and investigation is reported annually to the Monitoring and Audit Committee. Overall, we have concluded that the Council has satisfactory arrangements in place for investigating and reporting data matches identified by the NFI.

Standards of conduct for prevention and detection of fraud and error

97. 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.

98. 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.

Cyber security

99. The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017 which requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate.

100. We concluded that the Council is actively strengthening its cyber resilience arrangements. Cyber essentials (basic) accreditation was obtained in February 2018 and plans are in place to obtain cyber essentials (plus) accreditation in 2019.

General Data Protection Regulation

101. The new General Data Protection Regulation (GDPR) came into force on 25 May 2018. This replaced the UK Data Protection Act 1998. As a Regulation, all EU member states must implement it in the same way. GDPR sets out further requirements than the DPA and has introduced new and significantly changed data protection concepts.

102. GDPR introduces a wide range of new rights for individuals in respect of their personal data. These include the right to be forgotten, the right to object to certain processing activities and to decisions taken by automated processes. Failure to

comply with new GDPR data handling arrangements could result in the Council incurring significant fines.

103. The Council revised and updated its Data Protection Policy in April 2018 to comply with the new GDPR.

104. Internal Audit reported on the Council's preparation towards compliance with GDPR to the Monitoring and Audit Committee in March 2018. The Council is generally demonstrating good progress in complying with the requirements of GDPR for example updating policies, mandatory awareness staff training and regular reporting of data protection issues to the Senior Management Team and Corporate Management Team.

105. An action plan has been agreed for implementing outstanding elements of GDPR and the Council is developing and monitoring progress towards compliance with regulations.

106. Overall, we concluded that the Council has taken appropriate steps to comply with GDPR.

Integration of health and social care

107. 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.

108. The Orkney Integration Joint Board (IJB) is provided in partnership with NHS Orkney and became fully operational on 1 April 2016.

109. The Orkney IJB is also supported in its work by a Chief Officer and Chief Finance Officer. The Chief Officer provides strategic and operational advice to the Board while the Chief Finance Officer is responsible for financial management including budget monitoring reports.

110. Ms Caroline Sinclair was Chief Officer for the whole of 2017/18 and she left for a new post in April 2018. A new Chief Officer, Mrs Sally Shaw, commenced with the IJB in September 2018. In the interim period, Chief Officer duties were allocated across the Senior Management Team.

111. Orkney IJB's financial position is challenging. During the year the original budget for 2017/18 was supplemented by additional funding from the partners of the Orkney IJB, with NHS Orkney and Orkney Islands Council providing additional funding of £0.478 million and £0.184 million respectively in order to achieve a break-even position. Total net expenditure for the Orkney IJB delegated services in 2017/18 was £49.63 million (including £7.2 million in relation to set-aside).

112. The 2018/19 indicative funding allocations were presented to the Orkney IJB in March 2018. Since March 2018, the budgets have been increased and approved by the partner bodies and now include a savings target. The revised budgets that have been allocated to the Orkney IJB are £23.208 million from NHS Orkney and £18.18 million from Orkney Islands Council which gives a total allocation of £41.39 million. This is £0.89 million less than net expenditure for 2017/18, excluding the set-aside figures.

113. The savings target for the Orkney IJB is £1.448 million for the financial year 2018/19. The breakdown of savings for NHS Orkney is £1.060 (4.4%) and Orkney Islands Council is £0.388 million (2.1%). However, to date, only £0.236 million recurring and £0.074 million non-recurring savings have been found resulting in unidentified savings of £1.138 million. In addition, the set aside budget for 2018/19 has not been included as it still requires approval.

114. Budget monitoring will be critical to ensure the Orkney IJB achieves the projected break-even position. Therefore, regular monitoring and reporting is crucial to address shortfalls and implement budget recovery plans.

