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EXPLANATORY FOREWORD BY THE DIRECTOR OF FINANCE

INTRODUCTION

The purpose of the annual Statement of Accounts is to demonstrate proper stewardship of the Council's financial affairs. The Accounts of the Islands Council are set out on the following pages and have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom.

This foreword provides an explanation of the Statement of Accounts and of the most significant matters reported in the Accounts, together with a summary of the financial outturn for the year ended 31 March 2005.

FINANCIAL STATEMENTS

Consolidated Revenue Account

The Consolidated Revenue Account provides a summary of expenditure and income for the year ended 31 March 2005 on the services which the Council provides and demonstrates how the net cost has been financed from central government grants and from local taxpayers. The Consolidated Revenue Account excludes the Pension Fund, Charity, Trust and Common Good Funds which are disclosed elsewhere in the Statement of Accounts. Notes to the Account provides supplementary information on the various financial transactions.

Harbour Authority Account

The Harbour Authority Account shows the trading position of the Harbour Authority and net movement in reserves for the year.

The main activities of the Harbour Authority includes managing the safe movement of oil tankers through the Scapa Flow Oil Port, the operation of miscellaneous piers and harbours as well as its responsibilities for Oil Pollution.

Orkney College

The Islands Council provides further and higher education provision through the Orkney College using a devolved Board of Management arrangement. The Orkney College is funded by direct grant from the Scottish Further Education Funding Council (SFEFC).

Housing Revenue Account (HRA)

The HRA reflects the statutory requirements to account separately for Local Authority direct housing provision. The account shows the main elements of housing revenue expenditure including capital financing costs, and how these costs are met by rents and other income.

Council Tax and Non Domestic Rate Income Accounts

These statements provide details of net income raised from Council Tax and Non Domestic Rates.

Consolidated Balance Sheet

This statement brings together all the assets and liabilities in the Council's account as at 31 March 2005, with the exception of the Pension Fund, Charity, Trust and Common Good Funds, which are disclosed separately.

Statement of Total Movement in Reserves

This statement brings together all the recognised gains and losses of the Authority during the period and defines those which have and have not been recognised in the Consolidated Revenue Account.

Cash Flow Statement

The Cash Flow statement provides the details of cash movements arising both from capital and revenue transactions for the financial year.

Pension Fund

The Orkney Islands Council Pension Fund is constituted under various Local Government Pension Fund Acts and related regulations. It is a defined benefits contributory pension scheme and provides pension benefits to all local Government employees, excluding principally teachers, of the Islands Council together with employees of a number of external organisations of a statutory and voluntary nature that have been accepted into the scheme as members.

Charity, Trust and Common Good Funds

The Islands Council as sole trustee administers a number of educational, social welfare and miscellaneous bequests. This statement provides a summary of the income and expenditure during the year together with a summary of the balances.

Statement on the System of Internal Financial Control

This statement provides an assessment of the adequacy and effectiveness of the system of internal financial control that has operated and been maintained within the Islands Council over the past financial year. If appropriate, it also includes an assessment of identified weaknesses and remedial actions taken or planned.

REVIEW OF THE YEAR

Local Taxation

The Islands Council on 12 February 2004 agreed a General Fund budget of £56.5M and under the Local Government Finance Act 1992 set Council Tax for Band D properties at £940.00. This was the third lowest Council Tax figure in Scotland being some £113 below the Scottish Average.

Consolidated Revenue Account

The net effect of the variations from budget is a General Fund deficit of £0.9M for the year, which with the use of balances amounting to £0.3M accounts for the overall movement in General Fund balances of £1.2M for the financial year 2005/06.

Revenue Services were financed by Revenue Support Grant of £43.3M, Non Domestic Rate Income of £7.2M and Council Tax Income of £6.6M.

The net overspend position has arisen as a result of a number of spending pressures within the Service Committee budgets during the year, including an increase in homeless presentations, elderly community placements outwith Orkney as well as community placements exceeding budget; the impact of transport and property costs on contract provision during the year; ferry refit costs; teaching staff costs being higher than anticipated due to recruitment difficulties, long term sickness cover and one-off early retirement costs.

Under the existing scheme for year end flexibility Service Committee's will carry forward the net overspends into the following financial year and consider how this position can be managed effectively during 2005/06.

Harbour Authority Account

The Harbour Authority generated a trading loss of £495k from its various harbour operations for the year. This was mainly as a result of a capital contribution to the Scapa Pier development during the year.

In addition to this, the Harbour Authority was able to generate a surplus on investment activities of £3,449k for the year, after netting off grants and other investment expenditure.

The net effect of this has been an increase of £2,954k on the Harbour Authority Reserves for the year.

Orkney College

During the year the Council settled a capital financing loan arrangement with the SFEFC, as the first phase of a review of the financial position of the Orkney College within the Islands Council.

This resulted in a deficit being generated by the College of £61k for the year, and a further increase in the accumulated deficit position on the College to £652k as at 31 March 2005.

Housing Revenue Account (HRA)

The HRA approved budget for the financial year 2004/05 included expenditure of £1,723k to be met from income generated on the year of £1,723k.

The HRA account achieved a break-even position for the year with actual figures realised for operational expenditure of £1,776k. This was principally as a result of a higher than planned contribution to the Capital Financing Account.

During the year the HRA account was able to generate more capital receipts through the sale of Right to Buy Council Houses. As a result the HRA account was able to repay its capital debt early and achieve debt free status as at 31 March 2005.

Capital Expenditure

The Local Government in Scotland Act 2003 abolished the system of capital consents, whereby the Scottish Executive set down annual limits on local authorities for capital expenditure. This has been replaced with a new Prudential Regime for capital finance from 2004/05. The Islands Council is now allowed to determine its own limits for borrowing and capital expenditure, as long as it can be demonstrated that these plans are affordable, sustainable and prudent..

During the year the following major Capital Projects were in progress or substantially completed:

Education	Kirkwall Grammar School Glaitness Primary Extension
Recreation and Cultural	St Margarets Hope Healthy Living Centre Sanday Healthy Living Centre
Roads	B9070 Sanday Road Widening
Harbours	Scapa Pier Improvements Kirkwall Marina
Other Housing	Garson Housing Development

Capital Expenditure for 2004/05 amounted to £14.6M, financed by borrowing £6.5M, capital and grant receipts £7.7M and revenue contributions £0.4M. Unapplied capital receipts increased by £0.4M, from £0.9M to £1.3M.

To meet capital expenditure, the Islands Council as at 31 March 2005 has a total internal borrowing requirement of £34.0M through the Loans Fund, borrowed against reserves and balances. The capital loan debt outstanding on the service accounts as at 31 March 2005 is : Harbours - £1.7M, other General Fund Services - £32.2M and Orkney College £0.1M.

Trading Organisations

The Local Government in Scotland Act 2003 sets out a statutory duty for Councils to achieve Best Value. It provides a strong link between the duty of Best Value, the delivery of services and the reporting of financial performance.

Councils are required to maintain statutory trading accounts for 'significant trading operations', and these operations should breakeven over a three year rolling period.

The Council has continued to maintain trading accounts in five areas of Construction & Municipal, Cleaning, Quarries, Waste Disposal and Catering pending an internal review.

Surpluses have been achieved in each of the statutory trading accounts maintained, with the exception of Quarries and Catering.

A review of the existing trading operations carried out by the Islands Council has since identified Quarries and Waste Disposal as the only 'significant' trading operations requiring the maintenance of Trading Accounts for these Services. All other service functions will therefore revert back to the client Service Committee during the financial year 2005/06.

Pension Liability

The Statement of Accounts include the future pension liability of the Islands Council resulting from the full implementation of the Financial Reporting Standard No 17 - Retirement Benefits (FRS 17).

In accordance with the FRS 17, the net pension fund liability as at 31 March 2005 is £25.2M. This represents an increase of £14.5M on the previous year, and is largely due to a change in the financial assumptions underlying the Present Value of the Scheme Liabilities. This is explained more fully in the Accounting Policies on pages 5 and 6.

The actuarial losses on the fund are regularly considered as part of a triennial revaluation process, with the last carried out for the Pension Fund as at 31 March 2002. At this time the actuarial valuation considered the appropriate level of employers contributions necessary for the three year period 2003/06, taking into account estimated revenues generated from investments in the future, to meet the fund's projected commitments in the long term. As a result the employers contribution rates were increased to address the Fund deficit position.

Euro

Although the Euro at this stage has a minimum impact on Council activities it is worth noting that the financial package the Council uses is Euro compliant.

Acknowledgements

I would like to take this opportunity to thank my colleagues in the Finance Department and in the other Service Departments for their help and co-operation in managing the financial affairs of the Authority.

A TAIT, C.P.F.A., F.C.C.A.
Director of Finance
29 June 2005

STATEMENT OF ACCOUNTING POLICIES

General

The Accounts have been prepared using the historic cost convention modified by the revaluation of fixed assets and in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom. The Code of Practice has been developed by the CIPFA/LASAAC Joint Committee. Any exceptions to the Code of Practice are disclosed in the notes to the Accounts.

Corporate and Democratic Core

Costs associated with democratic representation, including members expenses, and costs related to the corporate management of the Council, have been charged to Corporate and Democratic Core in accordance with CIPFA's Best Value Accounting Code of Practice (BVACOP).

Overheads

The costs of Central Support Services have been fully allocated using a time or unit based method of apportionment over the various accounts of the Authority after separately identifying the cost of Corporate and Democratic Core and Unapportionable Central Overheads in accordance with BVACOP. In 2004/05, £6.6M of Central Support Services were apportioned on this basis.

Debtors and Creditors

The Accounts are prepared on an accruals basis in accordance with the Code of Practice and FRS 18. Accordingly, best estimates of amounts due or payable which relate to activities during the year are included whether or not cash has actually been received or paid in the year.

Pension Costs

In 2003/04, the full implementation of Financial Reporting Standard 17 - Retirement Benefits (FRS 17) resulted in a material effect on substantial parts of the statement of accounts.

The Council participates in two different schemes, which meet the needs of employees in particular services. Both schemes provide members with defined benefits related to pay and service. These schemes are as follows:

Teachers:

This is an unfunded scheme administered by the Scottish Executive. The pension cost charged to the accounts is the contribution rate set by the Scottish Executive on the basis of a national fund. This scheme is exempt from the provisions of FRS 17.

