



# Orkney Islands Council

2015/16 Annual audit  
report to Members and  
the Controller of Audit

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## Key contacts

Stephen Boyle, Assistant Director  
[SBoyle@audit-scotland.gov.uk](mailto:SBoyle@audit-scotland.gov.uk)

Michael Oliphant, Senior Audit Manager  
[MOliphant@audit-scotland.gov.uk](mailto:MOliphant@audit-scotland.gov.uk)

Grietje Menger, Senior Auditor  
[GMenger@audit-scotland.gov.uk](mailto:GMenger@audit-scotland.gov.uk)

Audit Scotland  
4<sup>th</sup> Floor (South Suite)  
8 Nelson Mandela Place  
Glasgow  
G2 1BT  
Telephone: 0131 625 1500  
Website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)

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

Stephen Boyle is the engagement lead for the audit 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.

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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# Key messages

## Audit of 2015/16 financial statements

- We have completed our audit of the 2015/16 financial statements of Orkney Islands Council, its group and Orkney Islands Council General Charitable Trust and have issued an unqualified independent auditor's report.
- We received the unaudited financial statements on 29 June 2016, in accordance with the agreed timetable. The supporting working papers were of a good standard and council staff provided good support to the audit team which assisted the delivery of the audit to deadline.

## Financial management and sustainability

- We conclude that the council's financial management arrangements are broadly satisfactory. However, it needs to improve the financial management of its capital programme arrangements in order to improve its overall financial management.
- The financial results of Orkney College remain poor, with a deficit of £0.49 million reported for 2015/16. The college, together with the council need to take steps to arrest ongoing deficits in order to secure its financial sustainability. We have recommended that a framework agreement is established that sets out the council's financial commitment to the college.
- The council continues to hold substantial levels of reserves largely due to the strength of its Strategic Reserve Fund. This provides the council with a relatively strong longer-term financial position compared with many other councils in Scotland. Nevertheless, with rising demand for council services, increasing costs and further budget reductions expected, it is essential that the council has an effective long-term financial plan in place.
- The council's Change Programme aims to deliver significant savings towards the funding gap of £9.5 million identified over financial years 2016/17 to 2019/20. To date, detailed proposals about how this target will be achieved remain outstanding. The success of the Change Programme is fundamental to how the council is able to respond to the financial challenges over the next few years.

## Governance, transparency and Best Value

- The council's current governance arrangements provide an appropriate framework for decision making. The integration of health and social care services provides the opportunity for the council to revise its governance and scrutiny arrangements for social care in conjunction with the new Orkney Integration Joint Board.
- Arrangements for the prevention and detection of fraud and corruption in the council are satisfactory. The council conducts its business in an open and transparent manner.
- The Accounts Commission's new approach to Best Value will be rolled out in October 2016. The Controller of Audit is planning to provide the Accounts Commission with a Best Value Assurance Report on the council during 2017/18.



### Outlook

- The next few years will see significant changes in how public services are delivered in Scotland. Councils will continue to face rising costs and demand for their services at the same time as budgets and funding allocations are expected to reduce. Major reforms in welfare and health and social care will continue to be challenging to deliver and will require strong governance and leadership, as well as effective partnership working across the public sector to ensure continuous improvement.
- The council will need to take tough decisions over the next few years in light of these challenges. Success in meeting these challenges will depend on the council's approach to long-term planning in finance, workforce, capital investment and asset management. These areas have a significant role in delivering the required savings identified in the council's Change Programme. Developing longer-term plans and objectives will help set a clear framework to support the challenging decisions facing the council.

# Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Orkney Islands Council (the council).

## Our annual audit report

2. Our report is divided into the following sections which reflect our public sector audit model. These are:
  - Audit of the 2015/16 financial statements
  - Financial management and sustainability
  - Governance and transparency
  - Best value
3. [Appendix I](#) highlights significant audit risks that we identified in the annual audit plan issued in March 2016. In addition a number of reports, both local and national, were issued by Audit Scotland during the course of the year. These reports summarised at [appendix II](#) and [appendix III](#), include recommendations for improvements. [Appendix IV](#) is an action plan setting out our recommendations to address the high-level risks we identified during the course of the audit.
4. 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.
5. 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 although it is important the council understands its risks and has arrangements in place to manage these. 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.
  6. Our report includes 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.

## Our appointment as external auditors

7. Our responsibility, as external auditors 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.
8. 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. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

9. This is the final year of the current five-year audit appointment. From 2016/17, Audit Scotland will continue as external auditors of the council although the appointed auditor and audit team will change. In accordance with agreed protocols and International Standards on Auditing we will liaise closely with the new audit team as part of this transition.