115. Orkney had a good arrangement and buy-in regarding joint working by partners prior to the commencement of the Orkney IJB and management consider, as a result, that most of the shift in resources was completed prior to the implementation of the IJB, for example the closure of the Piper Ward and the establishment of the Integrated Care Team pre-date the IJB. Partners consider hospital beds to now be at minimum levels, as agreed in the New Hospital business case.

116. In December 2015, Audit Scotland published the first of three national reports *Health and Social Care Integration* looking at the integration of health and social care. In the report we recognised that The Public Bodies (Joint Working) (Scotland) Act 2014 introduced a significant programme of reform affecting most health and care services and over £8 billion of public money. The reforms are far reaching and have scope to address previous barriers to providing the right care for people closer to home.

117. Audit Scotland also reported some significant risks to the success of health and social care integration. These included complex governance arrangements, difficulties in budget-setting and consequent delays in strategic planning. The scale of the change is significant and will not happen quickly.

118. Audit Scotland have carried out a second national review, in 2018, now that integration authorities are more established, to look at progress and to follow up on these risks. The audit examines changes to the system, including evidence for shifts in service delivery from acute to community-based and preventative services, and for impact on the lives of local people. The report is due to be published in November 2018.

Local scrutiny plan

119. The 2018/19 Local Scrutiny Plan (LSP) prepared by the Local Area Network (LAN) of scrutiny partners for the Council was presented to the Monitoring and Audit Committee in June 2018. The LAN did not identify any new scrutiny risks in the year which would require specific scrutiny work during 2018/19.

Good practice points

120. The Community Empowerment (Scotland) Act 2015 gave local communities new powers to take control of and manage community assets. The Council has demonstrated that it is prepared to adopt the ethos of the Act by giving favourable consideration to the transfer of assets to the community whether or not a formal asset transfer request has been made in terms of the Act.

121. The Council transferred two assets to ORIC in 2017/18 (exhibit 3, finding 5). This was part of a project aimed at the redevelopment of the assets and to attract academic institutions and associated research and business activity to Orkney, although it did not comprise an asset transfer in terms of the provisions of the 2015 Act. The Old Stromness Primary School was no longer required by OIC due to the building of a new primary school in Stromness while the Old Stromness Academy which was let as commercial units required a major overhaul.

Part 5

Value for money



Main judgements

A number of activities are underway in response to the Best Value Assurance Report published in December 2017. The Council will wish to ensure it can demonstrate what difference they are making in respect of improved outcomes and the realisation of efficiencies.

The Council has appropriate arrangements in place to follow the public pound with some room for improvement with respect to one ALEO.

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

Best value

122. 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.

123. The Council's response to the Accounts Commission's recommendations, in the form of the Best Value Response Plan, was approved in April 2018.

124. We have followed up the council's progress in implementing our recommendations. Exhibit 10 details the recommendations for improvement and progress reported by the council to date.

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

Exhibit 10

Progress in implementing best value recommendations

BVAR Recommendation	Progress in implementing each recommendation
The council must maintain the current pace of improvement and in particular ensure it makes progress with the following: Developing a detailed workforce plan	Corporate workforce plan – a report was presented to the HR sub-committee on 31 May 2018 outlining a number of broad areas for future direction and next steps in implementing a corporate workforce plan. The work will now commence to ensure that plans are developed by March 2019.

