



Orkney Islands Council

Annual audit report to
Members and the
Controller of Audit

September 2015

The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies. (www.audit-scotland.gov.uk/about/ac)

Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General. (www.audit-scotland.gov.uk)

The Accounts Commission has appointed Stephen Boyle as the external auditor of Orkney Islands Council for the period 2012/13 to 2015/16.

This report has been prepared for the use of Orkney Islands Council and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

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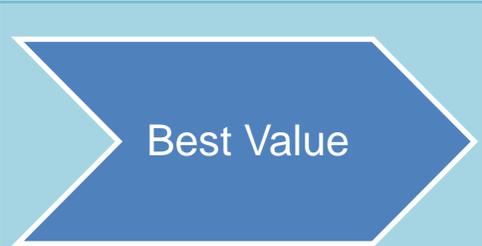
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Key messages

 <p>Audit of financial statements</p>	<ul style="list-style-type: none"> • The independent auditor's report on the 2014/15 annual accounts of Orkney Islands Council and its group is unqualified. • The independent auditor's reports on the two charitable trusts administered by the council are unqualified.
 <p>Financial management and sustainability</p>	<ul style="list-style-type: none"> • The council's financial position, supported by its substantial harbour authority account, is sustainable currently and in the foreseeable future. Rising demand for, and costs of, services will continue to place a strain on the council's capacity to deliver services at the current levels. • The council has identified that it may need to make annual savings of £9.500 million by 2019/20 but has yet to develop firm plans for making these savings. • The council needs to address significant slippage in the delivery of its capital programme.
 <p>Governance and transparency</p>	<ul style="list-style-type: none"> • The council's current governance arrangements provide an appropriate framework for decision making and the council is open and transparent. • Systems of internal control operated effectively. • The council has an effective internal audit function. • The council participated in the National Fraud Initiative in 2014/15. No significant frauds were identified, however one case is still under investigation by the council.
 <p>Best Value</p>	<ul style="list-style-type: none"> • Good progress has been made in addressing the Community Planning Partnership improvement agenda. It is important that this continues. • The council has a sound framework for monitoring and reporting performance against its priorities. • The council could improve its approach to public performance reporting.



Outlook

In common with other councils, the council faces rising demands for services and continued funding pressures alongside managing major reforms in welfare and health and social care. Strong governance and leadership will be needed to ensure the council makes the best use of available resources.

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of Orkney Islands Council. The report is divided into sections which reflect our public sector audit model.
2. The management of Orkney Islands Council is responsible for:
 - preparing financial statements which give a true and fair view
 - implementing appropriate internal control systems
 - putting in place proper arrangements for the conduct of its affairs
 - ensuring that the financial position is soundly based.
3. Our responsibility, as the external auditor of Orkney Islands Council, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; this does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.
5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports, summarised at **appendices II and III**, include recommendations for improvements.
6. **Appendix IV** is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Orkney Islands Council understands its risks and has arrangements in place to manage these risks. The council and executive officers group should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Audit of the 2014/15 financial statements

<p>Audit opinion</p>	<ul style="list-style-type: none"> We have completed our audit and issued an unqualified independent auditor's report.
<p>Going concern</p>	<ul style="list-style-type: none"> The financial statements of the council, its group and the associated charitable trusts have been prepared on the going concern basis. We are unaware of any events or conditions that may cast significant doubt on the council, its group and associated charitable trusts' ability to continue as a going concern.
<p>Other information</p>	<ul style="list-style-type: none"> We review and report on other information published with the financial statements, including the management commentary, annual governance statement and the remuneration report. We have nothing to report in respect of these statements.
<p>Charitable trusts</p>	<ul style="list-style-type: none"> We have completed our audit of the 2014/15 financial statements of the two charitable trusts administered by Orkney Islands Council and issued an unqualified independent auditor's report for each of the relevant trusts.
<p>Group accounts</p>	<ul style="list-style-type: none"> Orkney Islands Council has accounted for the financial results of three subsidiaries and one associate in its group accounts for 2014/15. The overall effect of consolidating these balances on the group balance sheet is to reduce total reserves and net assets by £5.451 million.

Submission of financial statements for audit

9. We received the unaudited financial statements on 29 June 2015, in accordance with the agreed timetable. The working papers were of a good standard and council staff effectively supported the audit team to deliver the audit on time.

Overview of the scope of the audit of the financial statements

10. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Monitoring and Audit Committee on 19 February 2015.
11. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. As such, the agreed fee for the 2014/15 audit, which was set out in the Annual Audit Plan, remains unchanged.
12. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements and consequently had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. **Appendix I** sets out the significant audit risks identified during the course of the

audit and how we addressed each risk in arriving at our opinion on the financial statements.

13. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

14. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).
15. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
16. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of Orkney Islands Council we set our planning materiality for 2014/15 at £1.100 million (1% of gross expenditure). We report all misstatements greater than £0.050 million. Performance materiality was calculated at £0.550 million, to reduce to an acceptable level

the probability of uncorrected and undetected audit differences exceeding our planning materiality level.

17. In our Annual Audit Plan we set separate materiality in the audit of the two charitable trusts' financial statements of £650 for both Orkney Islands Council General Charitable Trust and Orkney Educational Trust.
18. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our original audit approach remained appropriate.

Evaluation of misstatements

19. All misstatements identified during the audit, which exceeded our misstatement threshold, have been amended in the financial statements.
20. A number of presentational and monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements. The effect of these adjustments is to increase group comprehensive income by £23.033 million and increase group net assets by £23.033 million. These changes relate to:
 - £0.362 million increase in depreciation due to errors in information transferred to the council's new fixed asset management system

- £23.395 million increase in property, plant and equipment due to the reclassification and revaluation of the Pickaquoy Centre from an investment property to an operational asset on the council's balance sheet.

Significant findings from the audit

21. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:
 - The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
 - Significant difficulties encountered during the audit.
 - Significant matters arising from the audit that were discussed, or subject to correspondence with management.
 - Written representations requested by the auditor.
 - Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
22. During the course of the audit we identified the following significant issues that, in our view, require to be communicated to you.

Significant findings from the audit

Issue	Resolution
<p>Depreciation calculation:</p> <p>We found a number of errors in the calculation of depreciation in the unaudited annual accounts. This was caused by errors in the information migrated to the council's new fixed asset management system. It led to incorrect remaining asset lives being applied to all assets and depreciation being wrongly applied to land assets. This resulted in a net understatement of depreciation of £0.362 million and a corresponding overstatement of non-current assets of the same amount.</p> <p style="text-align: right;">Refer Action Plan Point 1</p>	<p>Officers have adjusted the annual accounts to correct for the errors in the depreciation calculation.</p>

Issue	Resolution
<p>Classification of the Pickaquooy Centre from investment property to operational asset:</p> <p>Following a review of its classification of operational and investment properties, the council identified that the Pickaquooy Centre, a multi-use leisure centre in Kirkwall, should be reclassified as an operational asset from an investment property. The council determined that it is not an investment property as the use of the centre fulfils a statutory council function and it is leased by the council to the Pickaquooy Centre Trust for a notional annual rent of £1. These factors have led the council to reclassify the asset as operational. As a result income through a revaluation gain has increased by £23.395 million and non-current assets have increased by the same amount. The council has not made a prior year adjustment due to the difficulty in obtaining the information required to reclassify the comparative balances. The council has disclosed the reason for not reclassifying the amounts and the nature of the adjustments that would have been made if the amounts had been reclassified in the annual accounts.</p> <p>The council's review of its asset categorisation is expected to be completed in 2015/16. Any further changes will be reflected in the 2015/16 annual accounts.</p> <p style="text-align: right;">Refer Action Plan Point 2</p>	<p>The council holds a significant number of investment properties. Officers are reviewing the classification of the council's remaining properties during 2015/16. The Pickaquooy Centre is expected to be the most significant change and officers do not anticipate that completion of the review will result in a material change in the overall value of the council's non-current assets in 2015/16. The Head of Finance has provided us with an assurance on asset classifications in the letter of representation.</p>

Issue	Resolution
<p>Future costs of restoring waste disposal sites and quarries:</p> <p>The council does not yet have a contingency plan in place in relation to waste disposal and quarry sites. Some of these may have specific restoration responsibilities as part of the Scottish Environmental Protection Agency licenses. Any anticipated costs of restoring land associated with these sites could require a contingent liability to be included in the accounts. The timing of any liability is uncertain and the associated costs cannot be reliably estimated at this time.</p> <p style="text-align: right;">Refer Action Plan Point 3</p>	<p>The council has disclosed an unquantified contingent liability in the 2014/15 annual accounts. It is progressing with its review of the cost implications of restoration and expects to complete this by the end of 2015. The council is expected to disclose a quantified contingent liability or provision, depending on the results of the review, in its 2015/16 annual accounts.</p>

Future accounting and auditing developments

Revisions to the Code of Practice

23. The financial statements of the council are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which interprets and adapts International Financial Reporting Standards (IFRS) to the local authority context. The following paragraphs set out the most significant changes to accounting requirements introduced by the 2015/16 Code.
24. **(IFRS) 13 Fair value measurement:** Although the measurement requirements for operational property, plant and equipment will not change, enhanced valuation disclosures will be required. However, the 2015/16 Code requires surplus assets to be measured at fair value in accordance with IFRS 13. The council will need to make the necessary preparations to ensure that the new requirements are addressed for the 2015/16 financial statements.
25. **Transport infrastructure assets:** The council's highway assets are currently carried within infrastructure assets in the