## Outlook

10. The next few years will see significant changes in how public services are delivered in Scotland. Councils will continue to face rising costs and demand for their services at the same time as budgets and funding allocations are expected to reduce. Major reforms in welfare and health and social care will continue to be challenging to deliver and will require strong governance and leadership, as well as effective partnership working across the public sector to ensure continuous improvement.
11. Orkney Islands Council will need to take tough decisions over the next few years in light of these challenges. The 2016/17 financial settlement reduction for the council was significantly greater than the 'worst' case scenario outlined in their medium-term financial strategy. This, combined with a previously identified savings requirement of £9.5 million to 2019/20, means there is increasing

pressure on the council to take decisive action to ensure the long-term sustainability of its finances and service delivery. The council's current financial position is eased by sizeable reserves but there is a need for a revised and extended long-term financial plan to outline how it will prioritise its resources to meet these challenges.

12. Success in meeting these challenges will depend on the council's approach to long-term planning, not only in finance, but in other key areas such as workforce, capital investment and asset management. These areas will have a significant role in delivering the required savings identified in the council's Change Programme. Developing and understanding longer-term plans and objectives will help set a clear framework to support challenging decisions facing the council.

# Audit of the 2015/16 financial statements

<p><b>Audit opinion</b></p>	<ul style="list-style-type: none"> <li>We have completed our audit of the council and its group and issued an unqualified independent auditor's report.</li> </ul>
<p><b>Going concern</b></p>	<ul style="list-style-type: none"> <li>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's, its group and associated charitable trusts' ability to continue as a going concern.</li> </ul>
<p><b>Other information</b></p>	<ul style="list-style-type: none"> <li>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.</li> </ul>
<p><b>Charitable trusts</b></p>	<ul style="list-style-type: none"> <li>We have completed our audit of the 2015/16 financial statements of Orkney Islands Council General Charitable Trust administered by the council and issued an unqualified independent auditor's report.</li> </ul>
<p><b>Group accounts</b></p>	<ul style="list-style-type: none"> <li>The council has accounted for the financial results of three subsidiaries and one associate in its group accounts for 2015/16. The effect of consolidating these balances on the group balance sheet is a decrease in reserves of £1.5 million.</li> </ul>

## Submission of financial statements for audit

13. We received the unaudited financial statements on 29 June 2016, in accordance with the agreed timetable. The supporting working papers were of a good standard and council staff provided good support to the audit team which assisted the delivery of the audit to deadline.
14. In 2015/16, for the first time, local government group accounts are required to include the financial results of Integration Joint Boards (IJBs) in their area, where material. The Orkney IJB was established on 6 February 2016 and did not become operational until 1 April 2016. Due to the low levels of IJB income and expenditure in 2015/16 for the period 6 February to 31 March 2016, there was no material effect on the group accounts.
15. On 17 June 2016, the council published the public inspection notice of the draft accounts in line with regulations. However, reference was made to the incorrect regulations. The correct reference should have been to the Local Authority Accounts (Scotland) Regulations 2014, and not 1985 as presented.

## Overview of the scope of the audit of the financial statements

16. 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 24 March 2016.

17. 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 2015/16, as set out in our Annual Audit Plan, remains unchanged.
18. 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 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.
19. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the statements are free from material misstatement, whether caused by fraud or error.

## Materiality

20. 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).

21. 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.
22. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of the council Orkney Islands Council we set our planning materiality for 2015/16 at £1.16 million (one per cent of gross expenditure). We report all misstatements greater than £0.06 million. Performance materiality was calculated at £0.58 million, to reduce to an acceptable level the probability of uncorrected and undetected audit differences exceeding our planning materiality level.
23. In our Annual Audit Plan we set a separate materiality level of £950 for the audit of Orkney Islands Council General Charitable Trust.
24. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our original calculation remained appropriate.

## Evaluation of misstatements

25. All misstatements identified during the audit, which exceeded our misstatement threshold, have been amended in the financial statements.
26. 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 £0.034 million and to increase group net assets by £3.093 million. The latter was due mainly to an adjustment required to remove a creditor within the Group accounts relating to funds due to the council by Orkney Towage Limited. Intra-group balances should be eliminated in the preparation of Group accounts.