BVAR Recommendation	Progress in implementing each recommendation
<p>Managing capital projects effectively to avoid slippage and the negative impact on delivering strategic priorities.</p>	<p>Capital programme – capital project appraisal guidance has been approved and training provided to service officers. Going forward the council plan to see improvements once the new process has bedded-in.</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>Long-term financial planning – the Council is developing a long-term financial strategy and anticipates that the plan will be available for members by the end of 2018 and approved by March 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), with 12 out of 42 actions complete. The Council is also making substantial progress with the IT Strategy Delivery Plan, with 9 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>The Council's Performance and Risk Management Team have proposed an approach which was endorsed by the Corporate Management Team and Senior Management Team and will be reported to the Monitoring and Audit Committee in November 2018 for approval.</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>Work is being undertaken with Voluntary Action Orkney. The Council also has a consultation and engagement officers group to take forward areas such as actioning the communications and community engagement strategy, social media, 'Orkney opinions', participatory budgets and community consultations.</p>
<p>The council should set out how its activities will contribute to improved outcomes for communities so that it can evidence and monitor the impact.</p>	<p>The Council Plan 2018-23, which has been agreed, has greater focus on how actions and agreed activities will impact on positive outcomes. A similar approach will be taken to Service Plan reviews in 2019.</p>
<p>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.</p>	<p>A performance workshop for members of the Orkney Partnership Board, Executive Group and Delivery Groups was held on 14 June 2018, facilitated by the Improvement Service. Output and learning from the workshop is being used by the delivery groups to inform the selection and monitoring of performance indicators to support their target outcomes.</p>
<p>The council should consider how it can enhance its councillor training and development programme and encourage better uptake by councillors of personal development opportunities.</p>	<p>The Chief Executive and all elected members have had one to one meetings to discuss all aspects of the council business and challenges going forward. All councillors received an in-depth induction programme and the Council is developing an elected member CPD framework</p>

BVAR Recommendation	Progress in implementing each recommendation
	through their supporting change, transformation and improvement agenda.

125. 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 and review options for modernising and delivering frontline services more efficiently. The Change Programme has been in place since 2011 and has still to deliver the intended outcomes. We noted that:

- the programme has a baseline savings target of £3.75 million; only 40% of the baseline savings plans have been approved to date.
- the staff terms and conditions project has been placed on hold for a number of reasons, including the national work on gradings compression following the introduction of the Living Wage
- the property asset management project is underway, but anticipated savings are taking longer to realise than had initially been anticipated.

126. In contrast the Council is making good progress in actively looking at new sources of income, to help overcome financial challenges the council and wider Orkney community face over the years ahead. One consideration being investigated is whether a large-scale wind farm could serve as an important source of income as well as providing benefit for the community. The council is actively engaging with local residents on this innovative project.

127. Overall, the Council is progressing a number of activities in response to the Best Value Assurance Report published in December 2017. The Council will wish to ensure it can demonstrate what difference they are making in respect of improved outcomes and the realisation of efficiencies.



[Recommendation 7 \(refer appendix 1, action plan\)](#)

Following the public pound

128. 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).

129. 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.

130. 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 with regard to the content of the Service Agreement and the actual operating arrangements between the Council and the Trust.



[refer appendix 2,risk 9](#)

- 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 2017/18 the net effect of Orkney College activities resulted in a deficit of £0.24 million. The deficit was matched by a transfer from the reserve fund.

131. 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

132. 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.

133. 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. A similar approach will be taken to Service Plan reviews in 2019. Councillors have ownership of the council plan and monitor progress against actions every six months.

134. 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.

135. Performance management arrangements are in place but they do not systematically include monitoring the impact of the council's policies and actions. We have recommended that 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. In response to our recommendation, a performance workshop for members of the Orkney Partnership Board, Executive Group and Delivery Groups was held in June 2018, facilitated by the Improvement Service. Output and learning from the workshop is being used by the delivery groups to inform the selection and monitoring of performance indicators to support their target outcomes.

136. The council publishes an annual performance report (APR), which is available on its website. The APR 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

137. 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.

138. The most recent [National Benchmarking Overview Report 2016/17](#) by the Improvement Service was published in February 2018 and covered the 2016/17 reporting period. This report concluded that the Council performed well in comparison to other councils.

139. 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. 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 2018 several positives were highlighted including:

- 20 indicators are rated green, 4 amber and 13 red
- Continuing support towards the regeneration of Kirkwall town centre including refresh of the BID business plan
- Working with Transport Scotland in developing a funding and responsibility arrangement with the Scottish Government for internal air and ferry services
- Working with the Scottish Government and other agencies such as Ofgem, to facilitate a reduction in transmission charges.