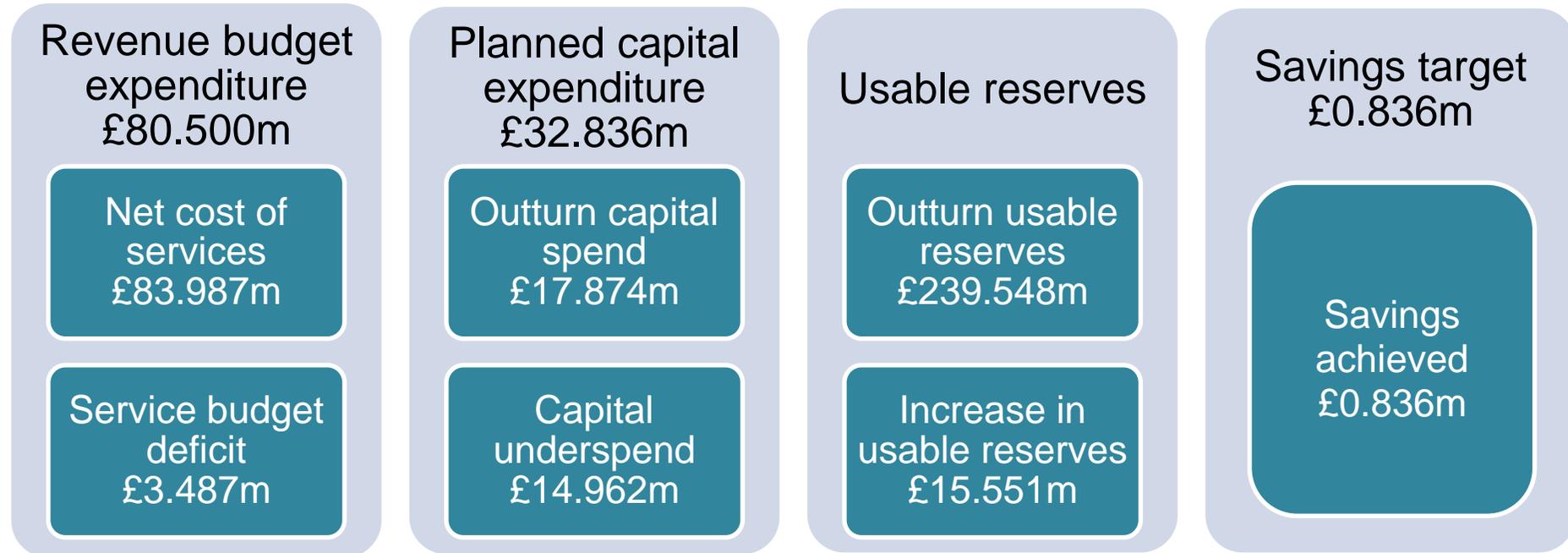
balance sheet at depreciated historic cost. The 2016/17 Code will require highways to be measured, for the first time, on a depreciated replacement cost basis. This is a major change in the valuation basis for highways and will require the availability of complete and accurate management information on highway assets.

26. The council has adopted the CIPFA model for the valuation of highways. The council is reviewing its measurements under the new valuation basis. It will prepare a shadow set of annual accounts for 2015/16 which comply with the requirements for valuation of transport infrastructure assets set out in the 2016/17 Code.

Health and social care integration

27. From 1 April 2016 Integrated Joint Boards (IJBs) will be accountable for the provision of health and social care. IJBs will be required to produce financial statements in compliance with the Code and the Accounts Commission will appoint auditors to audit the financial statements. We comment on the progress of the Orkney IJB at paragraphs 102 to 109.

Financial management and sustainability



Financial management

28. In this section we comment on the council's financial outcomes and assess the council's financial management arrangements.
29. The council sets an annual budget to meet its service and other commitments for the forthcoming financial year. The setting of the annual budget impacts directly on residents as it determines council tax and other fees and charges. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management.

Financial outcomes

30. The council reported a net general fund deficit of £3.487 million (4.3%) against its revised budget of £80.500 million. Adjusting this balance to remove the accounting entries required by the Code, the council achieved a balanced general fund budget. The council also increased its usable reserves by £15.551 million. This increase is largely attributable to an increase in the value of investments in the council's harbour authority account reserves. The general fund deficit resulted from the council approving the transfer of £3.360 million to earmarked reserves to establish a number of funds including:
- Insurance fund
 - Workforce management fund
 - Innovation fund.
31. The outturn in the 2014/15 general fund service budget is satisfactory.
- ### Capital programme 2014/15
32. The council approved total capital expenditure of £32.836 million for 2014/15. However, actual capital spending amounted to £17.874 million, an underspend of £14.962 million (45.6%). Significant capital investment projects progressed during 2014/15 included:
- £4.473 million schools investment programme
 - £1.846 million for development of harbour infrastructure
 - £4.354 million house build programme.
33. There was significant slippage on the following projects:
- Evie School - £1.771 million
 - Extension and refurbishment of St Rognvalds House - £3.177 million
 - Phase two of social housing development programme - £4.612 million.
34. In previous years we have reported on poor performance against the council's capital programme. Slippage in the capital programme has increased since 2013/14, when the council reported a £9.740 million (25.7%) underspend.
35. The council's methodology for capital expenditure includes phasing capital spend over the number of years it is expected individual projects will take to complete. Unrealistic timescales and limited resources to tackle multiple projects at the same time are affecting

the ability of the council to deliver its capital programme commitments. This has resulted in the ongoing underspend.

36. In October 2014, the council decided to increase staff resources but progress in establishing a new capital programme team has been slower than hoped. The council has now recruited the required staff and the capital programme team is in place. This team will work on re-profiling the capital programme and establishing new capital programme management processes.
37. The council has established a management framework structure to support the integration of asset management planning and investment decisions. The Senior Management Team acts as an Officer's Capital Working Group, chaired by the Chief Executive, to provide oversight of the council's corporate assets. It is supported by the capital planning and asset management strategy group.
38. The council has prepared a corporate asset management plan and is developing a suite of detailed asset management plans. To date, fleet and plant and housing asset management plans have been agreed. The council is still developing plans for its remaining services.
39. Despite these arrangements, the council is failing to identify capital slippage at an early stage and is not taking remedial action by bringing forward the timing of other planned capital projects. Capital expenditure monitoring reports are presented to the Policy and Resources Committee showing the six month, nine month and year end position. These reports identify capital projects where there are

underspends and provide explanations, but do not propose actions to address the slippage in the overall programme.

Refer Action Plan Point 4

Financial management arrangements

40. As auditors, we need to consider whether councils have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
 - the proper officer has sufficient status within the council to be able to deliver good financial management
 - financial regulations are comprehensive, current and promoted within the council
 - reports monitoring performance against budgets are accurate and provided regularly to budget holders
 - monitoring reports do not just contain financial data but are linked to information about performance
 - members provide a good level of challenge and question budget holders on significant variances.
41. We assessed the role and status of the proper officer against CIPFA's "Statement on the role of the Chief Financial Officer in Local Government". The council's arrangements do not fully comply with the governance requirements because the Head of Finance does not report directly to the Chief Executive. The council's arrangements largely achieve the intended outcomes of the CIPFA

statement, however, and comply with it in all other material respects.

42. We reviewed the council's financial regulations and concluded that they are comprehensive and current. The council's financial regulations are available on its website.
43. Revenue financial monitoring reports are submitted to the Policy and Resources committee on a quarterly basis. Service committees also receive regular budget monitoring reports. Reports are comprehensive and well laid out with explanations and required actions outlined for any significant budget variances.
44. As auditors we attend a number of council and committee meetings each year. Members provide a good level of challenge and question budget holders on significant variances and service performance issues.

Conclusion on financial management

45. The council needs to improve its financial management arrangements to address the ongoing significant underspends in its capital programme.

Financial sustainability

46. The council delivers a broad range of services, both statutory and discretionary, to its communities. Financial sustainability means that the council has the capacity to meet the current and future needs of its communities.

47. In assessing financial sustainability we are concerned with whether:
 - there is an adequate level of reserves
 - spending is being balanced with income in the short term
 - long term financial pressures are understood and planned for
 - investment in services and assets is effective.

Effective long-term financial planning, asset management and workforce planning are crucial to sustainability.

Reserves

48. The overall level of usable reserves held by the council increased by £15.551 million compared to the previous year and totalled £239.548 million, see exhibit 1.
49. The general fund balance includes £5.267 million of unallocated reserves. Planned commitments from the general fund balance amounted to £15.687 million. The most significant earmarked balances include:
 - Renewable energy fund - £3.729 million
 - Innovation fund - £2.193 million
 - Development grants fund - £2.073 million
 - Schools investment programme life cycle fund - £1.418 million
 - Pathfinder project fund - £1.388 million.