## Significant findings from the audit

27. 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.
28. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

**Table 1: Significant findings from the audit**

Significant findings from the audit in accordance with ISA260
<p><b>Available for sale financial instruments</b></p> <p>The investment portfolio held as part of the Harbour Accounts and shown as short-term investments in the balance sheet was classed as ‘fair value through profit and loss’. The treatment of such assets means that the increase or decrease in market values of the assets are shown as a gain or loss in the Comprehensive Income and Expenditure Statement. During the audit, we found that a number of investments, in particular the investment in fishing quota and in Hammars Hill Energy Limited do not meet the Code’s definition of ‘fair value through profit and loss’. These financial instruments are long-term investments and therefore any gains in value should not be shown in the Comprehensive Income and Expenditure Statement. Instead they should be added to an ‘Available for Sale financial instruments’ reserve. This reserve will be debited in future when losses on the value of the investments are incurred, or when the investments are sold with any profits taken reflected in the Income and Expenditure Statement.</p> <p><b>Resolution:</b> Council officers agreed to adjust the accounts to reflect the appropriate classification of these assets. The impact in the accounts is a decrease in usable reserves of £2.37 million with a matching increase in unusable reserves. There is also a decrease in financing and investment income of £0.061 million to correct the gain shown in the Comprehensive Income and Expenditure Account for 2015/16. Prior year figures were also adjusted for comparison purposes.</p>
<p><b>Strynd Houses and Common Room</b></p> <p>In reviewing a sample of title deeds for property assets, we found that the council does not hold the title for seven properties, commonly referred to as the Strynd Houses and Common Room. These properties were obtained by Orkney Heritage Property Trust (OHPT), a subsidiary of Orkney Heritage Society in the 1960s and 1970s. After refurbishment, the properties were transferred to the management of the council for housing purposes. There is no legal agreement in place that settles a lease or other type of arrangement for the properties.</p> <p><b>Resolution:</b> Council officers are working with OHPT to develop a 100-year lease agreement to ensure the appropriate legal terms for the continued use of the Strynd properties.</p> <p style="text-align: right;"><i>Appendix IV – action No. 1</i></p>

**Significant findings from the audit in accordance with ISA260****Lease of Kirkwall Airport hangar**

The renewal of a lease (dated April 2013) for the hangar at Kirkwall Airport has not yet taken effect. This means a loss of rental income to the council of £5,000 per year, since April 2013. Lease negotiations remain ongoing, however the delay means there is a loss of income and decrease in cash-flow to the council during this time.

**Resolution:** Negotiations are expected to be concluded within the next couple of months. Once concluded, increased lease payments by the lessee are expected to be backdated to 2013.

**Investment property review**

A review of investment property was carried out in 2015/16. This resulted in properties totalling just under £4 million being transferred from investment property to operational property. Properties totalling £0.237 million in value moved from operational to investment property. In the asset register, the associated location code was modified to reflect the change. However, the CIPFA code in the asset register which links the values of assets to the disclosures in the accounts could not be changed. This resulted in a net adjustment in the audited accounts of £3.743 million between the operational and non-operational asset categories. Gains and losses on investment and operational properties were correctly accounted for.

**Resolution:** Council officers agreed to make the adjustment between operational and non-operational asset categories in the audited accounts.

### Significant findings from the audit in accordance with ISA260

#### **Non-current assets**

A number of small errors were identified in the accounting for non-current assets, in particular property. The errors consisted of:

- a duplicate asset with a net book value of £0.127 million.
- four errors in the calculation of revaluation gains and losses of £0.259 million.
- accumulated depreciation and in-year depreciation charge for an asset under construction of £0.039 million.
- expenditure on making an asset suitable for operational use which was not capitalised of £0.072 million.

The net effect of these errors is an increase in the balance sheet's unusable reserves of £0.242 million and a matching charge in the Comprehensive Income and Expenditure Statement.

**Resolution:** Council officers agreed to make adjustments to account for the errors identified.

## Future accounting and auditing developments

### Health and social care integration

29. From 1 April 2016, IJBs became accountable for the provision of health and social care. IJBs are required to produce financial statements in compliance with the Code of Practice on Local Authority Accounting in the United Kingdom. Where material, the financial results of Orkney IJB will need to be reflected in the council's group accounts in 2016/17. The council will need to include the IJB in its plans for the preparation and audit of the 2016/17 group accounts, including consideration of assurance arrangements relating to the annual governance statement.

### Highways network assets

30. The Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 will adopt a new measurement requirement for the valuation of the highways network asset. The changes introduced include the move to measuring local authority highways networks at Depreciated Replacement Cost instead of historical cost. This will have a significant impact on the value of local authority balance sheets. For Orkney Islands Council, there will be an increase in net assets of £877 million (163 per cent).