140. The Council recognises that it should improve service deliver in several key areas such as social housing construction which has recently slowed for both the Council and Orkney Housing Association Limited and digital communications.

Statutory performance indicators (SPIs)

141. 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.

142. For 2017/18 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.

143. 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

144. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2017/18, Audit Scotland published a number of reports some of which were issued which are of direct interest to the Council. These are outlined in [Appendix 3](#).

Appendix 1

Action plan 2017/18

2017/18 recommendations for improvement

No.	Issue/risk	Recommendation	Agreed management action/timing
1.	<p>Pension Scheme valuation</p> <p>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 were lower than actual returns. This resulted in pension fund assets reported in the Council's balance sheet being understated by £11.80 million.</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>Paragraph 28 Exhibit 3</p>	<p>Agreed.</p> <p>Responsible officer: Head of Finance 31 March 2019.</p>
2.	<p>Net pension asset measurement</p> <p>OIC are showing a net pension asset of £15.16 million on their balance sheet but the council's actuaries, Hymans Robertson, have not calculated the asset ceiling</p>	<p>In future periods, where it is likely that OIC will have an IAS 19 asset, the council should consider the need to calculate the asset ceiling during their discussions with the actuary.</p> <p>Paragraph 28 Exhibit 3</p>	<p>Agreed.</p> <p>Responsible officer: Head of Finance 31 March 2019.</p>
3.	<p>Non-current assets</p> <p>It was noted that many of the council's historic cost assets such as infrastructure assets (piers, roads) are being revalued on a regular basis but that the useful lives have not been reviewed for a number of years. As a result, many of the infrastructure assets are recorded with short useful lives.</p>	<p>The council should review the asset lives of infrastructure assets on an annual basis.</p> <p>Paragraph 28 Exhibit 3</p>	<p>Agreed.</p> <p>Responsible officer: Head of Finance 31 March 2019.</p>
4.	<p>Capital slippage</p> <p>The original approved limit for capital expenditure during 2017/18 was £21.3 million which included £1.5 million</p>	<p>The Council should ensure that slippage and rescheduling of capital projects does not have a significant impact on strategic priorities that are</p>	<p>Agreed</p> <p>Responsible officer: Head of Finance Agreed date: Ongoing</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>slippage from the previous financial year. During the year further projects were added and removed from the Council's Capital Programme, resulting in a revised limit of £26 million.</p> <p>Total capital expenditure in 2017/18 was, however, £14.8 million.</p>	<p>dependent on capital projects being completed on time.</p> <p>Paragraph 50</p>	
5	<p>Long Term Financial Planning</p> <p>The Council agrees that longer term financial plans are essential to ensure that funds are used to deliver the priorities of the Council and that the reserves continue to provide benefit for the people of Orkney in the way intended. The council does not currently have a longer term financial plan.</p>	<p>The Council should prioritise the preparation of a longer term (five to ten year) financial plan to ensure the sustainability, feasibility and practicalities of current spending and investment plans.</p> <p>Paragraph 60</p>	<p>Agreed</p> <p>Responsible officer: Head of Finance</p> <p>Agreed date: 31 December 2018</p>
6.	<p>Annual Budget</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>The council needs to consider reducing the level of General Fund expenditure to bring it into line with the financial support received.</p> <p>Paragraph 64</p>	<p>Work on developing the budgets for 2019/20 is underway, it is however apparent that service pressures are building and that these significantly outweigh the savings opportunities that have been identified.</p> <p>Responsible officer: Head of Finance</p> <p>Agreed date: 31 March 2019</p>