Exhibit 1: Usable reserves

Description	31 March 2014 £ million	31 March 2015 £ million
General fund	23.768	20.954
Capital receipts reserve	0.020	0.020
Other statutory funds	0.508	0.508
Harbours	196.784	214.255
Repairs and renewals fund	2.917	3.811
Total usable reserves	223.997	239.548

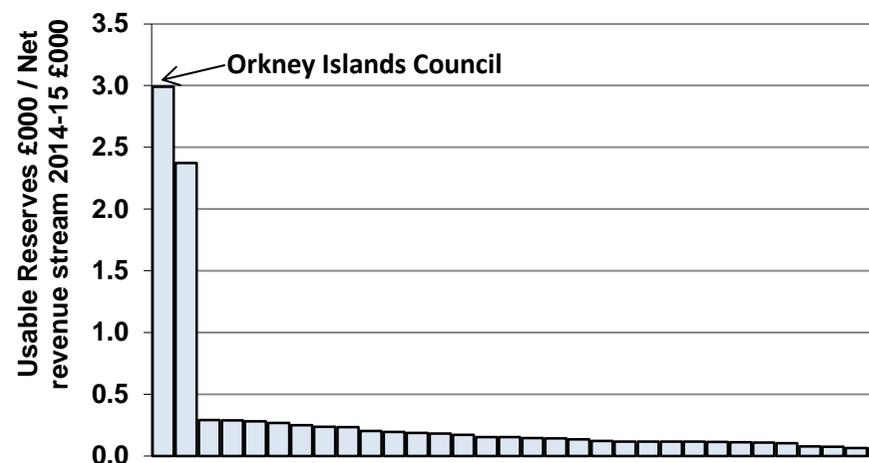
Source: Orkney Islands Council 2014/15 annual accounts

- 50. The general fund reserve has no restrictions on its use. The principal purpose of holding a general fund reserve is to provide a contingency fund to meet unexpected events and as a working balance to help cushion the impact of uneven cash flows.
- 51. The council has a strong usable reserves position compared to other Scottish councils, as shown in Exhibit 2. The median level of total usable reserves for all local authorities was approximately 15% of net revenue. For the council this was 300%, largely due to its strategic reserve fund (SRF), also referred to as its harbour authority account reserves. This is an investment fund established under the Orkney County Council Act 1974. It holds investment returns from surplus funds relating to harbour dues from the Flotta Oil Terminal and previous marine service and disturbance payments

made by the terminal operators. The balance on the fund at 31 March 2015 was £214.255 million.

- 52. The purpose of the SRF is to provide for the benefit of Orkney and its inhabitants, whilst recognising the long term commitments for the future decline and decommissioning of the Flotta Oil Terminal.

Exhibit 2: Usable reserves as a proportion of revenue

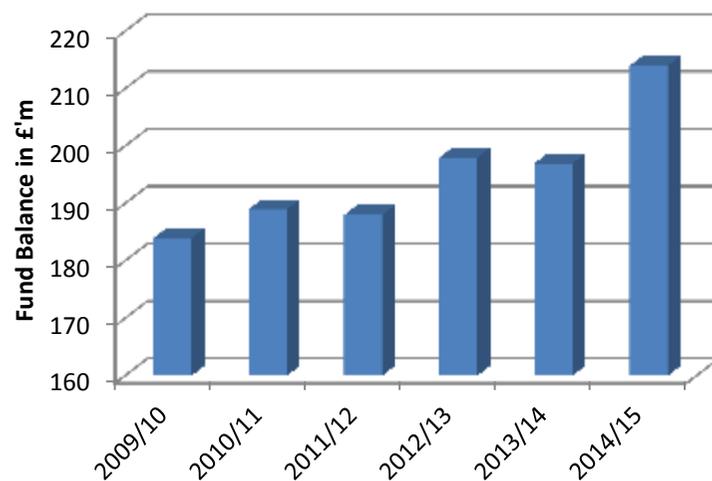


Source: Local government draft accounts 2014/15

- 53. In recent years, the council has approved contributions from the SRF to the general fund. This is treated as a funding source and allows the council to supplement the funding it receives from the Scottish Government and taxes raised locally from non domestic rates and council tax.

54. As shown in exhibit 3, SRF investments have performed well in recent years and the balance held has generally increased after taking account of funds transferred to support specific aspects of the revenue budget. This cushions the council against the ongoing financial constraints on public sector spending. The council has sought tenders for an independent review of its investment strategy for the SRF to ensure that the asset allocation and level of risk remains appropriate.

Exhibit 3: Strategic Reserve Fund balances 2009-2014



Source: Orkney Islands Council annual accounts 2009/10 to 2014/15

Financial planning

55. The council approved its 2015/16 budget in February 2015. The budget was set at £81.806 million and included agreed efficiency

savings of £0.540 million. Each of the savings proposals have been subject to challenge by the Senior Management Team and from elected members at a series of budget seminars.

56. The council has established a Change Programme team to harness new technologies and consider innovative solutions to deliver service efficiencies. In 2014/15, the team assessed a large number of potential projects to assess which were the most feasible to carry forward to a business case. A total of 21 projects were selected, with a further 22 awaiting further resources. Many ideas rely heavily on information technology, so an IT projects board has been set up alongside the Change Programme Board.
57. The Change Programme team is a small dedicated team of staff. The large number of detailed business cases expected means there is considerable pressure on resources. In response to this the council has recently increased the Change Programme team by one full time equivalent member of staff. Also, in May 2015 the council's senior management team agreed that the Change Programme should focus on those ideas which would provide the largest financial gain.
58. The Change Programme led to development of the council's medium term resource strategy 2016/17 to 2019/20 which was approved by the Policy and Resources Committee in February 2015. This provides a financial forecast over a rolling four year period. The forecast is based on assumptions about future Government funding, service pressures and inflation, which have

been used to determine a best, worst and likely outturn. Exhibit 4 outlines the results of these three scenarios.

Exhibit 4: Budget forecasts 2016/17 to 2019/20

Scenario	Service Pressure £ million	Funding Reduction £ million	Annual Savings £ million	Total Savings £ million
Worst case	2.200	1.700	3.900	15.600
Best case	1.000	0.700	1.700	6.800
Likely case	1.000	1.400	2.400	9.500

Source: Orkney Islands Council medium term resource strategy 2016/17 to 2019/20

59. As exhibit 4 shows, the council has identified that it is likely to need to make annual savings of £2.400 million in 2016/17, rising to £9.500 million in 2019/20. The council is in a strong financial position as illustrated by its level of usable reserves, however it is still to develop a plan for how it will make these savings. It has identified a range of options including:
- Innovation fund cost savings
 - Reassessment of spending priorities
 - Use of reserves.
60. The council has started to review how it can better allocate its resources but this work is at an early stage and requires further development. There is also limited information on the level of

savings it expects to achieve from its Change Programme. The council should develop fully costed proposals for how it will make the savings required. This should include identifying the savings that will be made through the Change Programme.

Refer Action Plan Point 5

Workforce management

61. The council has difficulty attracting and retaining sufficiently qualified staff in areas such as finance and procurement. Its human resources strategy 2014-2018 aims to address this by ensuring that the council has the right people in the right place with the right skills to deliver its priorities. The strategy focuses on three main areas:
- reshaping the workforce
 - exploring new ways of working
 - enhancing capacity and improving performance.
62. The council plans to develop a workforce planning approach. This will involve identifying the key challenges for the council and individual services and developing workforce plans. This work is at an early stage. The council is in the process of gathering and organising workforce demographics and other information to help inform its workforce strategy and plans.
63. In February 2015, the council approved the establishment of a workforce management fund of £1.000 million. This will provide for the costs associated with redundancy and early retirements should the council be required to make reductions in its workforce.

Treasury management

- 64. At 31 March 2015 long term borrowing stood at £40.000 million, an increase of £10.000 million in the year. During the same period, short term borrowing reduced from £10.450 million to £0.538 million. This is in line with the council's treasury management strategy for 2014/15. Interest payable and similar charges fell by £0.045 million in 2014/15 to £1.349 million.
- 65. The council's net external debt as a proportion of net revenue spend continues to remain low in relation to other Scottish local authorities.

Pension liability

- 66. The council is the administering authority for the Orkney Islands Council Pension Fund which is a funded defined benefit scheme. The scheme is operated under the regulatory framework of the Local Government Pension Scheme.
- 67. The council's own pension liability increased from £35.721 million in 2013/14 to £38.583 million in 2014/15. This is due to a reduction of £2.862 million in the appointed actuaries assessment of the funding level of the pension fund. The reduction is largely due to less favourable financial assumptions as a result of the current economic climate.
- 68. The pension liability represents the difference between expected future pension payments and the underlying value of pension fund assets available to meet this cost. The last triennial valuation, as at 31 March 2014, revealed that Orkney Islands Council Pension Fund was 114.4% funded and had assets of £227.000 million. Taking into

account recent market conditions the actuary recommended that the current contribution rate of 21.4% be maintained during 2015/16.

Conclusion on financial sustainability

- 69. The council has substantial reserves and is containing its expenditure within annual budgets, excluding the impact of transfers to earmarked reserves. It has also published a medium term financial plan. However, the council needs to prepare a clear plan for how it will address forecast funding gaps and develop an approach to prioritising resources. The council's financial position is sustainable currently and in the foreseeable future, although rising demand for, and costs of, services will continue to place a strain on the council's capacity to deliver services at the current levels.