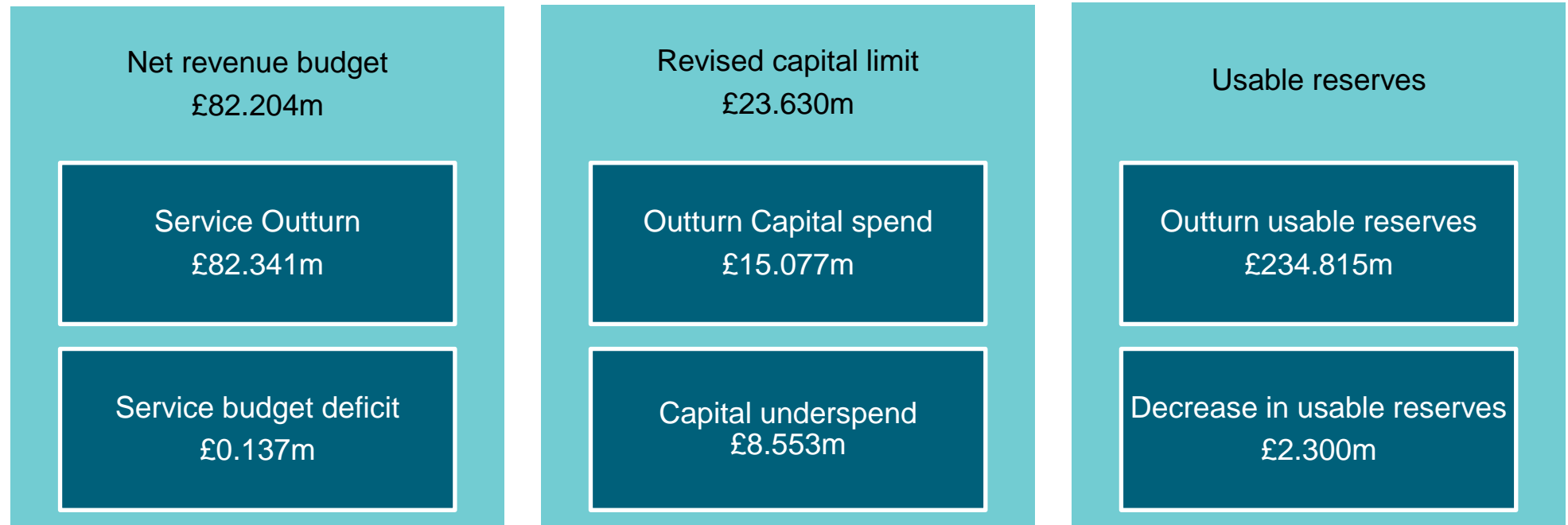
### Code of Audit Practice

31. From 2016/17, a new Code of Audit Practice will apply to all public sector audits, replacing the Code issued in May 2011. The new

Code outlines the objectives and principles to be followed by auditors appointed by the Accounts Commission. There will be a focus on four areas:

- Financial sustainability
  - Financial management
  - Governance and transparency; and
  - Value for money
32. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition to publishing all annual audit reports, other significant outputs, such as the annual audit plan, will be available on our website.

# Financial management and sustainability



## Financial management

33. In February 2015, the council set its annual budget to meet its service and other commitments for 2015/16. The setting of the annual budget impacts directly on residents as it determines the level of spending on services as well as council tax and other fees and charges. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management.

## Financial performance 2015/16

34. The council reported a net general fund deficit of £0.137 million (0.2 per cent) against its revised budget of £82.204 million. The actual net cost of general fund services was £82.341 million and was matched by sources of finance including £3.760 million from reserves. The council decreased its usable reserves by £2.300 million to a balance of £234.815 million. Although general fund reserves increased by £2.664 million in 2015/16 this was offset by a reduction in the harbour authority fund balance of £6.414 million to £207.841 million during the year. This was due to contributions made from the fund to support both the general services fund and the Housing Revenue Account (HRA) services and the creation of an unusable reserve.

## Capital expenditure 2015/16

35. In 2015/16, the council's capital expenditure was £15.077 million. This was £8.553 million (36 per cent) lower than the revised approved limit of £23.630 million. As we reported in previous years, the council continues to have problems with slippage in their capital

programme which accounts for the large underspend. Of the £8.553 million underspend, £4.3 million has been transferred to capital expenditure plans for 2016/17.