7.	<p>BVAR follow up</p> <p>The Council is progressing a number of activities in response to the Best Value Assurance Report published in December 2017. The Council will wish to ensure it can demonstrate what difference they are making in respect of improved outcomes and the realisation of efficiencies.</p>	<p>The Council will wish to ensure it can demonstrate what difference they are making in respect of improved outcomes and the realisation of efficiencies.</p> <p>Paragraph 129</p>	<p>Agreed</p> <p>Responsible officer: Chief Executive</p> <p>Agreed date: 31 March 2019</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
b/f	<p>1. Governance Statement assurances</p> <p>The Council needs to reflect on how to obtain assurances in future years when we are not required to complete full system reviews for all key financial systems.</p>	<p>The Council should ensure appropriate procedures and processes are in place to obtain assurances for the annual Governance Statement in 2017/18.</p>	<p>Additional systems work was completed by Internal Audit to support the assurances in the Governance Statement for 2017/18.</p>
	<p>2. Capital slippage</p> <p>The Council has a history of slippage in its capital programme</p>	<p>The Council should ensure that slippage and rescheduling of general fund capital projects does not have a significant impact on strategic priorities that are dependent on capital projects being completed on time.</p>	<p>The council reported an improved position for 2017/18. The original approved limit for capital expenditure during 2017/18 was £21.3 million. During the year further changes were made to the Council's Capital Programme, resulting in a revised limit of £26 million. Capital spend for 2017/18 totalled £14.8M resulting in capital slippage of £11.2 million. Capital slippage totalled £13.1 million in 2016/17. Refer to action plan point 4.</p>
b/f	<p>3. Financial monitoring reports</p> <p>From our review of financial monitoring reports and attendance at committee we concluded that they provided an overall picture of the budget position at service level but can be three months out of date by the time they are reviewed.</p>	<p>Financial monitoring reports should be prepared and reported on a timely basis so that members can make informed decisions on the financial position of the Council.</p>	<p>The council receive regular up to date reports in addition to those submitted quarterly to Committee.</p>
b/f	<p>4. Financial ledger user access</p> <p>We performed a review of access rights to the financial management system and found there to be a significant number of users with system administration/super user rights including eleven officers within the IT service.</p>	<p>User access to council systems should be reviewed on a regular basis to ensure that only users with a business need have access to those systems.</p>	<p>A review of ledger access has been completed with user access changes implemented. It is proposed that an annual review of user access be carried out.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
b/f	<p>5. Funding Position</p> <p>The Council is forecasting a likely funding gap of £30.8 million over the period 2017/18 to 2021/22. The Council plans to bridge this gap mostly through transfers from reserves from the General Fund and efficiency savings of £9.8 million, however there is a residual funding gap of £9.8 million.</p>	<p>The council should prepare detailed savings plans for the period 2017/18 to 2021/22 which identify how the residual funding gap of £9.8 million will be addressed.</p>	<p>Additional funding of £5.5 million was received for internal ferry services in 2018/19 and this is anticipated to continue for 2019/20. The work on preparing for the 2019/20 budget has confirmed however that service pressures exceed the identified savings opportunities. The funding gap will continue to be refined as the long term financial plan is developed.</p>
b/f	<p>6. Long Term Financial Planning</p> <p>The Council's very strong usable reserves position provides a good degree of reassurance to the Council's financial sustainability.</p> <p>68% of the value of useable reserves, (£178.955 million at 31 March 2017) are held in the Strategic Reserve Fund (SRF) and 6% of the value of reserves (£15.781 million at 31 March 2017) are held in the General Fund.</p> <p>There is a risk that suitable spending plans are not in place to support delivery of the council's strategic aims.</p>	<p>The Council should prepare a longer term (five to ten year) financial plan to ensure the sustainability, feasibility and practicalities of current spending and investment plans.</p>	<p>The council does not have a longer term financial plan.</p> <p>Action plan 5.</p>