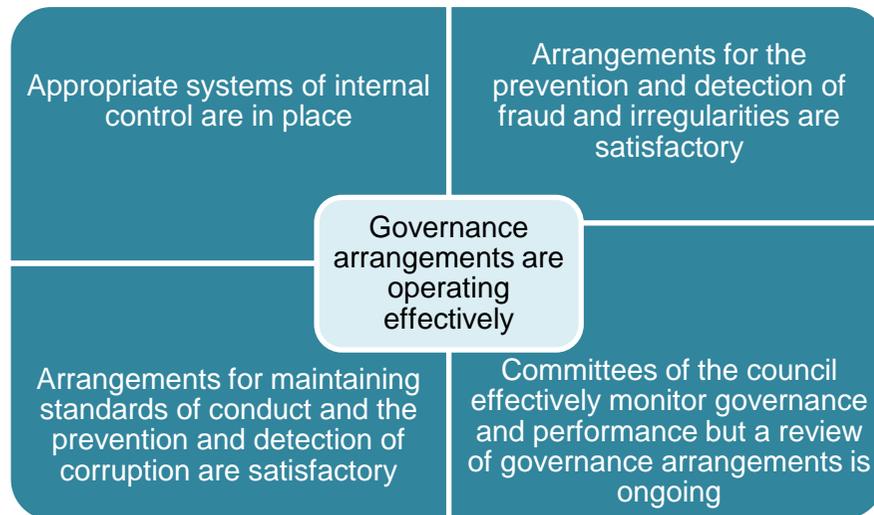
Outlook

- 70. Councils face increasingly difficult financial challenges. Public sector revenue budgets are decreasing and demand for council services is increasing. Increased pension contributions, from auto enrolment, and national insurance changes will create further cost pressures on the council.
- 71. In common with many other councils, Orkney Islands Council is now reporting gaps between income and the cost of providing services over the next few years. With further funding reductions expected, councils face tough decisions to balance their budgets. These decisions must be based on a clear understanding of the current

financial position and the longer-term implications of decisions on services and finances.

72. The Scottish Government plans to wait until the UK Government's spending review is published in November 2015 before approving its 2016/17 budget. This is likely to impact on councils' ability to approve their own budgets within their usual timetable. The council may have to revise its budget setting arrangements in response to this potential delay.

Governance and transparency



73. Members and management of the council are responsible for establishing arrangements to ensure that its business is conducted in accordance with the law and proper standards, that public money is safeguarded and for monitoring the adequacy and effectiveness of these arrangements.

Corporate governance

74. The corporate governance framework within Orkney Islands Council is centred on the council which is supported by the following standing committees:

- Policy and Resources
- Development and Infrastructure
- Education, Leisure and Housing
- Orkney Health and Care
- Monitoring and Audit

75. A review of the council's governance arrangements is ongoing and is due to be concluded during 2015. Following this, the council's scheme of administration and delegation will be reviewed. The scheme sets out the terms of reference of the business of the council, its committees and sub-committees. The results of this review will be reported to the Policy and Resources Committee in late 2015. The scheme of administration and delegation was last reviewed in April 2013.
76. The council's two charitable trusts are governed by trustees. Trustee meetings have been held on a regular basis during the year for the Orkney Islands Council General Charitable Trust (OICGCT). There is no evidence of trustees of the Orkney Educational Trust (OET) meeting during the year, however a joint meeting has been arranged to approve the audited accounts of both trusts. The Office of the Scottish Charity Regulator granted approval in June 2015 for the assets of the OET to be transferred to the OICGCT.
77. We have concluded that the council's current governance arrangements provide an appropriate framework for decision making, although these will need to be revised in response to health and social care integration (see paragraphs 102 to 109).

Local code of corporate governance

78. The council has developed and adopted a local code of corporate governance which reflects the key components as set out in the CIPFA/SOLACE Framework Corporate Governance in Local Government: A Keystone for Community Governance. The council carries out an annual self-assessment to establish the extent to which it meets the requirements of the local code and, where necessary, takes action to address non-compliance.

Internal control

79. As part of our audit we reviewed the high level controls in a number of systems fundamental to the preparation of the financial statements. Our objective was to obtain evidence to support our opinion on the council's financial statements.
80. We reported our findings to the Monitoring and Audit Committee on 25 June 2015. No material weaknesses in the accounting and internal control systems were identified which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. We did, however, identify a small number of actions which would strengthen the controls environment. Officers have accepted our recommendations and agreed actions to address the risks identified.

Internal audit

81. Internal audit provides members and management of the council with independent assurance on risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.
82. Our review of internal audit concluded that it complies with the main requirements of the Public Sector Internal Audit Standards and has sound documentation standards and reporting procedures in place.
83. Internal audit substantially completed its 2014/15 plan, with two audits transferred to 2015/16 and one deferred. This did not affect our ability to place reliance on work carried out in the following areas:
- trade receivables
 - council tax billing and collection
 - non domestic rates.

ICT audit

84. We have reviewed the recently implemented change management process in the council's IT service. This process covers the procedures used to ensure efficient handling of changes to the IT infrastructure to minimize the impact on other council services. The IT service needs to consider the impact of any change across a

large number of areas, including people, hardware, software and networks.

85. The new change management procedures are starting to be embedded in the way the IT service delivers its services. Progress has been slow, however, and a self-assessment carried out six months after introducing the process concluded that there is still some way to go. Additional resource has been identified by the council to support this and the IT Change Programme Officer is now working with the IT service to progress this action.
86. Last year, we followed up our 2012/13 computer services review. In our report we noted that progress on the outstanding actions would be reported to the Asset Management Sub-committee. No such reports have been submitted to date. The Computer Services Member Officer Working Group is being reconvened and the intention is to progress this work in late 2015 and early 2016.

Arrangements for the prevention and detection of fraud

87. The council has updated its fraud policy but it is still to be approved by the council. Officers have confirmed that it will be presented to the council for approval before the end of 2015.
88. With the above minor exception, the council's arrangements in relation to the prevention and detection of fraud and irregularities are satisfactory.

National Fraud Initiative in Scotland

89. The National Fraud Initiative (NFI) in Scotland brings together data from councils, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. Matching data obtained from the systems of participating bodies allows the identification of potentially fraudulent claims on the public purse including housing benefit fraud, occupational pension fraud and payroll fraud. If fraud or overpayments are not identified in a body, and the NFI exercise has been undertaken properly, assurances may be taken about internal arrangements for preventing and detecting fraud.
90. The council participated in the NFI in 2014/15 and also signed up to the real time matching service which allows immediate checks on individuals. A total of 1,214 matches were identified and investigated. No significant frauds were identified, however one case is still under investigation by the council.
91. Overall, we concluded that the council has satisfactory arrangements in place for investigating and reporting data matches identified by the NFI.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

92. The council's whistle blowing policy has not been reviewed for a number of years. It has acknowledged that the policy needs to be updated and will ensure that this is done before the end of 2015.

93. With the above exception, the arrangements for the prevention and detection of corruption in Orkney Islands Council are satisfactory.
94. The council has set up a Corporate Protection Group following advice from Police Scotland to all local authorities. This met for the first time in November 2015 and will respond to issues such as organised crime, fraud and data protection.

Transparency

95. Local residents should be able to hold the council to account for the services it provides. Transparency means that residents have access to understandable, relevant and timely information about how the council is taking decisions and how it is using its resources. We have considered this under various headings including:
- Clarity and presentation of financial statements – a copy of the council's unaudited accounts was made available on its website. The format of the accounts complies with the Code and the narrative sections are written, as far as possible, in plain English to provide the reader with an understanding of the council's business
 - Budget monitoring reports – refer paragraph 43
 - Performance reporting – refer paragraphs 142 to 146
 - Registers of interest – these are available on the council's website
 - Withholding information from public scrutiny – the council makes use of Local Government (Scotland) Act 1973 – Section 50A to exclude the public from council and

committee meetings during consideration of particular items of business. We have no evidence that the council is using this clause to routinely and unjustifiably withhold information from public scrutiny

- The council has recently introduced an audio casting service for most committee meetings which allows the public to listen to meetings in real time or as a recording.
96. Overall we have concluded that the council is open and transparent.

Orkney College

97. In Orkney, further and higher education is provided through Orkney College. The college is funded by the Scottish Funding Council and through grants claimed from outside bodies. It is an academic partner in the University of the Highlands and Islands. The college is responsible for managing its own finances and aims to realise a surplus each financial year.
98. The council provided Orkney College with funding of £0.005 million in 2014/15 to address a deficit in its reserves. This deficit relates to three small trading units set up under the oversight of the college (Agronomy Institute, Centre of Nordic Studies, and Archaeology Institute). The council has no obligation to fund the college. By funding the deficit arising from these trading units, there is a potential for an expectation to be created that the council will fund future deficits in the college's accounts, which could be significant.

99. If the council intends to provide further financial support to Orkney College a framework for doing so should be agreed with members and the implications reflected in future council budgets.

Refer Action Plan Point 6

Freedom of Information requests

100. The Freedom of Information (FOI) (Scotland) Act 2002 requires public bodies to respond fully to FOI requests within 20 working days. The council reports its performance in responding to FOI requests to the senior management team every quarter. An annual briefing is produced for elected members and heads of services which reports performance for the calendar year.
101. The council received 954 FOI requests in 2014 and answered 92% of these within 20 working days. This is a considerable improvement on previous years. In 2013, only 79% of FOI requests were responded to within the statutory timescale. The Scottish Information Commissioner rated the council's 2014 performance in responding to FOI requests as very good.