36. During 2015/16, the council implemented some changes to their capital programme arrangements to help improve performance in this area. This included establishing an advisory board, a dedicated capital programme team and manager as well as the use of good practice checklists and guidance to support project managers. The nature and profile of capital expenditure means it was too early for these changes to impact on the capital finance position in 2015/16 although improvements should be expected from 2016/17 onwards.
37. The council has a number of significant capital projects underway including the development of new social housing, new schools and its harbour infrastructure. Undertaking multiple capital projects of different types and sizes requires careful oversight. Unrealistic timescales and budgets are likely to result in slippage in completion dates or overspends and therefore delaying or reducing the benefits expected from investment. Where there is effective oversight, any slippage is identified early presenting an opportunity to transfer budgets and accelerate projects in other areas.
38. In January 2016, we published [a follow-up report on Major capital investment in councils](#). We found that although councils have improved their management of capital investment they need to increase the pace of improvement. A key component of improvement is the development of a long-term capital investment strategy (10 to 15 years) to help to set out the needs and constraints

for local capital investment and to help maintain, direct and control their investment.

39. It is important that the council develops and maintains a capital investment strategy. This should identify priorities to help decide the level and nature of investment spending and to help assess how they can finance and afford the spending. Such a strategy should provide a robust framework for elected members to make potentially difficult decisions about priorities and consider the needs and constraints of investment over the longer term. **Appendix IV – Action plan no. 2**

### 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 reviewed the council's financial regulations and concluded that they are comprehensive and current. The council's financial regulations are available on the council's website.
42. 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 generally comprehensive and well laid out with explanations and required actions outlined for any significant budget variances.
43. 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.

### Financial sustainability

44. 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.
45. 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.



## Financial planning

46. In June 2015, the council's Policy and Resources Committee approved a medium-term financial strategy. The strategy followed the establishment of a Change Programme aimed at delivering significant savings towards the £9.5 million identified funding gap between 2016/17 and 2019/20. The Change Programme initially consisting of 21 significant projects, now refined to six initial change reviews, aims to deliver solutions to generate efficiencies in service delivery, with an emphasis on the use of IT. The strategy provides a model for revenue spending over the years 2016/17 to 2019/20, with scenarios covering 'best', 'likely' and 'worst' cases. The purpose of the strategy was to aid planning decisions and act as a statement on the medium-term financial challenge.
47. The 2016/17 Scottish Budget outlined significant reductions for councils' revenue grants. The financial settlement for Orkney Islands Council was a reduction of 3.9 per cent, significantly greater than the 'worst' case scenario of a 2.5 per cent reduction outlined in the medium term financial strategy. The council's 2016/17 budget planned to bridge the funding gap mainly by deferring some elements of capital spending (thereby reducing capital charges), the suspension of a Kirkwall renewal project, greater efficiency savings and the use of contingency funds.
48. It is important for the council to revise its medium-term financial strategy in light of these reductions and planned actions. This will help the council monitor progress with savings expected from the Change Programme. It will also help to direct and control spending

as appropriate to allow for savings opportunities to be taken where they may arise. The council should also extend the period under which financial planning is considered, ideally between five and ten years in line with good practice. This will help the council clarify their financial sustainability over an extended period including the impact of any further settlement reductions on the council's future spending plans and reserves. **Appendix IV – action No. 3**

49. In our 2014/15 Annual Audit Report we highlighted the need for the council to develop fully-costed proposals for how it will make the £9.5 million savings required. To date, detailed proposals remain outstanding. Change programme activities contributed to identified savings as part of the 2015/16 and 2016/17 budget setting process. Approved projects have identified a total of £270,000 in savings. Projects, either under consideration, deferred, or in the pipeline, together estimate potential savings of £2.6 million. The success of the Change Programme is fundamental to how the council is able to respond to the financial challenges over the next few years. It is essential that each change review project is fully assessed in terms of both the anticipated costs (i.e. spend to save) and savings. The timing and profile of costs, savings and additional income will also be crucial if the £9.5 million identified funding gap is to be closed by 2019/20. **Appendix IV – action No. 4**

## Reserves

50. The overall level of usable reserves held by the council decreased by £2.300 million in 2015/16 to £234.815 million. Exhibit 1. The general fund balance includes £5.267 million of unallocated general

fund reserves. Planned commitments from the general fund balance of £21.185 million amounted to £15.918 million. The most significant of these are:

- Renewable energy fund - £3.599 million
- Innovation fund - £2.567 million
- Schools investment programme life cycle fund - £1.988 million
- Development grants fund - £1.536 million
- Pathfinder project fund - £1.298 million.