Other Employees:

Other employees, subject to certain qualifying criteria, are eligible to join the Local Government Pension Scheme. This is known as The Pension Fund and is administered by Orkney Islands Council. The pension costs included in the accounts in respect of this scheme have been determined in accordance with FRS 17. This means that the accounts include the current service cost rather than the actual contributions made to the scheme. The policies are as follows:

- attributable assets of the scheme have been measured at fair value
- attributable liabilities have been measured on an actuarial basis using the projected unit method which assesses the future liabilities discounted to their present value
- scheme liabilities have been discounted at 2.4% in excess of inflation
- the deficit in the scheme is the shortfall of the value of the assets below the present value of the scheme liabilities
- the current service cost is deducted based on normal contributions paid by the Council, allowing for any changes in assumptions used for FRS 17 purposes. It is based on assumptions appropriate at the start of the year
- the interest cost is based on the discount rate and the present value of the scheme liabilities at the beginning of the period

- the expected return on assets is based on long term expectations at the beginning of the period and is expected to be reasonably stable
- actuarial gains and losses arising from new valuations and from updating the latest actuarial valuation have been taken into account to reflect conditions at the balance sheet date
- past service costs have been disclosed on a straight line basis over the period in which the increases in benefit vest.

In assessing liabilities for retirement benefits at 31 March 2004 for the 2003/04 Statement of Accounts, the actuary was required by the SORP to use a discount rate of 3.5% in excess of inflation. For the 2004/05 Statement of Accounts, a rate based on the current rate of return on a high quality corporate bond of equivalent currency and term to scheme liabilities is to be used. The actuary has advised that a rate of 2.4% in excess of inflation is appropriate. Application of this rate has resulted in an increase in liabilities measured at today's prices of £14,556K. This has been adjusted for by an increase in actuarial losses recognised for the year in the Statement of Total Movements in Reserves.

Grants

All Revenue Grants are matched with the expenditure to which they relate. Accruals have been made for balances known to be receivable for the period to 31 March 2005.

Stocks and Work in Progress

Stocks have been valued at the lower of cost or net realisable value. Work in progress has been valued at an amount inclusive of attributable profits and foreseeable losses.

Fixed Assets

All expenditure on the acquisition, creation or enhancement of fixed assets has been capitalised on an accruals basis.

Fixed assets have been valued on the following basis:

Infrastructure and Community Assets are valued at historical cost net of depreciation.

Operational land and buildings and other operational assets are valued at the lower of Net Current Replacement Cost (NCRC) and Net Realisable Value (NRV) in existing use.

Non Operational Assets, including investment property and assets that are surplus to requirements, are valued at the lower of NCRC and NRV. This will normally be open market value.

The fixed assets are to be revalued not less than every five years. The difference between the current value of the fixed assets and the amount of debt outstanding on these assets in the balance sheet is reflected in the value of the Fixed Asset Restatement Account.

Capital Receipts

Receipts from the sale of tangible fixed assets and capital grants received/receivable during the year are recorded in the Capital Account. Grants and contributions received towards the creation of fixed assets are credited to the Government Grants Deferred Account and released to the Consolidated Revenue Account over the life of the asset.

Depreciation

All assets are depreciated over their estimated economic useful lives using the straight line method. Where land is estimated to have an infinite useful life no depreciation is applied. Provision has been made for depreciation on buildings, infrastructure, vehicles and equipment, as follows:-

Buildings	- each property has been individually assessed to derive outstanding useful life, up to a maximum of 100 years.
Infrastructure	- the majority of infrastructure assets are depreciated over 40 years.
Vehicles	- varies between 3 and 15 years according to class of vehicle.
Equipment	- 5 years.

Capital Charges

Capital charges are levied on all service revenue accounts under the Capital Accounting arrangements to reflect the true cost or value of fixed assets used in the delivery of local authority services. The capital charges include amounts for notional interest and depreciation based on the fixed asset values. The notional interest charge reflects the opportunity cost to the Islands Council of holding the fixed assets, while the depreciation charge reflects the loss in value of the assets over time. These capital charges are then reversed out below the line and replaced with actual capital finance charges using the Capital Financing Account, so that these notional charges do not impact on the Local Taxpayer.

Deferred Charges

Deferred Charges represent capital expenditure for which no tangible asset exists. As the Deferred Charges do not reflect continuing benefit to the Islands Council they have been amortised to the service revenue accounts.

Loan Debt

A Loans Fund is maintained under powers contained in the Local Government (Scotland) Act 1975. All loans raised by the Council are paid into the Fund and all advances to finance capital expenditure are made from the Fund except for capital projects financed directly from Revenue Accounts or financed from capital receipts.

It is the policy of the Council to extinguish loan debt as quickly as possible and consequently some annual repayments of principal have been made on an accelerated basis. The Capital Financing Account is charged with annual repayments of principal and the Asset Management Revenue Account with an average rate of interest on the balance outstanding.

The average rate of interest charged by the fund in 2004/05 were as follows:

Revenue balances	4.32% (2003/04 3.52%)
Capital balances	4.21% (2003/04 3.49%)

Reserves and Provisions

Reserves represent amounts set aside for specific policy purposes, contingencies or earmarked balances. Expenditure is not charged directly to any Reserve, but all movements on the Reserves are disclosed on the Consolidated Revenue Account.

The capital accounting guidelines require the establishment of capital reserve accounts in the Consolidated Balance Sheet, the Fixed Asset Restatement Account and the Capital Financing Account. The Fixed Asset Restatement Account relates to the valuation of assets. The Capital Financing Account reflects the amounts set aside from revenue and capital receipts applied to finance capital expenditure together with amounts repaid to the loans fund. Both reserves do not, therefore, represent funds available for use.

Provisions are amounts set aside for liabilities or losses likely to be incurred but where there is uncertainty as to the precise amounts or dates on which they will arise. Provisions have been made for doubtful debts as follows:

Debt Outstanding 2-3 month - 10%

Debt Outstanding 3+ month - 25%

Debt Outstanding 1 year+ - 100%

Harbour Authority Revenue Account Balances

Surplus income from the Council's harbour operations is credited to the Harbour Reserve Fund. The Harbour Reserve Fund encompasses all the Harbour Authority Revenue Account Balances which can be used for purposes specified in the Orkney County Council Act 1974. The Relevant Services Contingency Fund is used to support General Fund expenditure.

Pension Reserve

The Pension Reserve recognises that a net pension liability exists in terms of the Islands Councils obligation to fund the employees defined benefits pension scheme.

Valuation of Investments

Investments are shown at cost less related provision for loss in value. Investments held by the Pension Fund are valued at market value. Property investments and Fishing Vessel Track Record investments are valued at open market value.

Foreign Currency Translation

Monetary assets denominated in a foreign currency have been translated at the prevailing rate at the year end.

Financial Relationship with Companies

Full disclosure is made of all material relationships with related companies by way of note 7 to the Consolidated Balance Sheet. All investments in companies are valued at historic cost

Group Accounts

The Council has taken advantage of the transitional arrangements for the preparation of group accounts, so none has been prepared this year.

CONSOLIDATED REVENUE ACCOUNT

31-Mar-04 Net Expenditure £000		Gross Expenditure £000	Income £000	31-Mar-05 Net Expenditure £000
	Continuing Operations			
24,434	Education	28,813	2,247	26,566
3,855	Cultural and Recreation	5,332	967	4,365
9,351	Community Social Services	15,715	4,808	10,907
1,359	Police Services	1,499	-	1,499
1,049	Fire Services	1,326	-	1,326
12,340	Roads and Transportation	14,586	1,109	13,477
942	Planning and Development	1,711	556	1,155
3,417	Environmental Services	4,350	543	3,807
(1,345)	Central Services	3,651	2,723	928
1,704	Corporate and Democratic Costs	1,847	-	1,847
465	Housing Services	2,976	2,531	445
(272)	Housing Revenue Account	1,690	1,776	(86)
(357)	Harbour Authority	14,058	10,899	3,159
309	Non Distributed Cost	802	-	802
57,251	NET COST OF SERVICES	98,356	28,159	70,197
(8,581)	Net (Surplus)/Deficit on Harbour Investment Income			(3,449)
364	Net (Surplus)/Deficit on Orkney College			(800)
(198)	Interest on Balances			(240)
	Pensions Interest cost and expected			
1,069	return on Pension Assets			(267)
	Net(Income)/Expenditure on			
(7,105)	Asset Management Revenue Account			(7,211)
42,800	NET OPERATING EXPENDITURE			58,230
8,731	Contribution to/(from) Harbour Authority Fund			2,261
(2,284)	Contribution to/(from) Direct Services Organisation			-
116	Contribution to/(from) Reserves			(33)
2,619	Contribution to/(from) Capital / Repairs and Renewals Funds			1,136
(588)	Movement on Pensions Reserve			(492)
1,657	Contribution to/(from) Capital Financing Reserve			(2,817)
53,051	AMOUNT TO BE MET FROM GOVERNMENT GRANTS AND LOCAL TAXPAYERS			58,285
40,966	Revenue Support Grant			43,320
6,848	Distribution of Non-Domestic Rate Pool			7,205
6,233	Council Tax			6,586
996	SURPLUS/(DEFICIT) FOR YEAR			(1,174)
2,441	Balance at 1 April 2004			3,437
996	Surplus/(Deficit) for year			(1,174)
3,437	BALANCE AT 31 MARCH 2005			2,263

Notes on Consolidated Revenue Account

1. Publicity Expenditure

Under Section 5(1) of the Local Government Act 1986, the Council is required to separately account for expenditure on publicity, as follows:

2003/04		2004/05
£000		£000
151	Staff Recruitment Advertising	271
115	Other Advertising	104
34	Corporate Information Services	39
300		414

2. External Audit Fees

The fee payable to Audit Scotland in respect of external audit services undertaken in accordance with the Code of Practice is £0.187 million (2003/04 £0.184 million). No fees were paid in respect of other services provided by the appointed auditor.

3. Trading Organisations

The Council completes statutory trading accounts, within the definition of the Local Government in Scotland Act 2003, for five Organisations and maintains further non-statutory accounts for information purposes. Significant trading operations require to break even over a three year rolling period. This will be measured for the first time in 2005/06.

Statutory

Orkney Direct Construction and Municipal carries out general highway and road maintenance work for the Transport and Infrastructure Committee in addition to refuse collection and environmental cleansing for the Environment, Planning & Protective Services Committee.