Integration of health and social care

102. The Public Bodies (Joint Working) (Scotland) Act received royal assent on 1 April 2014. The Act provides the framework for the integration of health and social care services in Scotland.
103. The council and NHS Orkney agreed to adopt the 'body corporate' model for the provision of integrated health and social care across

Orkney. This will result in the delegation of functions to a new legal entity, the Integration Joint Board (IJB) which will be responsible for overseeing the provision of services.

104. Orkney Islands Council and NHS Orkney submitted their integration scheme to the Scottish Government for approval by the 1 April 2015 deadline. The council and NHS Orkney received feedback from the Scottish Government in May 2015. Members of the Orkney Integration Programme Board are considering this feedback and working with the Scottish Government to reach consensus on the changes required.
105. The Chief Officer of the IJB was appointed in July 2015. The Chief Officer was previously Head of Service and Chief Social Work Officer with Orkney Health and Care, a partnership arrangement between the council and NHS Orkney.
106. The Chief Officer has a crucial role in project management and ensuring completion of the strategic plan for the IJB by the required date of 31 March 2016. Prior to the appointment of the Chief Officer, the council and NHS Orkney agreed the number of localities and commissioned work to inform the strategic plan.
107. The council and NHS Orkney have still to agree some financial governance and assurance arrangements for the IJB, including the financial metrics that will be used to assess whether integration has met its objectives; and a process for obtaining baseline data for measuring progress. This work is being progressed in line with the joint integration project plan.

- 108.** Internal audit is planning to carry out financial due diligence work in 2015/16 to provide the Monitoring and Audit Committee with assurance that the resources delegated to the IJB are adequate, and that appropriate financial information and support systems are available. The reporting timescale for this work is still to be agreed.
- 109.** Until the integration scheme is finalised and due diligence work is conducted by internal audit, there is a risk that health and social care integration arrangements may not be fully developed by the statutory deadline of 1 April 2016.

Refer Action Plan Point 7

Welfare Reform

- 110.** The council recognises the impact that the changes to the UK welfare system could have on resources and service provision. In previous years we have highlighted that the council has been monitoring and planning ahead to mitigate against the impact of the reforms. The council has published welfare reform information on its website to help people understand the changes. It also set up a welfare reform working group to bring together a range of interested bodies and organisations to discuss the implications of welfare reform. The council's Policy and Resources Committee has considered a number of welfare reform reports over the last couple of years.
- 111.** The further roll out of welfare reform, particularly the implementation of universal credit, presents a risk to the council. Roll out of universal credit in Orkney started in May 2015.

- 112.** The council's total rent arrears were £0.201 million at 31 March 2015, which is an increase of £0.042 million (26.4%) on the previous year. This may be evidence of the impact of welfare reforms on resident's ability to pay rents. The main reason for the increase, however, is the council's tenancy turnover rate which is the highest in Scotland. Turnover has been particularly high for new builds with higher rents resulting in significantly higher former tenant arrears.

Housing benefit performance audit

- 113.** A risk assessment of the council's benefit service was carried out by Audit Scotland in July 2015 and was reported to the council in August 2015. This looked at the benefit service's self-assessment and supporting evidence, and analysed information from a number of other sources. The work was focused on three areas:
- national and local priorities
 - business planning and reporting
 - delivering outcomes.
- 114.** The work found that the service has made a very positive contribution to the delivery of the benefit service by addressing 17 of the 18 risks identified in the 2012 assessment. The service has improved claims processing times and was the second top performing council in Scotland in 2014/15 for processing new claims and the equal top performer for processing changes in circumstances. The service has also improved the quality and accuracy of its claims, and has delivered an excellent performance in recovering benefit overpayments.

115. In order to deliver continuous improvement going forward, and receive assurance that intervention activity is efficient and effective, the service should record the value of overpayments and underpayments arising from intervention activities.

Local scrutiny plan

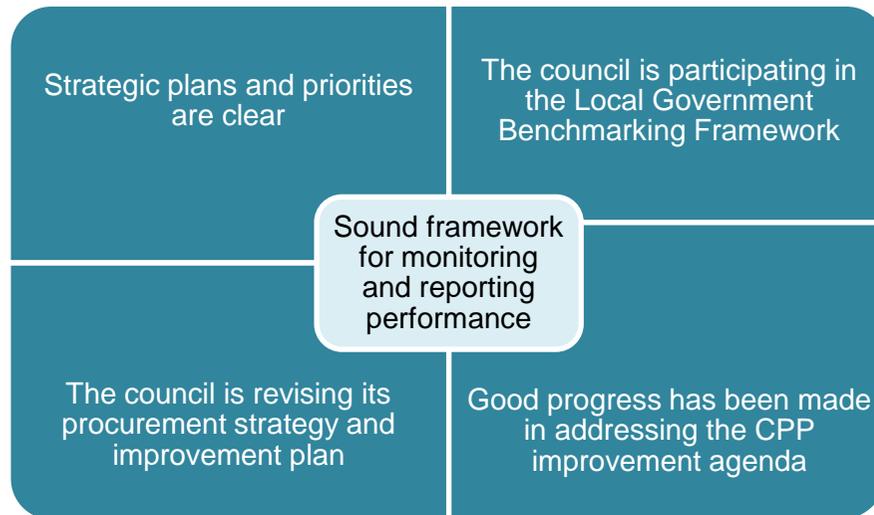
116. The 2015/16 Local Scrutiny Plan (LSP) prepared by the Local Area Network of scrutiny partners for the council was submitted to Orkney Islands Council on 19 March 2015.
117. The LSP highlighted two main areas of scrutiny work to be carried out by Audit Scotland in 2014/15. These were the housing benefit risk assessment (see paragraphs 113 to 115) and follow-up work on our November 2014 report on Orkney Community Planning Partnership (CPP). This involved assessing what progress the CPP has made in addressing outstanding improvement areas. The results of this work are reported in the Best Value chapter of this report.
118. The LSP also identified scrutiny work for the Scottish Housing Regulator (SHR). The SHR was to undertake further scrutiny work with the council to better assess the overall quality of the council's housing services. The exact nature of this scrutiny activity was to be determined following the council's submission of its Annual Return on the Charter (ARC).
119. The council asked the Scottish Housing Best Value Network (SHBVN) to carry out an independent review of the ARC data supplied to the SHR. The SHBVN found inaccuracies in the ARC

data and the council has produced an action plan to show how it will address these issues. As a result, the SHR has not been able to progress its scrutiny activity. SHR officers plan to visit the council in September 2015 to discuss the issues with the data and identify what improvement plans the council has in place. This may lead to further scrutiny of housing services.

Outlook

120. Councils will continue to operate in a changing environment within financial constraints. Under these circumstances councils will be obliged to consider the delivery of services by different means. Partnership, joint working and arms length organisations have become increasingly popular vehicles for planning and delivering council services and there is a sustained national focus on their use. Good governance will be particularly important where council resources and service delivery are devolved to third party organisations.
121. Health and social care integration will require an ongoing focus on governance and assurance to ensure that the council's priorities are being achieved.

Best Value



122. Best Value is a key factor to consider when planning policies, programmes and projects and when taking any spending decisions. The council should have systems and processes to ensure that it can demonstrate that it is delivering Best Value by assessing and reporting on the economy, efficiency, effectiveness and equality in service provision.

Community Planning Partnership audit

123. Audit Scotland has audited eight community planning partnerships (CPPs) since 2013 and produced a national report on community planning in Scotland *Community planning: turning ambition into action* in November 2014. The audit report on Orkney CPP was

published in the same month as part of the second tranche of five local CPP audits that took place during 2014/15.

124. The audit focused on:

- Whether Orkney CPP has set a clear strategic direction, agreed by all partners, which reflect Orkney’s needs
- The appropriateness of the CPP’s governance and accountability arrangements and whether they allow it to improve outcomes for local people
- The extent to which the CPP is encouraging collective behaviour among staff and using its resources to deliver joint priorities and outcomes
- How well the CPP is delivering the outcomes contained in the single outcome agreement (SOA) and is it reporting these clearly and accurately to the public.

125. The report included an 11 point improvement agenda for the CPP. In 2015, we carried out some follow up work to assess what progress the CPP has made in addressing these improvement areas.

Governance and accountability

126. The CPP has a new, more streamlined structure with clearer links to its strategic priorities. The new arrangements were agreed by the CPP in February 2015.

127. A new Board, Orkney Partnership Board, has been formed comprising of all partnership bodies with a duty to participate in

community planning under the Community Empowerment (Scotland) Act 2015. Three delivery groups have been set up to plan, progress and report against the CPP's strategic priorities. Finally, an executive group has been created to provide support and advice to the Board. The executive group comprises senior executive officers from partner bodies with a duty to facilitate community planning under the new Act.

128. The CPP has prepared a development plan with clear actions, measurable outputs and timescales for delivery. The plan also allocates responsibility for each action. Progress against the plan has been reported and considered at Board meetings.