**Exhibit 1: Usable reserves**

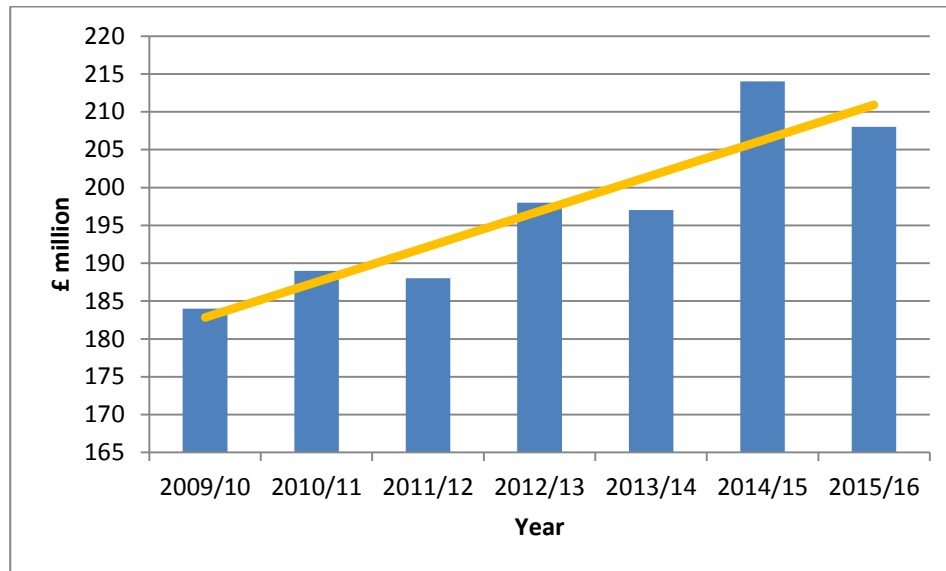
Description	31 March 2015 £ million	31 March 2016 £ million
General fund	18.521	21.185
Housing revenue reserve	0	0.476
Strategic reserve fund	214.255	207.841
Repair and renewal fund	3.811	4.785
Capital receipts reserve	0.020	0.020
Other statutory funds	0.508	0.508
<b>Total usable reserves</b>	<b>237.115</b>	<b>234.815</b>

*Source: Orkney Islands Council*

51. 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.

52. The council has a very strong usable reserves position which provides a good degree of reassurance to their financial sustainability. This is largely due to the Strategic Reserve Fund (SRF) balance of £207.841 million which accounts for 89 per cent of total usable reserves. The SRF is an investment fund established under the Orkney County Council Act 1974. It holds investment returns from surplus funds relating to harbour fees from the Flotta Oil Terminal and previous marine and disturbance payments made by the terminal operators.
53. The purpose of the SRF is to provide for the benefit of Orkney and its inhabitants. The council is clear that responsibility for decommissioning costs of the Flotta Oil Terminal rests with the operator, Repsol. SRF investments have performed well with an overall increasing trend in value. (Exhibit 2). In recent years, the council has approved contributions from the fund to supplement its funding from the Scottish Government and local taxes raised through council tax and non-domestic rates.

**Exhibit 2: Strategic Reserve Fund 2009/10 to 2015/16**

Source: Orkney Islands Council

## Asset Management

54. In October 2013, the council approved its Corporate Asset Management Plan covering the period 2013-2018. The Plan summarises the council's aims and objectives for their assets to ensure they are used in an efficient and effective manner. The Plan was to be supported by detailed plans across six main asset types:

- Property
- Open Spaces and Heritage
- Roads and Infrastructure

- Housing
- Fleet and Plant
- Information and Communications Technology (ICT)

55. Progress in developing the six asset type plans is slow. At the time of our audit, only the Fleet and Plant and Housing Asset Management plans were complete, although a draft Property Asset Management plan was approved by the Asset Management Sub-Committee in June 2016. There is a significant risk that the council will be unable to meet its Corporate Asset Management Plan objectives in the absence of detailed plans covering each asset management area. In addition, effective asset management can result in greater efficiencies and lower costs, making it a key area for savings within the council's Change Programme. In the absence of clear asset management plans, it will be challenging for the council to make effective decisions about how best to utilise assets within its estate and IT infrastructure. With only two years to go until the current Corporate Plan expires, it is important that the council develops suitable asset management plans for the remaining asset types. The plans should assess carefully what can be realistically achieved within the remaining time of the corporate plan as well as identifying longer-term objectives. **Appendix IV – action No. 5**

## Workforce planning

56. Workforce planning is the process that organisations use to make sure they have the right people with the right skills in the right place at the right time. To manage their workforces effectively, organisations need to have up-to-date information on:

- the numbers of people they employ to carry out different tasks
  - what skills the workforce has and where there are gaps
  - what skills and staff will be needed to deliver future services and priorities.
57. They must then plan and manage their workforces, and make any necessary changes, to meet their organisational objectives.
58. In June 2016, we presented a report to the Monitoring and Audit Committee on workforce planning arrangements in Orkney Islands Council. We found that:
- The council does not have an organisation-wide workforce plan in place, but work on developing workforce plans is underway. The council's HR strategy 2014-18 outlines the priorities for workforce planning but does not consider workforce needs reflecting financial constraints and skills.
  - The service delivery plans due in September 2016 include an action to prepare service workforce plans. Such plans should establish a platform for staffing requirements, including numbers, skills levels and training needs, as well as anticipating future requirements based on a changing legislative and regulatory environment. Without detailed service plans and service workforce plans, organisation-wide workforce planning will not be comprehensive
  - The council agreed workforce planning as one of the themes of an internal change review as part of their medium-term efficiency savings goals. An initial savings target of £0.311 million has been set, to be delivered over the three-year period 2017/18 to 2019/20
- Members had not received a report on the progress of implementing the *Human Resources Strategy 2014-2018*. Some progress has been made and there is a risk the strategy may not achieve its intended outcomes within the timeframe set. Similarly, without regular reporting, the opportunity for members to fulfill their scrutiny role is considerably reduced.
59. Our report made a number of recommendations including the need to develop a long-term organisational workforce plan. Council officers have agreed to implement such a plan by the end of January 2017. **Appendix IV – action No. 6**
60. In June 2016, the Policy and Resources Committee noted that the need to reduce workforce costs was critical to making anticipated budget reductions. As part of the change review on workforce, the Committee agreed to review current policies such as redeployment, redundancy and early retirement to ensure appropriate policies are in place to avoid the need for compulsory redundancies. A report is to be considered by the Committee in November 2016, although a review of current policies for managing redundancy and voluntary severance is expected in September 2016 to allow for the possible launch of a voluntary severance scheme later in 2016.

### Treasury Management

61. At 31 March 2016 long-term borrowing stood at £40 million, the same level as the previous year. During the same period, short-term

borrowing increased slightly from £0.538 million to £0.542 million. This is in line with the council's Treasury Management Strategy for 2015/16. Interest payable and similar charges increased by £0.119 million to £1.468 million.

### Pension liability

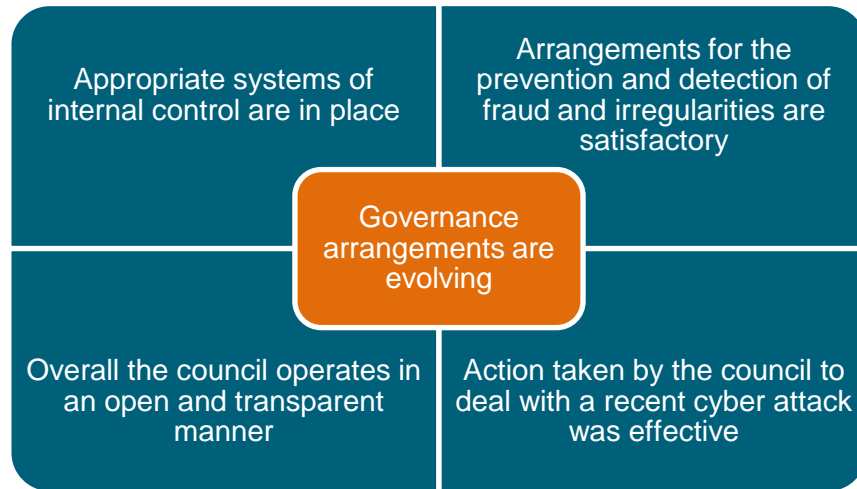
62. The council is the administering authority for the Orkney Islands Council Pension Fund which is a funded defined benefit scheme. The scheme is operated under the regulatory framework of the Local Government Pension Scheme.
63. The council's own pension liability decreased from £38.583 million in 2014/15 to £17.912 million in 2015/16 mainly due to an increase in the discount rate used by actuaries to estimate their current value. The pension liability represents the difference between expected future pension payments and the underlying value of pension fund assets available to meet this cost. At the last triennial valuation, at 31 March 2014, Orkney Pension Fund was 114.4 per cent funded (2016 update: 102 per cent) and had assets of £227 million. The next valuation will take place in March 2017.

### Conclusion on financial management and sustainability

64. We conclude that the council's financial management arrangements are broadly satisfactory. However, the council's needs to strengthen its capital programme arrangements in order to improve its overall financial management.

65. The council continues to hold substantial reserves largely due to the strength of the Strategic Reserve Fund. This provides the council with a relatively strong longer-term financial position compared with many other councils in Scotland. Nevertheless, with rising demand for council services, increasing costs and further budget reductions expected, it is essential that the council has effective long-term plans in place. Developing good long-term plans covering finance, workforce, capital and asset management are necessary to support effective decision making, particularly during a time where difficult choices are required.