Orkney Direct Cleaning carries out building cleaning for all public buildings.

Orkney Direct Quarries supplies most of the raw materials for work on the highways and roads in Orkney.

Orkney Direct Waste Disposal arranges for the destruction of all domestic and industrial waste generated in Orkney.

Orkney Catering Services supplies the schools in Orkney through the Education Committee.

Non-Statutory

Orkney Direct Warehouse & Transport is responsible for the maintenance of all Council vehicles, mainly servicing vehicles and plant employed in other trading organisations as well as vehicles held within Education and Social Services Departments.

The actual financial performance for the year is detailed below:

2003/04	2003/04		2004/05	2004/05
£000	£000		£000	£000
Turnover	Surplus/ (Deficit)	Statutory	Turnover	Surplus/ (Deficit)
6,307	200	Construction & Municipal	6,964	94
1,106	85	Cleaning	1,163	17
1,523	20	Quarries	1,804	(10)
1,743	83	Waste Disposal	1,843	23
1,185	3	Catering	1,147	(91)
		Non-Statutory		
672	25	Warehouse & Transport	733	(28)

4. Local Authority (Goods and Services) Act 1970

The Council is empowered by this act to provide Goods and Services to other public bodies. During the year the Council has provided building services for the following bodies on the basis that the services provided are ancillary to the Council's functions.

2003/04 Receipts £000	2003/04 Payments £000		2004/05 Receipts £000	2004/05 Payments £000
1	1	Orkney Housing Association	2	1
20	15	Northern Police Joint Board	4	4
-	1	Highlands and Islands Fire Joint Board	1	1
-	-	Highlands and Islands Strategic Transport Partnership	11	17
-	-	Firth Community Association	49	35
105	87	Orkney Islands Property Development	2	50
126	104		69	108

5. Asset Management Revenue Account

The Asset Management Revenue Account (AMRA) is used to reconcile the capital charges applied for the use of fixed assets in service revenue accounts, with the cost of financing those assets on the Consolidated Revenue Account.

Capital charges are levied on all service revenue accounts under the Capital Accounting arrangements to reflect the true cost or value of fixed assets used in the delivery of local authority services. The capital charges include amounts for notional interest and depreciation based on the fixed asset values. The notional interest charge reflects the opportunity cost to the Islands Council of holding the fixed assets, while the depreciation charge reflects the loss in value of the assets over time. These capital charges are then reversed out below the line and replaced with actual capital finance charges using the Asset Management Revenue Account, so that these notional charges do not impact on the Local Taxpayer.

2003/04 £000		2004/05 £000
	Expenditure	
1,365	Interest	1,504
21	Debt Management	22
8,113	Provision for Depreciation	9,052
9,499	TOTAL	10,578
	Income	
15,199	Capital Charges	16,298
1,405	Government Grants Deferred	1,491
16,604	TOTAL	17,789
	(Surplus) / Deficit to Consolidated	
(7,105)	Revenue Account	(7,211)

6. Pension Costs

Local Government Pension Scheme

The Consolidated Revenue Account reflects the ACOP accounting requirements as they relate to FRS 17 - Retirement Benefits.

Included within the net cost of services are the following pension costs:

2003/04		2004/05	
£000	% of Payroll	£000	% of Payroll
2,450	12.9	3,917	18.6
309	1.6	802	3.8
0	0.0	0	0.0
0	0.0	0	0.0
2,759	14.5	4,719	22.4
	Total Operating Charge		

In arriving at the net operating expenditure further provision has been made in respect of:

2,914	15.3	4,198	19.9
(3,982)	(21.0)	(3,931)	(18.6)
-1,068	-5.7	267	1.3
	Net return on assets		
1,068	5.7	4,452	21.1
	Net Revenue Account Cost		

Included in the appropriation section of the consolidated revenue account is a transfer of £492K from the pension reserve. The net effect of these accounting entries is that expenditure met from government grants and local taxation equals the actual employers contributions made to the Scheme of £3,380K, representing 16.47% of pensionable pay.

The employer's contribution rate is determined by the Fund's Actuary based on triennial actuarial valuations, the last review being 31 March 2002. Under Pension Fund Regulations contributions rates are set to meet the overall liabilities of the Fund. The employer's rates are set to meet the overall liabilities of the Fund. The employer's contribution was 275% of the employee's contribution for 2004/05.

In addition the Islands Council is responsible for all pension payments relating to added years benefits it has awarded, together with the related increases. In 2004/05 these amounted to £233,951 representing 1.14% of pensionable pay.

For further information see the Pension Fund Statement on pages 36-39.

Teachers

In 2004/05 the Islands Council paid an employer's contribution of £1.287M to the Scottish Executive in respect of teachers' pension costs, which represented 12.84% of teachers' pensionable pay.

In addition, the Islands Council is responsible for all pension payments relating to added years it has awarded, together with mandatory compensation and related increases. In 2004/05 these amounted to £265K representing 2.64% of pensionable pay.

7. Related Party Transactions

During the year transactions with related parties arose as follows:

2003/04 Receipts £000	2003/04 Payments £000		2004/05 Receipts £000	2004/05 Payments £000
		Central Government		
41,405	-	Revenue Grants Being payments made in support of Revenue Expenditure	43,682	-
2,932	-	Capital Grants Being payments made in support of Capital Expenditure	1,125	-
		Orkney Towage Company Limited		
-	2,466	Being payments for the provision of Towage Services	-	2,570
		Orkney Ferries Limited		
-	4,388	Being subsidy payments made in support of Ferry Services	-	5,585
		Northern Police Joint Board		
-	1,359		-	1,499
		Highlands and Islands Fire Joint Board		
-	1,049		-	1,326
		Orkney and Shetland Valuation Joint Board		
-	238	Being payment of annual requisition to Joint Boards	-	274
20	21	Chief Officials Being advances and repayments of Car Loans	24	21
		Orkney Islands Pension Fund		
-	3,240	Being payment of employers contributions in respect of employees	-	3,951

8. Members' Allowances and Officers' Emoluments

The total of Members' Allowances paid in the year amounted to £419K (2003/04 £412K).

An analysis of employees' remuneration (excluding pension costs) above £40,000, in bands of £10,000 is as follows:

2003/04 Number of Employees	Remuneration Band	2004/05 Number of Employees
45	£40,000 - £49,999	49
17	£50,000 - £59,999	11
1	£60,000 - £69,999	2
6	£70,000 - £79,999	10
1	£80,000 - £89,999	1

HARBOUR AUTHORITY SUMMARY ACCOUNT

This statement shows the trading position of the Harbour Authority and net movements in reserves for the year.

2003/04 Net Expenditure £000	Gross Expenditure £000	Income £000	2004/05 Net Expenditure £000
(296) Scapa Flow Oil Port	8,521	7,807	714
4 Miscellaneous Piers and Harbours	5,224	2,908	2,316
(65) Oil Pollution Account	313	184	129
(357) (Profit)/Loss for year	14,058	10,899	3,159
(336) Adjustments for Capital Financing Costs Pensions Interest Cost and Expected			(2,635)
83 Return on Pension Assets			(21)
(23) Transfer to Pension Reserve			(8)
(633) Transfer from/(to) Harbour Reserve Fund			495
Represented by :	Balance at	Net	Balance at
	01/04/04	Movement	31/03/05
	£000	£000	£000
Strategic Reserve Fund	118,226	3,771	121,997
Flotta Terminal Decline & Decommissioning Fund	42,000	-	42,000
Relevant Services Contingency	20,351	(816)	19,535
Conservation Fund	173	(6)	167
Talented Performers Fund	49	1	50
Travel Fund	77	4	81
Talented Young Persons Fund	42	-	42
TOTAL	180,918	2,954	183,872

Notes

1. The net movement on the Harbour Authority includes the trading loss on the Harbour Authority Revenue Account of £0.495M and a surplus generated on investment activities, of £3.449M after netting off grants and other non investment expenditure.
2. A contribution from the Harbour Funds to finance revenue and capital expenditure during the year was made as follows:-

2003/04 £000	2004/05 £000
Revenue Expenditure	
483 Relevant Services Contingency Fund	693
Capital Expenditure	
1,000 Relevant Services Contingency Fund	1,000
4,849 Strategic Reserve Fund	1,382
- Scapa Flow Oil Port	874
6,332 Total	3,949

ORKNEY COLLEGE OF FURTHER EDUCATION

The Islands Council maintains accounting records on behalf of the Orkney College. The College is funded by direct grants from the Scottish Further Education Funding Council.

2003/04		2004/05
£000		£000
	Expenditure	
1,712	Staff Costs	1,904
224	Property Costs	234
519	Supplies & Services	463
51	Transport Costs	84
75	Administration Costs	57
22	Apportioned Costs	28
430	Capital Charges	471
3,033		3,241
	Income	
2,098	Grants	3,345
470	Fees & Charges	579
101	Other Income	117
364	Deficit/(Surplus) for Year	(800)
3,033		3,241
(479)	Orkney College Reserve 1 April 2004	(591)
(364)	(Deficit)/Surplus for Year	800
307	Adjust for Capital Financing Costs	(823)
	Pensions Interest Cost and Expected	
(53)	Return on Pension Assets	12
(2)	Transfer to Pension Reserve	(50)
(112)	Transfer to Reserves	(61)
(591)	Orkney College Reserve 31 March 2005	(652)

HOUSING REVENUE ACCOUNT

This account reflects the statutory requirement to account for Local Authority housing provision, as defined in the Housing (Scotland) Act 1987. It summarises the main elements of housing revenue expenditure and capital financing costs, and shows how these costs are met by rents, housing support grant and other income.