Vision and strategic direction

129. The CPP has a clearer, more focused strategy and is preparing detailed plans to address its strategic priorities.
130. The Board has agreed three new priorities:
- Positive ageing
 - A vibrant economic environment
 - Healthy and sustainable communities.

These priorities will be reviewed on an ongoing basis to ensure they are still relevant. They may be replaced with new priorities as these emerge.

131. A new community plan and local outcomes improvement plan has been prepared for 2015-18. This sets out the actions the CPP will

take to achieve its strategic priorities. Actions are prevention focused and take account of local issues.

132. A six week consultation on the community plan launched at the end of August 2015. This involves asking stakeholders to respond to a range of questions to help ensure the CPP is focused on the right priorities. This exercise has been promoted through a wide range of traditional and new media, and direct communication with stakeholder groups.
133. The three delivery groups are developing more detailed plans to address the CPP's strategic priorities.

Collaboration and use of resources

134. Work to improve joint working and resourcing is at an early stage. However, the new CPP structure has been designed to encourage joint working. Senior officers from Voluntary Action Orkney, Highlands and Islands Enterprise and NHS Orkney have been appointed as chairs of the delivery groups to help ensure collective responsibility for the CPP's priorities.
135. The CPP is in the process of developing a joint resourcing plan to identify and align resources to its strategic priorities. A joint resourcing workshop with the council's change programme team, who are progressing a similar project, will be held in October 2015. Further workshops will be scheduled as required and the council is participating in a planned U.Lab Scotland hub which the Scottish Government is facilitating for CPP joint resourcing. U.Lab is a

global programme which aims to provide expertise on how to accelerate change.

Performance and outcomes

- 136. The CPP is still to agree performance measures for its new strategic priorities and decide how best to report these to the public.
- 137. The community plan sets out the planned outcomes, activities and outputs for each of the CPP's priorities. The delivery groups are in the process of developing a suite of performance indicators to demonstrate progress against the planned outcomes.
- 138. The Board agreed a new communications strategy in June 2015. This sets out the CPP's stakeholder groups, the messages it wants to communicate to these groups and the channels it will use to do this. A short life working group has been set up to address a number of improvement actions relating to communications. This includes how the CPP can improve public performance reporting.

Procurement

- 139. In 2009 the Scottish Government introduced an annual evidence-based assessment, the procurement capability assessment (PCA), to monitor public bodies' adoption of good purchasing practice and as a basis for sharing best practice. Due to staff absence, the council's decided not to undertake a PCA in 2014/15. The council's most recent PCA was undertaken in November 2013.
- 140. In July 2015, the Scottish Government introduced the Procurement and Commercial Improvement Programme (PCIP) to replace the

PCA. The PCIP focuses on the policies and procedures driving procurement performance and the results they deliver.

- 141. The council is revising its procurement strategy and improvement plan to ensure compliance with procurement legislation and in preparation for its PCIP assessment in May 2016. A procurement member officer working group has been convened and met in September 2015 to review progress.

Performance management

- 142. The council has a sound framework for monitoring and reporting performance against its priorities but could improve its approach to public performance reporting.
- 143. The 2013-18 council plan sets out six main priorities for Orkney. These priorities are consistent with the new priorities set out in the community plan for 2015-18. Service plans have been approved for all council services and are updated annually.
- 144. There are clear links between service plans and the council plan. Service plans list the actions in the council plan for which the service has the lead or contributes towards. Service plans also set out the actions required to address each target, the responsible officer and the timescale for completing the action.
- 145. Performance against council plan targets and actions is reported to the senior and corporate management team and the Policy and Resources Committee every six months. Services also report performance to their respective management teams and service

committees on a six monthly basis. Performance reports are sufficiently detailed and use a traffic light system to identify underperformance and/or failure to achieve targets.

146. The council publishes an annual performance report, which is available on its website. The report is in two parts. The first part shows the council's performance towards meeting the targets set out in its council plan. The second part shows how well the council performed against the national Local Government Benchmark Framework (LGBF) indicators. The report outlines the council's performance in a clear, user friendly format.

Statutory performance indicators (SPIs)

147. The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The Commission does not prescribe how councils should report but expects councils to provide citizens with fair, balanced and engaging performance information reporting.
148. For 2014/15 three (SPIs) were prescribed:
- SPI 1: covering a range of information relating to areas of corporate management such as employees, assets and equalities and diversity
 - SPI 2: covering a range of information relating to service performance
 - SPI 3: relates to the reporting of performance information as required by the LGBF.

149. Overall we concluded that the council's arrangements were satisfactory.

150. An evaluation of all Scottish councils' approaches to public performance reporting was carried out by Audit Scotland's Performance Audit and Best Value group during 2014/15 and reported to the Accounts Commission in June 2015. An individual assessment for Orkney Islands Council was issued to the Convener, Chief Executive and the Chair of the Monitoring and Audit Committee in July 2015.

151. The council is fully meeting requirements for 14 of the 19 areas assessed. The assessment identified two areas of improvement for SPI 1 and three areas for improvement for SPI 2. These are:

- the council does not publish the results of customer surveys on its website
- performance information on procurement is not publicly available
- performance data on homelessness is not included in the council's annual performance report
- the council could report more comprehensively on the performance of protective services
- the performance information for roads and lighting services includes a narrow range of indicators and limited contextual narrative.

152. The council could also make a few overall improvements to its approach to public performance reporting. These are:

- the performance page on the council's website could be made more accessible to the public
- the council could make better use of customer satisfaction information
- the council could use social media to engage and consult with the public on its performance.

National performance audit reports

- 153.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15, a number of reports were issued which are of direct interest to the council. These are outlined in appendix III.
- 154.** The council has processes in place to ensure that all national reports and their impact on the council are considered by members. Council committees considered a range of national reports in 2014/15 and the local arrangements and actions taken by the council.

Equalities

- 155.** The Equality Act 2010 introduced a new public sector 'general duty' which encourages equality to be mainstreamed into public bodies'

core work. The Act requires that by no later than 30 April 2015, and every two years thereafter, public bodies must publish a report on the progress made to achieve the quality of outcomes it has set.

- 156.** The council published its Annual Equality Report 2015 in accordance with the statutory deadline. The report explains how the council promotes and integrates equality into its work and what progress it has made towards achieving its equality outcomes.

Outlook

- 157.** In common with other councils, Orkney Islands Council faces the key challenges of reducing budgets, an ageing population with higher levels of need and the public expectation of high quality services. Savings have been made in recent years largely through service specific initiatives. However, as choices on how to address funding gaps become increasingly difficult, councils will have to focus on making the very best use of all available resources and to challenge existing ways of doing things. A strong and effective performance management framework will be critical to the success of the council achieving its key priorities.

Appendix I – Significant audit risks

The table below sets out the financial statement audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
<p>Income</p> <p>Orkney Islands Council receives a significant amount of income from investments. The extent and complexity of investment income means there is an inherent risk of fraud in accordance with ISA 240.</p>	<ul style="list-style-type: none"> Reviewed the governance arrangements for the strategic reserve fund. Assessed the procedures in place for valuation of the council's investments. 	<p>The governance arrangements for the strategic reserve fund are satisfactory.</p> <p>The procedures for valuation of the council's investments are appropriate. All significant council investments have been agreed to independent valuations.</p> <p>No areas of fraud in relation to investment income and expenditure identified.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>Management override of controls</p> <p>As stated in ISA 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>	<ul style="list-style-type: none"> • Performed detailed testing of journal entries. • Reviewed accounting estimates for bias. • Evaluated significant transactions that are outside the normal course of business. 	<ul style="list-style-type: none"> • Journals - a sample of 48 journal entries was tested as part of year-end journals (30), debtors (6) and creditors (12) testing. We found no evidence to suggest that management were overriding controls. • Estimates - based on testing of debtors, creditors and provisions/contingencies, we found no evidence of bias in accounting estimates. • Significant transactions - based on our work on the annual accounts, we did not find any evidence of transactions outwith the scope of the council. <p>No fraud concerns identified in respect of management override of controls.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>Financial regulations</p> <p>The Local Authority Accounts (Scotland) Regulations 2014 have introduced some changes to the contents of the financial statements. These include the inclusion of a management commentary. The Code encourages authorities to take into account the requirements of the Government financial reporting manual for management commentaries.</p> <p>The new regulations also require the local authority (or a committee whose remit includes audit or governance) to meet by 30 September to consider whether to approve the audited annual accounts for signature.</p> <p>There is a risk that the council's accounts do not fully comply with the requirements of the new accounting regulations.</p>	<ul style="list-style-type: none"> Reviewed compliance with the new accounting regulations. Worked with council officers to ensure audit work could be completed in sufficient time to allow approval of the audited accounts at the September Monitoring and Audit Committee. 	<p>The accounts have been reviewed for compliance with the Regulations. Adjustments have been made to the unaudited accounts as necessary.</p> <p>The Monitoring and Audit Committee met on 28 August to consider the draft accounts. The Monitoring and Audit Committee will meet on 23 September to approve the audited accounts.</p>
<p>Group accounts</p> <p>The 2014/15 Code of Practice on Local Authority Accounting in the United Kingdom has adopted new group accounts standards. The new standards mean that decisions made under previous standards regarding the classification of entities will need to be reviewed to confirm they remain appropriate.</p> <p>There is a risk that the council's group accounts do not comply with the new accounting standards.</p>	<ul style="list-style-type: none"> Agreed classification of components in the group accounts before the preparation of the financial statements. 	<p>At the planning stage of the audit we advised officers that in our view the Pickaquoy Centre Trust should be consolidated as a subsidiary in the group accounts. Officers carried out a review and in February 2015 agreed to consolidate the trust in the group accounts.</p>