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
Risks of material misstatement in the financial statements		
<p>1 Management override of controls</p> <p>As stated in International Standard on Auditing 240, management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p>	<p>Reviewed the appropriateness of journal entries and other adjustments recorded in the general ledger and financial statements.</p> <p>Reviewed accounting estimates for biases.</p> <p>Evaluated significant transactions that are outside the normal course of business.</p> <p>Focussed testing of the regularity and cut-off assertions during the financial statements audit.</p>	<p>Audit testing was satisfactory, and no fraud concerns were identified in respect of management override of controls.</p>
<p>2 Risk of fraud over income</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>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>	<p>Audit testing was satisfactory, and no concerns were identified.</p>
<p>3 Risk of fraud over expenditure</p> <p>The Financial Reporting Council's Practice Note 10 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>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>Audit testing was satisfactory, and no concerns were identified.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>4 Estimation and judgements</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>Review and comment on the appropriateness of the Council's policy regarding 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>Satisfactory – notwithstanding the audit finding detailed in Exhibit 3 point 8, we found the estimates and judgements (where applied) were appropriate.</p>
<p>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</p>		
<p>4 Financial Sustainability</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>Monitor progress with preparing longer term financial plans providing comment in our annual audit report 2017/18.</p>	<p>Work is progressing to identify best practice in preparing a long term financial plan.</p>
<p>5 Financial management</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 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 2017/18.</p>	<p>The council reported a significantly improved position for 2017/18. Capital spend for 2017/18 totalled £14.8 million, against an original planned capital investment of £26 million resulting in capital slippage of £11.2million. Capital slippage totalled £11.9m in 2016/17.</p>
<p>6 PSN Compliance</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>Review the results of the PSN health check providing comment in our annual audit report 2017/18.</p>	<p>The Council is PSN compliant.</p>
<p>7 Governance Statement assurances</p> <p>Internal audit have planned some reviews of key financial systems during 2017/18 but the</p>	<p>Liaise with Internal Audit early in the year.</p> <p>Review the work of internal audit and assess the adequacy of assurances</p>	<p>Internal audit completed a financial systems health check during the year in addition to systems testing on the nominal ledger and housing rents. We</p>

Audit risk	Assurance procedure	Results and conclusions
<p>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>provided to support the governance statement.</p>	<p>have placed reliance on the work of internal audit.</p>
<p>8 Financial ledger user access</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 fraudulent transactions are made as inappropriate or unauthorised access to the computer systems is not prevented.</p>	<p>Review and assess the work of Internal Audit and adjust our testing strategy for financial ledger transactions as appropriate.</p>	<p>We performed substantive analytical review and additional transaction testing in key account areas. We also monitored progress on reviewing user access.</p> <p>No errors or fraudulent transactions were identified during our testing and our substantive analytical reviews were concluded as satisfactory.</p>
<p>9 Pickaquoy Centre Trust</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>Monitor progress in reviewing the service agreement between the council and the Trust providing comment in our annual audit report 2017/18.</p>	<p>This action was followed up by internal audit during 2017/18. Internal audit concluded that there are several recommendations outstanding which relate to the review of the Service Level Agreement between the Pickaquoy Centre Trust and the Council. Work is ongoing with respect to reviewing the Agreement and revised completion dates have been agreed for the recommendations to correspond to this planned work.</p>

Appendix 3

Summary of national performance reports 2017/18



		Apr		
		May		
Common Agricultural Policy Futures programme: further update		Jun		Scotland's colleges 2017
		Jul		NHS workforce planning
Self-directed support: 2017 progress report		Aug		
Equal pay in Scottish councils		Sept		
Transport Scotland's ferry services		Oct		NHS in Scotland 2017
Local government in Scotland: Financial overview 2016/17		Nov		
		Dec		
		Jan		
Early learning and childcare		Feb		
Managing the implementation of the Scotland Acts		Mar		

Local government relevant reports

[*Principles for a digital future*](#) – May 2017

[*Self-directed support: 2017 progress report*](#) – August 2017

[*Equal pay in Scottish councils*](#) – September 2017

[*Local government in Scotland: Financial overview 2016/17*](#) – November 2017

Orkney Islands Council

2017/18 Annual Audit Report

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