2003/04		2004/05
£000		£000
1,698	Dwelling Rents(gross)	1,688
21	Non-Dwelling Rents(gross)	25
82	Other Income	63
1,801	TOTAL INCOME	1,776
520	Repairs and Maintenance	395
434	Supervision and Management	607
707	Capital Finance Costs	725
30	Bad or Doubtful Costs	21
101	Other Expenditure	30
	Pensions Interest Cost and Expected	
14	Return on Pension Assets	(3)
(5)	Transfer to Pension Reserve	1
1,801	TOTAL EXPENDITURE	1,776
-	(Surplus)/Deficit for Year	-
-	(Surplus)/Deficit from Previous Years	-
-	Accumulated (Surplus)/Deficit	-

Housing Revenue Account Notes

1. Housing Stock

The numbers and types of dwellings included in the Council's Housing Stock as at 31 March 2005 are as follows:

2003/04		2004/05
Number of		Number of
Dwellings		Dwellings
51	1 Apartment	51
292	2 Apartment	284
251	3 Apartment	245
224	4 Apartment	216
14	5 Apartment	14
832		810

2. Rent Arrears

2003/04		2004/05
£56,209	Dwelling Arrears	£68,980
£20,581	Non Dwelling & Other Arrears	£21,299
£76,790		£90,279
171	Number of Tenants in Arrears	188

3. Provision for Bad Debts

2003/04		2004/05
£30,902	Dwelling Arrears	£29,967
£17,068	Non Dwelling & Other Arrears	£16,874
£47,970		£46,841

4. Reconciliation to Consolidated Revenue Account

The reconciliation of the HRA to the Consolidated Revenue Account is as follows:-

2003/04		2004/05
£000		£000
-	Net Expenditure	-
	Less:	
444	Loan Charges	636
263	CFCR	88
42	Pension Contributions	45
	Add:	
444	Capital Charges	636
33	Current Service Costs	47
(272)	Net Cost of Service	(86)
	Add:	
263	Adjust for Capital Financing Costs	88
14	Return on Pension Assets	(3)
(5)	Transfer to Pension Reserve	1
-	Transferred to HRA Balances	-

COUNCIL TAX INCOME ACCOUNT

This account shows the net income raised from the Council Tax levied under the Local Government Finance Act 1992.

2003/04	2004/05
£000	£000
6,123 Gross Council Tax Levied	7,808
(141) Less Relieved, Remitted and Written Off	1,173
6,264 Net Council Tax Due for Year	6,635
4 Provision for Bad Debts	42
31 Less Council Tax Benefit (Net of Government Grants)	17
6,229 Net Council Tax Income	6,576
Adjustment for previous years:	
3 Council Tax	15
1 Community Charge	(5)
6,233 Transfers to General Fund	6,586

Notes

1. Calculation of Council Tax Base

		Bands								Total
		@	A	B	C	D	E	F	G	
Number of Dwellings	-	2,604	2,610	1,860	1,384	851	166	16	2	
Exemption	-	(105)	(56)	(39)	(13)	(7)	(1)	-	-	
Disabled Relief	9	17	(4)	(6)	(3)	(11)	(2)	-	-	
Discounts (25%)	(2)	(307)	(246)	(131)	(75)	(27)	(6)	(1)	-	
Discounts (50%)	-	(171)	(87)	(52)	(20)	(8)	(2)	(1)	-	
Equivalent Dwellings	7	2,038	2,217	1,632	1,273	798	155	14	2	8,136
Ratio	5/9	6/9	7/9	8/9	9/9	11/9	13/9	15/9	18/9	
Band D Equivalents	4	1,359	1,724	1,451	1,273	975	224	23	4	7,037
Less provision for non-collection										(262)
Council Tax Base										6,775

@ denotes additional relief for disabled persons occupying Band A properties.

Council Tax is payable on any domestic dwelling which is not exempted by the Secretary of State. The amount of Council Tax payable depends on the valuation band into which the property falls, and the number of people aged 18 or over using the property as their sole or main residence. The Council Tax is set to cover the cost of Council Services, net of fees and charges, grants received, and non-domestic rates.

In addition water and sewerage charges are collected by the Islands Council on behalf of Scottish Water. These charges are not accounted for on the Council Tax Income Account.

2. Details of Charges Levied

2003/04	2004/05
£	£
900.00 Council Tax - Band D - General Rate	940.00

Council Tax Charges for 2004/2005

Band	Property Value	Proportion of Band D	Council Tax £
A	Up to £27,000	6/9	626.67
B	£27,000 to £35,000	7/9	731.11
C	£35,000 to £45,000	8/9	835.56
D	£45,000 to £58,000	9/9	940.00
E	£58,000 to £80,000	11/9	1,148.89
F	£80,000 to £106,000	13/9	1,357.78
G	£106,000 to £212,000	15/9	1,566.67
H	Above £212,000	18/9	1,880.00

The above table shows the Council Tax Charges due for 2004/05 on a domestic dwelling with an unmetered public water supply, based on two or more people aged 18 years or over resident in the property before any exemption, discounts or relief is applied.

Generally, exemptions apply to properties which are unfurnished and unoccupied, or where a person is in long term care or the property is occupied by students. Discounts apply where fewer than two people aged 18 years or over are resident in the property, or where a person is disabled. Properties which have been adapted for the disabled or are used for charitable purposes are also eligible for relief.

However, exemptions, discounts and relief against the Council Tax can only be obtained by application to the Council.

3. Residual Community Charge Income

During the year Community Charge arrears were collected as follows:

2003/04	2004/05
£000	£000
1 Reduction in Provision for Bad Debts	-
(1) Less Written Off	-
1 Less Cost of Collection	-
1 Net Community Charge Income	-

4. Arrears of Council Tax and Community Charge

31-Mar-04	31-Mar-05
£	£
515,392 Council Tax Arrears	595,535
5,857 Community Charge Arrears	5,857

NON DOMESTIC RATES INCOME ACCOUNT

This account shows the income from the rate levied under the Local Government (Scotland) Act 1975 as amended by the Local Government Finance Act 1992 on non domestic property.

2003/04		2004/05
£000		£000
7,371	Gross Rates Levied and Contributions in Lieu	7,838
954	Less Relief's and Other Deductions	1,007
10	Payment of Interest	1
(2)	Provision for Bad and Doubtful Debts	(13)
6,409	Net Non Domestic Rates Income	6,843
439	Contribution from national non-domestic rate pool	362
6,848	Transfer to Consolidated Revenue Account	7,205

Notes

1. Rateable Values and Number of Premises as at 1 April 2004

Number of Subjects	Rateable Value 01-Apr-03 £000		Number of Subjects	Rateable Value 01-Apr-04 £000
106	6,094	Industrial & Freight Subjects	101	5,490
7	842	Public Utilities	8	1,061
		Commercial Subjects :		
259	1,257	Shops	267	1,279
154	1,059	Offices	159	1,091
153	225	Hotels, Boarding Houses etc.	194	801
656	3,296	Other	584	2,555
1,335	12,773		1,313	12,277
473	3,642	Miscellaneous	517	3,676
1,808	16,415	TOTAL	1,830	15,953

2. Non Domestic Rate Poundage

2003/04	2004/05
£0.478 Property Rate	£0.488

Non Domestic Rates are levied by the Islands Council on local Commercial and Industrial properties. The rate is, however, set by Central Government. An additional supplement of £0.003 is applied to properties with a rateable value exceeding £25,000.

3. Non Domestic Rates Arrears

31-Mar-04	31-Mar-05
£	£
35,930 Arrears of Non Domestic Rates	101,392

4. Contribution to National NDR Pool

2003/04	2004/05
£000	£000
6,807 Provisional Contributable Amount	6,719
(398) Difference from Notified Amount	124
6,409 Contribution to National NDR Pool	6,843

**CONSOLIDATED BALANCE SHEET
AS AT 31st MARCH 2005**

31-Mar-04		Notes	31-Mar-05
£000			£000
	Fixed Assets	1	
	Operational Assets		
16,345	Council Dwellings		15,345
89,285	Other Land and Buildings		90,647
4,297	Vehicles and Plant		3,900
73,160	Infrastructure		74,200
3,285	Community Assets		3,420
9,121	Non Operational Assets		5,452
195,493	Total Fixed Assets		192,964
155,996	Long Term Investments	7	153,702
4,088	Long Term Debtors	3	4,148
355,577	TOTAL LONG TERM ASSETS		350,814
	Current Assets		
752	Stocks and Work in Progress	4	760
6,094	Debtors		6,937
6	Cash in Hand		7
5,450	Investments	7	9,064
12,302			16,768
	Less Current Liabilities		
3,479	Creditors		6,313
2,052	Bank Overdraft		961
6,098	Advances from Pension, Charity and Trust Funds		3,465
11,629			10,739
356,250	TOTAL ASSETS LESS CURRENT LIABILITIES		356,843
10,674	Net Pension Liability	11	25,230
345,576	TOTAL ASSETS LESS LIABILITIES	8	331,613
	REPRESENTED BY:		
	Capital Reserves		
113,787	Fixed Asset Restatement Account		105,720
5,952	Capital Financing Account		8,683
865	Usable Capital Receipts		1,277
41,571	Government Grants Deferred		44,929
1,551	Capital Fund		1,952
163,726			162,561
	Revenue Reserves		
3,437	General Fund Balances		2,263
180,918	Harbour Authority Fund		183,872
(10,674)	Pension Reserve		(25,230)
8,169	Repairs and Renewals Fund		8,147
181,850			169,052
345,576	TOTAL EQUITY		331,613

A TAIT, C.P.F.A., F.C.C.A.
Director of Finance
29 June 2005

Notes on the Consolidated Balance Sheet

1. Fixed Assets

The following represents an analysis of fixed assets owned by the Islands Council as at 31 March 2005.

Number of Items 2003/04			Number of Items 2004/05
832	Council Dwellings	Council Dwellings	810
1	Operational Buildings	Concert Halls & Theatres	1
44		Other Housing Properties	47
82		Depots & Workshops	82
2		Museums	4
11		Community/Day Centres	11
2		Sports Centres & Pools	2
2		Libraries	2
29		Schools	29
9		Office Buildings	9
3		Parks & Amenity Properties	3
		Miscellaneous :	
37		Public Conveniences	37
10		Refuse Sites	10
2		Quarries	2
16	Infrastructure	Sea Defences	16
978		Roads (Kilometres)	978
56		Piers & Harbours	56
9		Airfields	9
24		Car Parks	24
41	Community Assets	Cemeteries	41
21		Historic Buildings/Monuments	19
12		Parks	12
6	Operational Equipment	Computers	6
203		Mechanical Plant	198
237		Vehicles	242
79		Other Equipment	123
13		Ferries	13
38	Non Operational Property	Surplus Assets	23
96		Commercial Property	95
6		Land Awaiting Development	10
6		Assets Under Construction	5
2,907	TOTAL		2,919

Fixed Asset Transactions

All expenditure on the acquisition, creation or enhancement of fixed assets has been capitalised on an accruals basis.