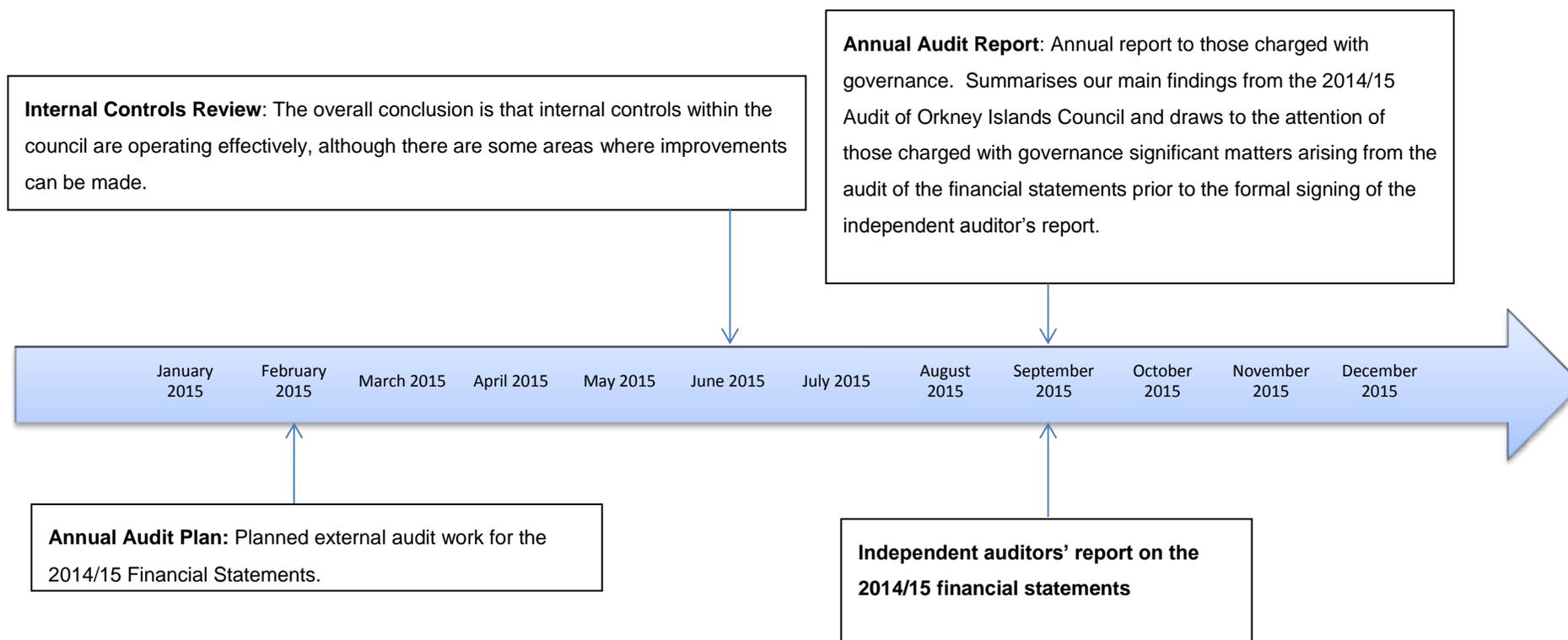
Audit Risk	Assurance procedure	Results and conclusions
<p>Upgrade of key financial management systems</p> <p>The council has purchased a new system to provide the accounting entries for non-current assets from 2014/15 onwards. In addition, the database for the financial management system will be migrated from Oracle to Microsoft SQL Server. Any migration of balances and transactional data carries risks to the completeness and accuracy of the information required to prepare financial statements.</p>	<ul style="list-style-type: none"> Reviewed the planning of the migration process. Confirmed balances and transactions migrated to the new system as part of the review of system control processes. 	<p>We have carried out additional work to ascertain the completeness of data transferred and identified no issues with this. During the financial statements audit, some residual issues were identified which resulted in the depreciation audit adjustment reported in paragraph 20.</p>
<p>Risks identified from the auditor’s wider responsibility under the Code of Audit Practice</p>		
<p>Change Programme</p> <p>The council has established a change management programme to reduce costs and, where feasible, improve services through developing new approaches to service delivery. The programme includes the development of a long term financial strategy.</p> <p>Without sound financial planning there is a risk that the council will be unable to respond effectively to budget pressures.</p>	<ul style="list-style-type: none"> Carried out additional work to understand and monitor the arrangements in place. Reviewed progress in developing a long term financial strategy. 	<p>There is limited information on the level of savings the council expects to achieve from its Change Programme.</p> <p>The council has published a medium term resource strategy covering the period 2016/17 to 2019/20. This identifies future funding gaps but does not include a plan for how the council will make the required savings.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>Capital programme</p> <p>The profile of the council’s capital expenditure suggests there will be significant slippage in the capital programme. There is a risk that the council is unable to deliver its 2014/15 capital expenditure programme.</p>	<ul style="list-style-type: none"> Reviewed capital expenditure monitoring reports to the Policy and Resources Committee. Reviewed the progress made against actions in our 2013/14 Major Capital Investment in Councils follow up report. 	<p>The 2014/15 capital programme has slipped significantly.</p> <p>The council's capital programme for 2014/15 totalled £32.836 million. Actual capital spend was £17.874 million, an underspend of £14.962 million (45.6%).</p>
<p>Health and social care integration</p> <p>Work is ongoing to meet the Scottish Government deadlines for health and social care integration, including the integration scheme which is due at the end of March 2015. However, lack of capacity may result in delays in implementing the necessary arrangements resulting in the statutory deadlines not being met.</p>	<ul style="list-style-type: none"> Made enquiries with officers on the progress of the integration programme. Reviewed the integration scheme. 	<p>The integration scheme was submitted to the Scottish Government by the 1 April 2015 deadline. The Integration Joint Board Chief Officer was appointed in July 2015. Recruitment of a Chief Financial Officer is in progress. The integration scheme has not yet been approved by the Scottish Government.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>Information security</p> <p>During 2014 the council identified a number of risks affecting network security and the configuration of IT equipment. It has taken action in response to the weaknesses identified; however there is a risk that further weaknesses may arise unless management processes are strengthened. This could have an adverse impact on the council’s ability to maintain its PSN accreditation.</p>	<ul style="list-style-type: none"> Reviewed the process in place to monitor network infrastructure vulnerabilities. 	<p>New change management procedures are starting to be embedded in the way the IT service is delivering its services. The progress has been slow, however, and there is still some way to go.</p> <p>During the summer of 2015, the council responded to two virus attacks which impacted on staff in corporate services ability to deliver support services. Immediate action was taken in both instances to mitigate the risk to service users.</p> <p>The council is on course for successful PSN re-accreditation and we will continue to monitor its progress in 2015/16.</p>