The following statement shows the movements in fixed assets during the year:

	Council Dwellings £000	Other Land & Buildings £000	Plant and Vehicles £000	Infrastructure £000	Community £000	Non Operational £000	Total £000
Net book value of assets at 01/04/04	16,345	89,285	4,297	73,160	3,285	9,121	195,493
Movement in 2003/04							
Additions	651	7,197	1,686	3,546	205	1,305	14,590
Disposals	(455)	-	-	-	-	(3,913)	(4,368)
Revaluations	(600)	(7,002)	(216)	(2)	-	4,121	(3,699)
Reclassifications	-	5,000	-	-	-	(5,000)	-
Depreciation	(596)	(3,833)	(1,867)	(2,504)	(70)	(182)	(9,052)
Impairments	-	-	-	-	-	-	-
Net book value of assets at 31/03/05	15,345	90,647	3,900	74,200	3,420	5,452	192,964

Assets held on behalf of the Community Councils increased by £10k to £35k during the year.

1(a) Valuation of Fixed assets carried at current value

The following statement shows the progress of the Council's rolling programme for the revaluation of fixed assets. The valuations were carried out by the Orkney Islands Council's Technical Services Department, by a Chartered Surveyor and Associate Member of the RICS. The basis for valuation is set out in the statement of accounting policies.

	Council Dwellings £000	Other Land & Buildings £000	Plant and Vehicles £000	Infrastructure £000	Community £000	Non Operational £000	Total £000
Valued at historic cost	-	-	3,900	74,200	3,420	-	81,520
Valued at Current Value in:							
31 March 2005	-	90,647	-	-	-	5,452	96,099
31 March 2004	15,345	-	-	-	-	-	15,345
Total	15,345	90,647	3,900	74,200	3,420	5,452	192,964

The authority is not aware of any material change in asset values since the last valuation.

The value of assets employed as at 31 March 2005 are analysed as follows:

2003/04		2004/05
£000		£000
112,123	General Fund	108,783
57,181	Harbour Fund	58,397
16,514	Housing Revenue Account	15,587
1,712	Statutory Trading Operations	1,863
7,252	Orkney College	7,607
638	Quarries	671
73	Waste Disposal	56
195,493	Total Assets Employed	192,964

1(b) Sources of Finance for Fixed Assets acquired

The following statement shows how capital expenditure in the year has been financed. The total of fixed asset expenditure in the year excluding Community Council assets should match the sum of the individual sources of finance.

2003/04		2004/05
£000		£000
6,172	Loans	6,468
477	Capital Receipts	4,425
4,222	Grant Receipts	3,247
7,605	CFCR	440
902	Other Income	-
19,378		14,580

1(c) Commitments under Capital Contracts

The following significant contracts for capital investment have been entered into by the Islands Council and extend beyond the 31 March 2005:

Project Name	Purpose	Approximate Value	Anticipated Completion
		£000	
Glaitness Primary School	Extension	1,491	Jun-2006
St Margarets Hope School	Healthy Living Centre	23	May-2005
Sanday School	Healthy Living Centre	162	Jul-2005
Sanday B9070	Road Improvements	239	Jun-2005
Scapa Pier	Improvements	209	May-2005
Kirkwall Harbour	Marina	958	Nov-2005

2. Deferred Charges

Deferred charges represent capital expenditure for which no tangible asset exists. As deferred charges do not reflect continuing benefit to the Islands Council they are amortised in full in the year the expenditure is incurred.

	Balance as at	Expenditure	Amortised	Balance as at
	01-Apr-04	in Year	in Year	31-Mar-05
	£000	£000	£000	£000
Improvement Grants	-	766	766	-
Other	-	-	-	-
Total	-	766	766	-

3. Long Term Debtors

Long Term Debtors include Housing Loans and Car Loans which are repayable to the Islands Council

2003/04		2004/05
£000		£000
400	Housing Loans	332
288	Car Loans	234
3,297	Harbours	3,537
103	Others	45

4,088

4,148

4. Stocks and Work in Progress

2003/04		2004/05
£000	Stocks	£000
138	General Fund	110
98	Quarries	89
190	Harbours	189
164	Orkney Direct	169
147	Vehicle Maintenance	142
737		699
	Work in Progress	
15	Orkney Direct	61

5. Debtors

Debtors are shown net of bad debt provision, and represents the net amount due to the Council as at 31 March 2005.

The Islands Council provides for any bad or doubtful debts at the end of each financial year, based on the age of debtors outstanding. At 31 March 2005 the Bad Debt Provision has increased from £952,000 to £972,000 being an increase of £20,000 on the year.

6. Loan Debt

Long Term : The Islands Council has no long term debt as at 31 March 2005.

Short Term:	2003/04	2004/05
	£000	£000
	2,052	961
	Bank Overdraft	

7. Investments

The investments shown in the Consolidated Balance Sheet consist of a number of individual funds, each valued at the lower of cost or market value. The following is a summary of the investments held by the Islands Council as at 31 March 2005:

Lower of Cost & Market Value	Market Value	Investments	Lower of Cost & Market Value	Market Value
2003/04	2003/04		2004/05	2004/05
£000	£000	Long Term	£000	£000
127,787	128,221	Bonds and Equities	120,237	124,461
11,998	11,998	Land and Buildings	14,116	14,116
672	672	Private Companies	1,172	1,172
348	348	Fishing Quota	447	447
14,265	14,265	Deposits	16,817	16,817
926	926	Miscellaneous	913	913
155,996	156,430		153,702	157,926
		Short Term		
5,450	5,450	Cash Deposits	9,064	9,064

The Islands Council has controlling interest in the following private limited companies:

2003/04	Orkney Towage Company Ltd	Weyland Farms Ltd	Orkney Ferries Ltd	Orkney Meat Ltd
Principal Activity	Tug Operation	Mixed Farming	Sea Transport	Meat Processing
Shares Held	75%	100%	100%	38%
	£000	£000	£000	£000
Investments Less Provision	1	510	-	61
Net Assets	210	141	31	1,109
Profit / (Loss) After Tax	(503)	16	-	56
Profit / (Loss) Before Tax	(503)	16	-	65
2002/03				
Net Assets	714	125	31	1,063
Profit / (Loss) After Tax	(228)	(27)	-	(3)
Profit / (Loss) Before Tax	(349)	(27)	-	(6)

The Profit or Loss after Tax is the figure shown in the latest set of audited accounts.

The appointed auditors for the above companies report that in their opinions the accounts give a true and fair view of the state of each company's affairs, and that no qualifications have been necessary.

No dividends were received from any of the above companies during the year.

The Islands Council has provided in full against a diminution in the value of its £7,498,999 investment in Orkney Ferries Limited.

At the 31 March 2005 the Islands Council's Reserve Fund loan to Weyland Farms Limited stood at £112,260, a increase of £20,000 on the year. The Loan Balance has been provided for in full. The Islands Council is committed to ensure an orderly winding up of the Company should it cease trading and will ensure that all bona fide creditors are paid in full.

The Council acquired 25% of the share capital in Orkney Towage Company Limited on 3rd November 2004, increasing its shareholding from 75% to 100%.

Copies of the companies' audited accounts are available for inspection from the Director of Finance.

8. Net Assets Employed

The value of net assets employed as at 31 March 2005 are analysed as follows:

2003/04		2004/05
£000		£000
84,947	General Fund	67,651
237,266	Harbour Fund	240,271
16,371	Housing Revenue Account	15,287
1,712	Statutory Trading Organisations	1,863
4,569	Orkney College	5,815
638	Quarries	670
73	Waste Disposal	56
345,576		331,613

9. Reserves

The following table provides a detailed analysis of the Reserves held by the Islands Council as at 31 March 2005:

	31/03/04	Movement	31/03/05
	£000	£000	£000
Capital Reserves			
Fixed Asset Restatement Account	113,787	-8,067	105,720
Capital Financing Account	5,952	2,731	8,683
Usable Capital Receipts	865	412	1,277
Government Grants Deferred	41,571	3,358	44,929
Capital Fund	1,551	401	1,952
	163,726	-1,165	162,561
Revenue Reserves			
General Fund Balances:			
General Fund	3,148	-1,264	1,884
Modernising Government Fund	191	-108	83
Corporate Development Fund	199	45	244
Modernising Teachers Fund	280	200	480
Community Council	175	1	176
Devolved School Management Fund	35	13	48
Orkney College	-591	-61	-652
	3,437	-1,174	2,263
Repairs and Renewals Funds:			
Replacement Ferries Fund	2,593	46	2,639
Plant & Vehicle Replacement Fund	4,934	-132	4,802
Repairs & Renewals Fund	642	64	706
	8,169	-22	8,147
Harbour Authority	180,918	2,954	183,872
Pension Reserve	-10,674	-14,556	-25,230
	181,850	-12,798	169,052
Total Reserves	345,576	-13,963	331,613

Description of Reserves

Capital

The Fixed Asset Restatement Account records any surpluses or deficits arising from the revaluation or disposal of fixed assets.

The Capital Financing Account records all the transactions relating to the financing of capital expenditure, such as Capital Receipts Applied, Capital Receipts Set Aside and Capital Financed from Current Revenue. It also records the difference between loans fund principal charges and the amount of depreciation provided for in the Consolidated Revenue Account.

The Usable Capital Receipts reserve records all capital receipts generated and applied to finance capital expenditure. The balance in this reserve is available to finance future capital expenditure.

Government Grants Deferred arise where the acquisition of a fixed asset is financed wholly or in part by a government grant, the amount of the grant should be credited to the government grants - deferred account, and written-off over the useful life of the asset matching the depreciation of the asset to which it relates. The balance of deferred grants carried forward has been written down in respect of assets no longer held by the Islands Council.

A Capital Fund is maintained in terms of Schedule 3 of the Local Government (Scotland) Act 1975.

Revenue

The General Fund balance represents the surplus on General Fund Services after crediting all income due and debiting the cost of providing the appropriate services, and after taking account of transfers from Reserves.

Modernising Government Fund represents ring fenced grant funding set aside in respect of the modernising government projects.

Corporate Development Fund represents general balances earmarked for corporate development priorities.

Modernising Teachers Fund represents general balances earmarked for the education service.

Community Councils Fund being the balance of the accumulated fund held on behalf of the Community Councils.

The Devolved School Management Fund represents the balance of the funds held on behalf of the schools under the Devolved School Management Scheme. The DSM funds are committed solely to the Education Service and are not available for use by other services.

The Orkney College deficit represents the balance of College losses.

The Harbour Fund represents the balance of accumulated funds generated on harbour operations and held by the Islands Council as a Harbour Authority.

The Pension Reserve recognises that a net pension liability exists in terms of the Islands Councils obligation to fund the employees defined benefits pension scheme.

Repairs and Renewals funds are maintained for the purpose of providing for the replacement of plant and vehicles on the General Fund of the Islands Council. In particular, funds in respect of general repairs and renewals, ferry replacement and plant and vehicle replacement.

10. European Single Currency

The Council is required to disclose certain information in connection with the possible entry to the European Single Currency.

As at 31 March 2005 no commitments in respect of costs associated with the Euro had been made, no exceptional expenditure had been incurred and it was not possible to forecast the total costs likely to be incurred.

11. Retirement Benefits

In accordance with the Financial Reporting Standard No.17 - Retirement Benefits (FRS 17), the Council is required to disclose certain information concerning assets, liabilities, income and expenditure related to the pension schemes for its employees. As explained in the Accounting Policies the Council participates in two formal schemes, the Local Government Superannuation Scheme, which is administered by the Orkney Islands Council Pension Fund and the Teachers Scheme. The Council is not required to record information related to the Teachers Scheme as the liability for payment of pensions rests ultimately with the Scottish Executive.

The Pension Fund assets attributable to the Orkney Islands Council are valued at fair value, principally market value for investments, and are analysed as follows:

As at 31 March 2004				As at 31 March 2005		
Total Pension Fund Assets	OIC Pension Assets	Expected Return		Total Pension Fund Assets	OIC Pension Assets	Expected Return
£000	£000	% p.a.		£000	£000	% p.a.
45,394	44,305	7.7	Equities	54,243	52,395	7.7
10,050	9,809	5.1	Bonds	11,764	11,363	4.8
-	0	6.5	Property	-	0	5.7
5,270	5,144	4.0	Cash	4,862	4,696	4.8
60,714	59,258	7.0	Total	70,869	68,454	7.0

The net pension liability attributable to the Orkney Islands Council are as follows:

As at 31 March 2004 £000	As at 31 March 2005 £000
59,258 Estimated Assets	68,454
64,219 Present Value of Scheme Liabilities	86,586
5,713 Present Value of Unfunded Liabilities	7,098
69,932 Total Value of Liabilities	93,684
(10,674) Net Pension Asset / (Liability)	(25,230)

Local government legislation provides that local authorities have an obligation to meet the expenditure of the Joint Boards where they are constituent members. As a consequence Orkney Islands Council has additional liabilities arising from the pension deficits of the following bodies:

Highlands and Islands Fire Joint Board
Northern Police Joint Board
Orkney and Shetland Valuation Joint Board

Further information regarding these deficits can be found in the annual report and accounts of the relevant bodies.

Liabilities are valued on an actuarial basis using the projected unit method which assesses the future liabilities of the fund discounted at their present value. The valuations are based on a valuation as of 31 March 2002 and updated for the following three years by Hyman's Robertson the independent actuaries to the Orkney Islands Council Pension Fund. The main assumptions used in the calculation are as follows:

2003/04 %		2004/05 %
2.9	Price Increases	2.9
4.4	Salary Increases	4.4
2.9	Pension Increases	2.9
6.5	Rate used to discount scheme liabilities	5.4

The actuarial valuation considers the appropriate employers rates and this together with the revenues generated from the investments will be utilised to meet the funds commitments.

In real terms, the discount rate for valuing liabilities has decreased significantly by 1.1% per annum to 5.4% for employers who prepare their accounts in accordance with CIPFA guidance. For accounting periods to 31 March 2005 CIPFA guidance adopted a real discount rate of 6.5% p.a. After this period the discount rate is derived from the yield on long-dated, high quality corporate bonds which as at 31 March 2005 was 5.4%. The effect of using this lower real discount rate of 5.4% p.a. is to significantly increase the fund liabilities by around 30%, which more than negates the higher than expected return in assets. Overall, this has resulted in an actuarial loss of £14.064M being projected as at March 2005.

The movement in the Councils pension fund liability during the year is as follows:

2003/04	2004/05
£000	£000
(20,436) Surplus/(Deficit) at beginning of year	(10,674)
(2,450) Current Service Cost	(3,917)
2,761 Employer Contributions	3,388
479 Contributions in respect of Unfunded Benefits	572
0 Other Income	0
0 Other Outgoings (e.g. expenses etc.)	0
(309) Past service costs	(802)
0 Impact of settlements and curtailments	0
(1,069) Net return on assets	267
10,350 Actuarial gains/(losses)	(14,064)
(10,674) Surplus/(deficit) at end of year	(25,230)

The following is a history of the gains and losses:

2003/04	2004/05
£000	£000
10,385 Difference between the expected and actual return on assets	2,628
59,258 Value of assets	68,454
17.5% Percentage of assets	3.8%
(35) Experience gains/(losses) on liabilities	(182)
69,933 Present value of liabilities	93,684
(0.1%) Percentage of the present value of liabilities	(0.2%)
10,350 Actuarial gains/(losses)	(14,064)
69,933 Present value of liabilities	93,684
14.8% Percentage of the present value of liabilities	(15.0%)

Additional disclosures in respect of Pensions are included in the notes to the Consolidated Revenue Account and the Statement of Total Movements in Reserves

For further information on the Orkney Islands Council Pension Fund see pages 36-39.

12. Single Status

The Islands Council is in the process of carrying out a job evaluation exercise as part of Single Status. This exercise may result in a future liability being identified for the Islands Council, however at this stage it is not possible to estimate the likely amount.

STATEMENT OF TOTAL MOVEMENT IN RESERVES

This statement represents a summary of all gains and losses for the Authority during the financial year, and identifies those which have been recognised in the Consolidated Revenue Account. The statement further separates the movements between revenue and capital reserves.

2003/04		2004/05
£000		£000
	Surplus/(Deficit) for year	
996	General Fund	(1,174)
-	Housing Revenue Account	-
9,097	Add back Movements on specific revenue reserves	2,932
(588)	Deduct Appropriation from pensions reserve	(492)
10,350	Actuarial gains and (losses) relating to pensions	(14,064)
19,855	Total Increase / (Decrease) in revenue resources	(12,798)
136	Increase / (Decrease) in useable capital receipts	412
-	Increase / (Decrease) in unapplied capital grants and contributions	-
136	Total Increase / (Decrease) in realised capital resources (note 1)	412
(1,116)	Gains / (Losses) on revaluation of fixed assets	(3,699)
	Impairment losses on fixed assets due to	
-	- general changes in prices	-
(1,116)	Total Increase / (Decrease) in unrealised value of fixed assets (note 2)	(3,699)
(1,110)	Value of assets sold, disposed of or decommissioned (note 3)	(4,368)
1,942	Capital receipt set aside	5,548
1,657	Revenue resources set aside	(2,817)
2,432	Movement on Government Grants Deferred	3,358
6,031	Total Increase / (Decrease) in amounts set aside to finance capital investment (note 4)	6,089
	Specific Capital Reserves	
25	Capital Fund - Movement	401
23,821	Total recognised gains and losses	(13,963)

Notes to the Statement of Total Movements in Reserves

1. Movements in realised capital resources

Usable Capital Receipts 2003/04 £000		Usable Capital Receipts 2004/05 £000
948	Amounts receivable in 2004/05	1,236
(812)	Amounts applied to finance new capital investments in 2004/05	(824)
136	Total increase / (Decrease) in realised capital resources in 2004/05	412
729	Balance brought forward at 1 April 2004	865
865	Balance carried forward at 31 March 2005	1,277

2. Movements in unrealised value of fixed assets

Fixed asset restatement account 2003/04 £000		Fixed asset restatement account 2004/05 £000
(1,116)	Gains / (losses) on revaluation of fixed assets in 2003/04	(3,699)
-	Impairment losses on fixed assets due to general changes - in prices 2003/04	-
(1,116)	Total increase / (decrease) in unrealised value of fixed assets	(3,699)

3. Value of assets sold, disposed of or decommissioned

2003/04 £000		2004/05 £000
(1,110)	Amounts written off fixed asset balances for disposals in 2004/05	(4,368)
(2,226)	Total movement on reserve in 2004/05	(8,067)
116,013	Balance brought forward at 1 April 2004	113,787
113,787	Balance carried forward at 31 March 2005	105,720

4. Movements in amounts set aside to finance capital investment

2003/04 £000		Capital Financing Account £000	Gov't Grants Deferred £000	Total 2004/05 £000
	Capital receipts set aside in 2004/05			
1,703	- reserved receipts	5,548		
239	- useable receipts applied	-		
1,942	Total capital receipts set aside in 2004/05	5,548		5,548
	Revenue resources set aside in 2004/05			
6,915	- capital expenditure financed from revenue	440		
(5,258)	- reconciling amount for provisions for loan repayment	(3,257)		
1,657	Total revenue resources set aside in 2004/05	(2,817)		(2,817)
3,837	Grants applied to capital investment in 2004/05		4,849	
(1,405)	Amounts credited to the asset management revenue account		(1,491)	
2,432	Movement on Government Grants Deferred		3,358	3,358
6,031	Total Increase / (Decrease) in amounts set aside to finance capital investments			6,089
	Total movement on reserve in 2004/05	2,731	3,358	
	Balance brought forward at 1 April 2004	5,952	41,571	
	Balance carried forward at 31 March 2005	8,683	44,929	

5. Analysis of actuarial gains and losses recognised in the Pension Reserve

2003/04 £000		2004/05 £000
10,385	Actual Return less expected return on pension scheme assets	2,628
(35)	Experience gains and losses arising on scheme liabilities	(182)
	- Changes in financial assumptions underlying the present value of scheme liabilities	(16,510)
(18,016)	Actuarial gain/(loss) in pension plan	(14,064)