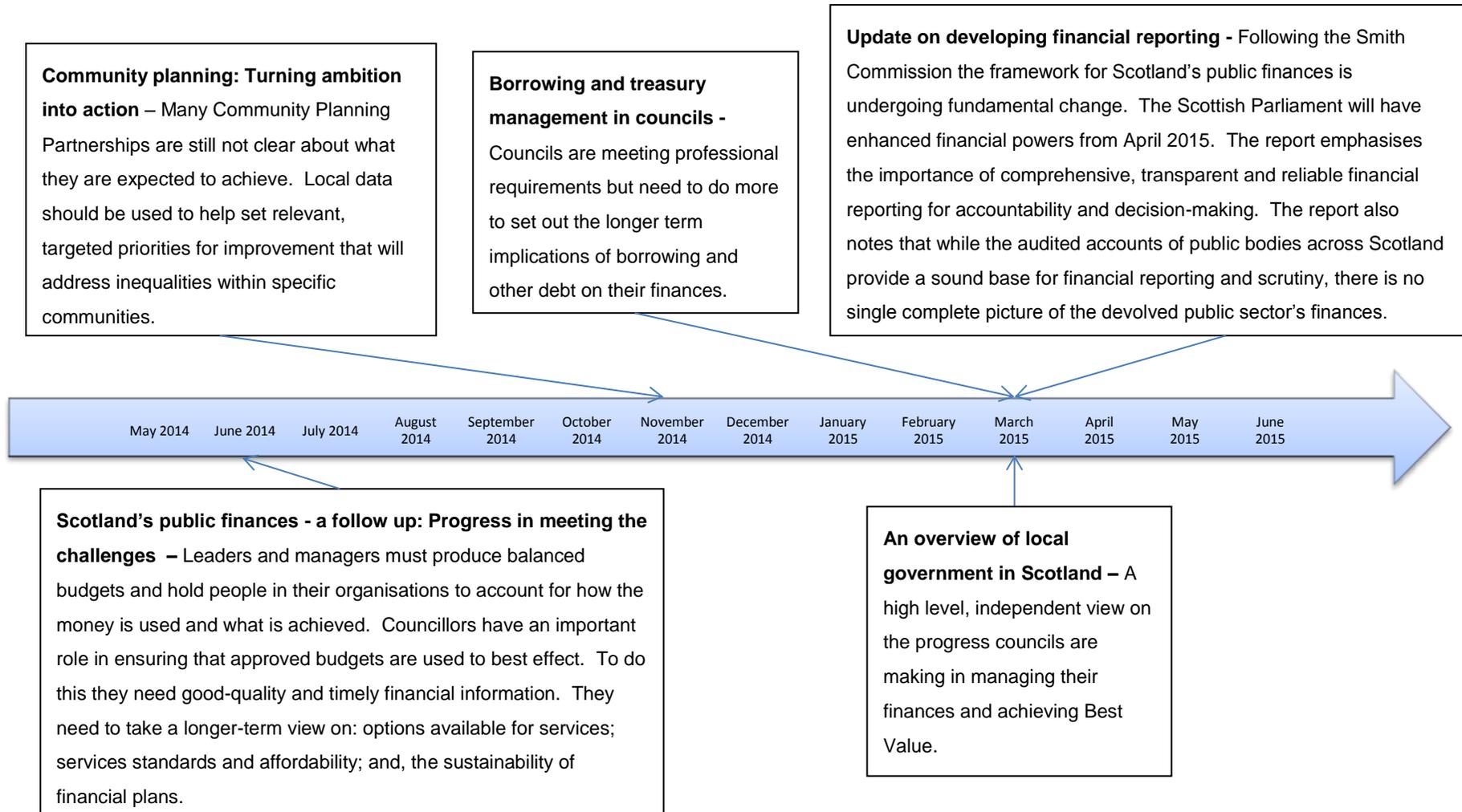
Appendix II

Summary of Orkney Islands Council local audit reports 2014/15



Appendix III

Summary of Audit Scotland national reports 2013/14



Appendix IV

Action plan

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
<p>1 10/22</p>	<p>Depreciation calculation</p> <p>We found a number of errors in the calculation of depreciation in the unaudited annual accounts. This was caused by errors in the information migrated to the council's new fixed asset management system. It led to incorrect remaining asset lives being applied to all assets and depreciation being wrongly applied to land assets. This resulted in a net understatement of depreciation and a corresponding overstatement of non-current assets.</p> <p>Risk:</p> <p>Errors in the information held in the council's fixed asset management system result in incorrect capital accounting.</p> <p>Recommendation:</p> <p>The council should review the information held in its fixed asset management system to ensure it is correct.</p>	<p>The errors identified have been corrected in the asset register and the annual accounts have been amended to reflect the correct level of depreciation. The transition to a new asset register was a significant undertaking with limited opportunity to verify the data migrated and although the asset life was believed to have been correct and verified this was one year out and resulted in the understatement of depreciation.</p> <p>A review of the information held on the asset register will be undertaken prior to the end of the financial year.</p>	<p>Head of Finance</p>	<p>31 December 2015</p>

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2 11/22	<p>Classification of investment properties</p> <p>Following a review of its classification of operational and investment properties, the council identified that the Pickaquoy Centre should be reclassified as an operational asset from an investment property. The council's review of its asset categorisation is expected to be completed in 2015/16. Any further changes will be reflected in the 2015/16 annual accounts.</p> <p>Risk:</p> <p>Operational and investment property is incorrectly accounted for resulting in the financial statements being materially misstated.</p> <p>Recommendation:</p> <p>The council should complete its review of operational and investment property as soon as possible.</p>	<p>As noted, the review of operational properties and investment has commenced.</p> <p>This review will be completed during the remainder of the 2015/16 financial year to ensure that any reclassifications of assets can be incorporated into the 2015/16 annual accounts.</p>	Head of Finance	31 March 2016

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3 12/22	<p>Future costs of restoring waste disposal sites and quarries</p> <p>The council does not yet have a contingency plan in place in relation to waste disposal and quarry sites. Some of these may have specific restoration responsibilities as part of the Scottish Environmental Protection Agency licenses.</p> <p>Risk:</p> <p>The council is required to pay significant restoration costs.</p> <p>Recommendation:</p> <p>The council should review whether it has responsibility for restoring its waste disposal and quarry sites and decide how it will deal with any future costs.</p>	<p>The council recognises that under IAS 37 Provisions, Contingent Liabilities and Contingent Assets it has obligations to undertake restoration and aftercare work on landfill and quarry sites from the commencement of depositing refuse or extraction of aggregate at these sites.</p> <p>The council incinerated waste for many years and has more recently exported waste for incineration in Shetland with only inert waste landfilled in Orkney. Any restoration liability is therefore thought to be modest. A review will however be undertaken and reported to the Development and Infrastructure Committee.</p> <p>A November 2014 committee report on the ongoing business case for quarrying operations noted that restoration for the quarry sites is about “making safe” rather than landfilling and returning to agriculture, for example. Provision will be made for making safe over the remaining life of the quarry sites.</p>	Executive Director of Development and Infrastructure	31 March 2016

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4 16/39	<p>Capital programme</p> <p>The council reported a £14.962 million underspend against its total capital programme for 2014/15. Unrealistic timescales and limited resources to tackle multiple projects at the same time are affecting the ability of the council to complete its capital programme. This has resulted in an ongoing underspend on capital expenditure in recent years.</p> <p>Risk:</p> <p>The council is unable to deliver its annual capital expenditure programme.</p> <p>Recommendation:</p> <p>The capital expenditure programme should be phased to ensure that annual capital expenditure is based on a realistic plan. The council should establish whether it has adequate levels of skills and resources to deliver the capital expenditure programme prior to its approval each year.</p>	<p>Whilst the council has expended significant sums on its capital programme over the last three years with £17.874M spent in 2014/15, capacity issues have clearly impacted on delivery timescales.</p> <p>There are several projects where planned expenditure has slipped into 2015/16 and the projects are now largely complete and others that have suffered longer hold ups and require to be re-profiled in the capital programme over a longer period.</p> <p>A report will be presented to the Policy and Resources Committee on 22 September 2015 recommending the carry forward of slippage of £13.380 million and the re-profiling of the capital programme.</p> <p>The council has now recruited the required staff and the capital programme team is in place. This team will work on re-profiling the capital programme and establishing new capital programme management processes.</p>	Head of Finance	31 December 2015

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5 20/60	<p>Financial planning</p> <p>The council has identified that it is likely to need to make annual savings of £2.4 million in 2016/17, rising to £9.5 million in 2019/20. It is still to develop a plan for how it will achieve these savings, but has identified a range of options. The council has also started to review how it can better allocate its resources but this work is at an early stage and requires further development.</p> <p>Risk:</p> <p>Residents of Orkney do not receive the range and quality of services they expect.</p> <p>Recommendation:</p> <p>The council should develop fully costed proposals for how it will make the savings required. This should include identifying the savings that will be made through the Change Programme.</p>	<p>The council approved the medium term resource strategy 2016/17 to 2019/20 on 7 July 2015 which represented one of the key milestones of the 2016/17 budget setting process and this process is now well underway. As part of that process fully costed proposals for the level of savings required are currently being developed.</p> <p>These will consist of concrete proposals for 2016/17 and indicative proposals from 2017/18 onwards which aim to deliver changes in service delivery which bridge the identified £9.5 million funding gap.</p>	Executive Director of Corporate Services	31 March 2016

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<p>6 27/99</p>	<p>Orkney College</p> <p>The council provided Orkney College with funding of £0.005 million in 2014/15 to address a deficit in the college's reserves. The college is responsible for managing its own finances and the council has no obligation to fund the college.</p> <p>Risk:</p> <p>An expectation is created that the council will fund future deficits in the college's accounts, which could be significant.</p> <p>Recommendation:</p> <p>If the council intends to provide further financial support to Orkney College this should be agreed with members and the implications reflected in future council budgets.</p>	<p>The council's current policy with regard to Orkney College is that the college should operate within a balanced budget. The council agreed in 2011 that the college would be permitted to operate within a £0.100 million financial limit.</p> <p>A report on the "Financial Forecast Return" was reported to the College Management Council on 26 August 2015. This highlighted the overspend position in 2014/15 and the requirement for the college to review its 2015/16 budget in light of the overdraft position.</p> <p>The council will reinforce with the college the requirement to eliminate the overdraft and balance its budget.</p>	<p>Executive Director of Education Leisure and Housing</p>	<p>31 March 2016</p>

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7 28/109	<p>Health and social care integration assurance</p> <p>Internal audit has not yet carried out due diligence work on health and social care integration. This is required to give the Monitoring and Audit Committee assurance on the financial and governance arrangements planned to support the Integration Joint Board.</p> <p>Risk:</p> <p>Health and social care integration arrangements are not fully developed by the statutory deadline of 1 April 2016.</p> <p>Recommendation:</p> <p>The council should agree the timing and scope of internal audit's due diligence work to ensure it meets the needs of the council and the requirements of the Scottish Government.</p>	<p>The integration scheme and governance arrangements for health and social care integration are still under development. The integration scheme has still to be finally approved by the Scottish Government and the Integration Programme Board has not yet approved a suite of governance documents.</p> <p>Internal audit will make arrangements for a review to be completed in order to provide an opinion on the assurance process completed by the council and NHS Orkney.</p>	Chief Internal Auditor	31 March 2016