**CASH FLOW STATEMENT FOR THE
YEAR ENDED 31 MARCH 2005**

2003/04		£000	2004/05
£000		£000	£000
	Revenue Activities		
	Cash Outflows		
43,963	Cash paid to and on behalf of Employees	47,960	
16,092	Other Operating Payments	14,449	
439	Housing Benefit Payments	1,109	
6,807	NDR Payments to Pool	6,719	
1,581	Precepts Paid	1,581	
68,882	Total Payments	71,818	
	Cash Inflows		
744	Rents (after Rebate)	782	
7,236	Council Tax Income	8,232	
1	Community Charge Income	-	
6,848	NDR Receipts from Pool	7,205	
6,422	Non Domestic Rates receipts	6,692	
40,996	Revenue Support Grant	43,682	
2,539	DWP Grant for Benefits	2,819	
4,555	Other Government Grants	6,051	
4,458	Cash received for Goods and Services	456	
73,799	Total Receipts	75,919	
4,917	Net Cash Inflows from Revenue Activities		4,101
	Returns on Investments and Servicing of Finance		
	Cash Outflows		
153	Interest Paid	218	
153	Total Payments	218	
	Cash Inflows		
271	Interest Received	253	
271	Total Receipts	253	
118	Net Cash Inflow from Investments and Servicing of Finance		35
	Capital Activities		
	Cash Outflows		
18,186	Purchase of Fixed Assets	14,109	
2,365	Purchase of Long Term Investments	2,175	
1,502	Other Capital Payments	1,522	
22,053	Total Payments	17,806	
	Cash Inflows		
948	Sale of Fixed Assets	1,236	
5,785	Capital Grants received	5,494	
122	Sale of Long Term Investments	12,057	
1,519	Other Capital Receipts	2,221	
8,374	Total Receipts	21,008	
(13,679)	Net Cash Outflow from Capital Activities		3,202
(8,644)	Net Cash Outflow before Financing		7,338
	Management of Liquid Resources		
6,262	Net (Increase)/Decrease in Short Term Deposits		(3,614)
	Management of Financing		
	Cash Outflows		
1,971	Repayments of Amounts Borrowed	2,633	
1,971		2,633	
	Cash Inflows		
-	New Loans raised	-	
(1,971)	Net Cash Outflow from Financing		(2,633)
(411)	Increase / (Decrease) in Cash		1,091

Notes to the Cashflow Statement

1. Reconciliation of Operating Surplus to net cash inflow from Revenue Activities

2003/04 £000		2004/05 £000
7,926	Operating Surplus	1,780
	Non Cash Transactions	
3,092	Contributions to Reserves	3,778
(15,288)	Adjustments not Involving the Movement of Funds	(8,942)
9,055	Contributions to Capital	4,744
54	Increase/(Decrease) in Bad Debt Provision	20
4,839		1,380
	Items on an Accruals Basis	
40	(Increase)/Decrease in Stock and Work in Progress	(8)
(19)	(Increase)/Decrease in Debtors	369
57	Increase/(Decrease) in Creditors	2,360
78		2,721
4,917	Cash Inflow from Revenue Activities	4,101

2. Movement in Cash

2003/04 £000		31-Mar-05 £000	31-Mar-04 £000	Movement £000
(411)	Bank Overdraft	(961)	(2,052)	1,091
-	Cash	7	7	-
(411)	Increase / (Decrease) in Cash	(954)	(2,045)	1,091

3. Reconciliation of Liquid Resources

2003/04 £000		31-Mar-05 £000	31-Mar-04 £000	Movement £000
(6,262)	Temporary Lending	9,064	5,450	3,614

4. Reconciliation of Financing

2003/04 £000		31-Mar-05 £000	31-Mar-04 £000	Movement £000
(1,971)	Revenue Advances from Common Good, Charities & Pension Fund	(3,465)	(6,098)	2,633

5. Analysis of Government Grants

2003/04 £000		2004/05 £000
	Grants Received	
91	Teacher Training	106
364	Other Education Grants	480
618	National Priorities Action Fund	732
49	Social Inclusion Partnership	-
266	Other Miscellaneous Grants	136
912	Community Social Services - Specific Training	1,011
133	Mental Illness Specific Grant	133
354	Offender Services	331
1,295	Scottish Funding Council for Further Education	2,552
473	Transportation - Rural Initiative	570
4,555	Total	6,051

PENSION FUND ACCOUNT

The Orkney Islands Council Pension Fund is constituted under the various Local Government Pension Fund Acts and related regulations and provides pension benefits to all local government employees, excluding principally teachers, of Orkney Islands Council, together with 13 other organisations of a statutory and voluntary nature which have been accepted into the fund as admitted bodies. The members of the fund increased from 1,391 employees at 31 March 2004 to 1,586 employees at 31 March 2005 and the number of pension payments increased from 384 at 31 March 2004 to 414 at 31 March 2005.

The Fund is built up from contributions from both employees and employing bodies, together with interest and dividends from investments, out of which pensions and other benefits are paid.

The monies belonging to the Pension Fund are entirely managed by appointed Investment Fund managers and are held separately from any of the employing bodies which participate in the Pension Fund. After meeting the cost of current benefits, all surplus cash income is invested and the increasing value of investment is then available to meet future liabilities to employees within the Fund. In addition to a contingent liability to meet future pension benefits payable to existing employees, the funds must also provide for the future payment of deferred pension benefits which have been preserved by former employees in respect of service prior to their leaving.

Employees contributions are fixed by statute, with employers contributions being assessed every three years by an independent Actuary to determine the level of contribution necessary by employing bodies to ensure that the fund is able to meet all future benefits. The standard employee contribution rate is 6% with some manual workers retaining the right to pay 5%. Following completion of the 2002 Actuarial valuation, the employers rate will see the implementation of a stepped increase in contribution rates for a period of three years commencing in 2003 at 250%. Rising to 275% in 2004 and 295% in 2005.

The funds have been invested in accordance with the investment controls laid down in the Local Government Pension (Scotland) Regulations 1989 and quoted investments of the fund have been revalued to market value at 31 March 2005 with the gain on revaluation being credited to the fund.

PENSION FUND ACCOUNT

2003/04	FUND ACCOUNT	2004/05
£000		£000
	Contributions Receivable	
1,350	Employees Contributions	1,495
3,240	Employer Contributions	3,951
1,562	Transfer Values	969
52	Contributions from Services (Pension Increases)	22
6,204		6,437
	Benefits Payable	
	Pension Benefits:	
1,702	Retirement Pensions	1,884
355	Retirement Allowances	535
37	Death Gratuities	61
14	Refund of Contributions	19
713	Transfer Values	407
9	Equivalent Payment Contributions	7
118	Fund Administration	133
2,948		3,046
3,256	Net Additions from Dealings with Members	3,391
	Returns on Investments	
1,631	Investment Income	1,969
	Gain in Market Value of Investments:	
(1,006)	Realised	108
10,102	Unrealised	4,874
(142)	Investment Management Expenses	(187)
10,585	Net Return on Investments	6,764
13,841	Net Increase in Fund during year	10,155
46,873	Opening Net Assets of Fund	60,714
60,714	Closing Net Assets of Fund	70,869
	Net Assets Statement (as at 31 March)	
	Investment Assets	
5,560	Fixed Interest - Public Sector	7,404
2,053	Fixed Interest - Overseas	1,762
27,306	Equities - UK	33,416
18,088	Equities - Overseas	20,827
2,219	Index Linked - UK	2,311
218	Index Linked - Overseas	287
1,181	Funds held by Investment Managers - Other (Cash)	3,407
56,625		69,414
	Current Assets	
22	Sundry Debtors	-
4,184	Loans Fund Deposit	1,513
	Less Current Liabilities	
117	Sundry Creditors	58
4,089	Net Current Assets	1,455
60,714	Net Assets	70,869
	Financed by:	
60,714	Accumulated Fund	70,869

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 Director of Finance
 29 June 2005

Notes to the Pension Fund Account

1. Actuarial Valuation Reports

Actuarial report was provided in 2003 after undertaking valuations on the fund as at 31 March 2002. Information from this actuarial valuation is undernoted:

(a) Market value of assets at valuation £57,156,000.

(b) Members Contributions

Officers	6.0%
Manual Workers before 01/04/98	5.0%
Manual Workers after 01/04/98	6.0%

(c) Employers contributions as a percentage of employees contributions

1 April 2003	250%
1 April 2004	275%
1 April 2005	295%

(d) Valuation assumptions:

Investment Return:	
Equities	6.65%
Bonds	5.20%
Pay Increases	4.10%
Price Inflation / Pension Increases	2.60%
Rate used to discount scheme liabilities	6.30%

(e) The Projected Unit method was used for the valuation of the fund

(f) The level of funding in terms of the percentage of assets available to meet liabilities was 96%

2. Investment Assets

(a) The undernoted table identifies for the market value of the assets for the Orkney Islands Council Pension Fund, the value and proportion which are under the management of the fund managers.

2003/04			2004/05	
£000	%		£000	%
56,625	93.27	Baillie Gifford and Company	69,414	97.95
4,184	6.89	Loans Fund Deposit	1,513	2.13
(95)	(0.16)	Sundry Debtors less Creditors	(58)	(0.08)
60,714	100.00		70,869	100.00

A copy of the Statement of Investment Principles is available from the Director of Finance.

(b) Details of the investment assets between UK or Foreign, and listed or unlisted are set out below:

2003/04			2004/05	
£000			£000	
35,085	UK	Listed	43,131	
-		Unlisted	-	
20,359	Foreign	Listed	22,876	
-		Unlisted		
55,444			66,007	

3. Purchases and Sales

The value for respective purchases and sales for the pension fund are as follows:

2003/04			2004/05	
£000			£000	
16,822	Purchases		29,223	
13,744	Sales		23,419	

4. Contributions Receivable and Payable

An analysis is provided below for the Orkney Islands Council Pension Fund of contributions receivable and payable between the administering authority and admitted bodies.

Contributions Receivable		Contributions Payable		Contributions Receivable		Contributions Payable	
2003/04		2003/04		2004/05		2004/05	
£000		£000		£000		£000	
3,936		2,021	Administering Authority	4,670		2,345	
654		73	Admitted Bodies	776		135	
4,590		2,094		5,446		2,480	

5. Investment Sub Committee

The Orkney Islands Council carries out its administration functions through its Investment Sub Committee which comprises the Convener S Hagan, Vice Convener S Scott, Councillor A K Johnson, Councillor M Drever and Councillor R Sclater.

6. Admitted Bodies

The list of bodies admitted to the fund is as follows:

- Orkney Tourist Board
- Orkney Heritage Society
- Orkney Towage Company Limited
- Weyland Farms Limited
- Orkney Meat Limited
- Orkney Ferries Limited
- Orkney Enterprise
- Drinkwise Orkney
- Orkney Islands Property Development Limited
- Pickaquoy Centre Trust
- Orkney Opportunities Centre
- Orkney & Shetland Joint Valuation Committee
- D & H Glue

CHARITY, TRUST AND COMMON GOOD FUNDS

The Islands Council as the sole Trustee administers a number of educational, social welfare and miscellaneous trusts. Income from the trusts is used to provide educational grants and prizes, comforts for residents in Islands Council homes for the elderly and handicapped and various community facilities.

2003/04	Expenditure	Income	2004/05
Net	£000	£000	Net
£000	£000	£000	£000
2 Educational Trust	3	3	-
(46) Education Bequests	13	20	(7)
(28) Social Bequests	31	48	(17)
(1) Miscellaneous	-	3	(3)
- Sheriff Thom's Bequest	1	1	-
(16) Common Good Fund	40	43	(3)
(3) Cathedral Promotion Fund	-	4	(4)
- Cathedral Fabric Fund	-	5	(5)
(92)	88	127	(39)
31-Mar-04 Balance Sheet			
£000			31-Mar-05
			£000
Investments			
15 Listed Securities			16
29 Property			29
44			45
149 Capital Deposits			149
193 Total Long Term Assets			194
Current Assets			
1,765 Loan Fund Deposit			1,803
- Less Current Liabilities			-
1,765 Net Current Assets			1,803
1,958 Net Assets			1,997
Financed by:			
64 Educational Trusts			64
330 Education Bequests			337
799 Social Bequests			816
89 Miscellaneous Trusts			92
447 Common Good Funds			450
6 Cathedral Promotion Fund			10
52 Cathedral Fabric Fund			57
22 Sheriff Thom's Bequest			22
149 Unapplied Capital Receipts			149
1,958			1,997

A TAIT, C.P.F.A., F.C.C.A.
Director of Finance
29 June 2005

STATEMENT ON THE SYSTEM OF INTERNAL FINANCIAL CONTROL

- 1 This statement is given in respect of the Statement of Accounts for Orkney Islands Council. We acknowledge our responsibility for ensuring that an effective system of internal financial control is maintained and operated in connection with the resources concerned.
- 2 The system of internal financial control can provide only reasonable and not absolute assurance that assets are safeguarded, that transactions are authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.
- 3 The system of internal financial control is based on a framework of regular management information, financial regulations, administrative procedures (including segregation of duties) management supervision, and a system of delegation and accountability. Development and maintenance of the system is undertaken by managers within the Council. In particular, the system includes:
 - comprehensive budgeting systems;
 - regular reviews of periodic and annual financial reports which indicate financial performance against the forecasts;
 - setting targets to measure financial and other performance;
 - the preparation of regular financial reports which indicate actual expenditure against the forecasts;
 - clearly-defined capital expenditure guidelines;
 - as appropriate, formal project management disciplines; and
 - best value review processes incorporating the preparation and implementation of service improvement plans.
- 4 Internal Audit is an independent appraisal function established by the Council for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.

The internal audit section reports directly to the Director of Finance and Housing. The section operates in accordance with the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom.

The council also has a Monitoring and Audit Committee who are responsible for ensuring that arrangements are in place to secure proper stewardship of the Council's resources, including the arrangements for internal audit and financial control.

The internal audit work plan, which is based on an audit needs assessment and a risk exposure analysis, is prepared following consultation across all departments and outlines the three year strategy to be adopted by the internal audit section in undertaking audit inspections. The plan is approved by the Monitoring and Audit Committee.

Audit reports are produced following the completion of each audit, which outline any system weaknesses identified, and/or non compliance with expected controls. These reports are presented to the Monitoring and Audit Committee to enable the committee to monitor the implementation of any audit recommendations made. Managers agree action to be taken following audits to correct any weaknesses identified in the system of internal control.

On the basis of information gained over the period from internal and external audit reports, the Director of Finance and Housing and the Council therefore have a better understanding of the adequacy and effectiveness of the system of internal financial control.

5 Our review of the effectiveness of the system of internal financial control is informed by:

- the work of managers within the Council;
- the best value review process;
- the work of the internal auditors as described above; and
- the external auditors in their annual audit letter and other reports.

6 The Council's external auditors have carried out a review of the Council's internal audit arrangements. The report findings conclude that although the Council has made progress in a number of areas, its internal audit arrangements are still weak, whereby the service scored 70% compliance with good practice across a range of indicators.

The main concerns arising from the report relate to the staffing of the section, whereby the external auditors are of the opinion that the service remains understaffed.

In conjunction with the developing remit of the Monitoring and Audit Committee the staffing resource of the internal audit function will continue to be kept under review by the Council.

The internal audit section are making progress in implementing the other improvement actions which were made following the external audit review. The service should therefore have achieved a greater percentage of compliance with the Code of Practice for Internal Audit in Local Government, when the external auditors carry out their next review of progress.

During the financial year, external audit reports were received in respect of Housing Benefits System and the Council Tax System. The Auditor identified specific concerns with both systems, which are or have been addressed, but in both cases reported that "in general, satisfactory controls are in place over the system". An update external audit report on Cash Income and Banking was also received during the year. This report highlighted that progress had been made on a number of previous audit recommendations and also noted some additional audit concerns. Action has been taken in respect of the concerns raised.

In the Statement of Internal Financial Control for 2003/04, I commented that action needed to be progressed in relation to corporate governance issues. There are still actions that require to be completed, however progress has been made with the adoption of a Local Code of Corporate Governance in September 2004.

A comprehensive revision of the Council's Financial and Contract regulations has taken place during the year. Proposals for amendment were widely consulted upon and recommended changes reported to the Finance and General Purposes Committee on 21 June 2005. An Anti Fraud Policy, an Anti Fraud and Corruption Strategy and a Fraud and Corruption Response Plan setting out detailed procedures and operation guidelines are included in the Revised Financial Regulations. The revised Financial and Contract Regulations will be made available on the Council's intranet.

The Code of Guidance on Funding External Bodies and following the Public Pound has been reproduced as an Appendix to the revised Financial and Contract Regulations. A register of all significant sums paid by way of grant assistance has been established and has been reported to the Council in accordance with the "Following the Public Pound" guidance.

A review carried out by external audit as follow up audits on the main accounting and budgetary control systems have highlighted a number of weaknesses in the system of internal controls that remain outstanding, having previously been included as part of approved action plans.

The successful completion of these action plans have been delayed in part due to the adoption of budget preparation arrangements aimed at integrating the strategic and service planning processes within the Council more fully. Further improvements have also been made to the capital project appraisal process.

The Accountancy function is committed to the development of budgetary control procedures during 2005/06, through in particular the adoption of a Budget Manual together with the provision of support and training to budget holders. Taken together these developments should address the concerns raised within the audit report.

External audits of the Pension and Payroll functions have identified a number of weaknesses in internal controls systems relating primarily to the lack of adequate segregation of duties and written procedural instructions within these areas. In response to this an action plan has been agreed to address the weaknesses identified and to improve the system of internal control.

The implementation of the action plan during 2004/05 has however been delayed due to a number of staffing related issues, and as a result, a further restructure of the Payments and Pensions function within the Council is currently being undertaken.

During the past year, the Council's internal auditors carried out an audit of the Creditors function within the Finance Division. As part of their findings they concluded that while effective procedures were in place within the payments function, some concerns were expressed at the controls in place within the Service Departments for the ordering and receipt of goods. Again, an action plan has been agreed to address these weaknesses.

A TAIT, C.P.F.A., F.C.C.A.
Director of Finance
29 June 2005

THE STATEMENT OF RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

The Authority's Responsibilities

The authority is required:

to make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the Director of Finance.

to manage its affairs to secure economic, efficient and effective use of resources and safeguard its assets.

The Director of Finance's Responsibilities

The Director of Finance is responsible for the preparation of the authority's statement of accounts which, in terms of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom ("the Code of Practice"), is required to present fairly the financial position of the authority at the accounting date and its income and expenditure for the year ended 31 March 2005.

In preparing this statement of accounts, the Director of Finance has:

selected suitable accounting policies and then applied them consistently;

made judgements and estimates that were reasonable and prudent;

complied with the Code of Practice.

The Director of Finance has also:

kept proper accounting records which were up to date;

taken reasonable steps for the prevention and detection of fraud and other irregularities.

I confirm that this Statement of Accounts presents fairly the financial position of the Authority at the accounting date and its income and expenditure for the year ended 31 March 2005.

**A TAIT, C.P.F.A., F.C.C.A.
Director of Finance
29 June 2005**

INDEPENDENT AUDITOR'S REPORT

To the members of Orkney Islands Council and the Accounts Commission for Scotland

I certify that I have audited the financial statements on pages 5 to 40 under the Local Government (Scotland) Act 1973. The financial statements have been prepared in accordance with the accounting policies set out on pages 5 to 8.

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and the Code of Audit Practice approved by the Accounts Commission and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by Audit Scotland, dated July 2001.

Respective responsibilities of the Director of Finance and Auditor

As described on page 44 the Director of Finance of the Council is responsible for the preparation of the financial statements in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom, a Statement of Recommended Practice ('the SORP'). My responsibilities, as independent auditor, are established by statute and the Code of Audit Practice approved by the Accounts Commission, and guided by the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements present fairly the financial position of the Council at 31 March 2005 and its income and expenditure for the year. I also report if, in my opinion, the Council has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I review whether the Statement on the System of Internal Financial Control on pages 41 to 43 complies with the requirements of the SORP. I report if, in my opinion, the statement does not comply with the requirements or if it is misleading or inconsistent with other information I am aware of from my audit. I am not required to consider whether the statement covers all risks and controls, or form an opinion on the effectiveness of the Council's corporate governance procedures or risk and control procedures.

I read the other information published with the financial statements and consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

I conducted my audit in accordance with Part VII of the Local Government (Scotland) Act 1973 and the Code of Audit Practice, which requires compliance with relevant United Kingdom Auditing Standards issued by the Auditing Practices Board.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Director of Finance in the preparation of the financial statements and of whether the accounting policies are appropriate to the Council's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion, I also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion the financial statements present fairly the financial position of the Council as at 31 March 2005 and its income and expenditure for the year then ended.

Fiona Kordiak CPFA, Assistant Director
Audit Scotland – Audit Services
Osborne House, 1/5 Osborne Terrace

20 September 2005

Edinburgh EH12 5HG