# Governance and transparency



66. 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

67. 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.

68. In June 2016, the results of a governance review were reported to Policy & Resources Committee. As a result of the review, a Harbour Authority sub-committee was approved to ensure focused governance and assurance arrangements for the statutory functions of the harbour authority and the safe and effective operation of the harbour area. It was also decided that the Orkney Health & Care Committee was going to be retained for the council's aspects of the Integration Joint Board (see paragraph 97-101), with a commitment to review this position in 12 months' time.

69. A number of actions have been retained as a result of the review, including a review of Standing Orders, a review of the Scheme of Administration and Delegation to Officers, and, prior to the 2017 local elections, a report on the potential separation of the roles of council leader and civic head.

70. Orkney Islands Council is the sole trustee for the Orkney Islands Council General Charitable Trust (OICGCT) which has charitable status and is registered with the Office of the Scottish Charity Regulator (OSCR).

71. In December 2015, the trustees of the council's other charitable trust, Orkney Educational Trust (OET), agreed to transfer OET into

the OICGCT. The transfer of assets took place on 31 January 2016 at which point the OET became part of the OICGCT.

72. We have concluded that the council's current governance structure and arrangements provide an appropriate framework for decision making. The integration of health and social care services in Orkney during 2016, provides the opportunity for the council to revise its governance and scrutiny arrangements for social care in conjunction with the newly established Orkney Integration Joint Board.

## Local code of corporate governance

73. 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 of Corporate Governance in Local Government: A Keystone for Community Governance. The council carries out an annual self-assessment to establish if it meets the requirements of the local code and, where necessary, takes action to address non-compliance. The self-assessment checklist was considered by the Monitoring and Audit Committee in August 2016. No issues of non-compliance were reported.

## Internal control

74. 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.

75. We reported our findings to the Monitoring and Audit Committee in June 2016. We identified one significant control weakness relating to the backing up of data held in major financial application systems and file shares. We found that although back-ups are routinely taken, they are not always successful and no assurance could be given that the data on the back-ups was recoverable. We also identified a few minor control weaknesses. Our findings included a number of recommendations that were accepted by the council's management including the need to ensure that all major systems are backed up on a planned schedule, with back-ups tested regularly.

## Internal audit

76. 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. Where it can be demonstrated that the means of achieving internal audit objectives are similar to those of external audit, the findings and results of internal audit exercises can be considered when determining the nature and extent of planned external audit coverage. To avoid duplication, we place reliance on internal audit work where possible.
77. Internal audit substantially completed its 2015/16 work plan. 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. We placed reliance on its key controls work carried out in relation to treasury management.

## ICT audit

78. In 2015/16 we carried out two reviews of information technology and information governance. This included a survey, hosted by Audit Scotland, called Your Business @ Risk (YB@R). This is a web-based survey that helps audited bodies quickly assess procedural, cultural and ethical compliance risks that have the potential to undermine the effectiveness of their information governance policies. The results of the survey were presented to the Monitoring and Audit Committee in March 2016.
79. The survey identified a number of areas where Orkney Islands Council's staff demonstrated an adequate level of awareness of good practice. Equally, the survey also identified gaps in the knowledge and awareness among staff in some areas, representing potential risks to the organisation. These issues were raised with management to consider as on-going information security awareness training is developed, and should inform development of future information security policies and procedures. The results of the survey helped the IT team prepare an action plan to help increase awareness and spread good practice across all staff.
80. We also reviewed the council's preparedness to deal with a cyber attack due to the increased risks that these may occur in any type of organisation. We found that the council's overall preparedness is

good, with some areas for improvement such as updating its incident response plan and assessing the costs of a cyber attack which occurred during summer 2015.

81. A cyber attack in April 2016 showed that the actions taken by the council are effective. Users reported the incident immediately, and prompt action was taken to remove the infected machines and normal services were restored quickly.

## Arrangements for the prevention and detection of fraud

82. The council updated its fraud policy which was subsequently approved by the council in April 2016. The policy and council's arrangements in relation to the prevention and detection of fraud and irregularities are satisfactory.

## National Fraud Initiative in Scotland

83. Orkney Islands Council participates in the latest National Fraud Initiative (NFI). The NFI is a counter-fraud exercise that is coordinated by Audit Scotland every two years. It uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error. 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.

84. In June 2016, we published our findings from the latest NFI exercise. Our work found a total of almost £17 million worth of fraud and error across public services in Scotland in the two years since the exercise was last conducted. We reviewed the council's ongoing engagements with the NFI process and 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

85. In November 2015, the council revised and updated its whistleblowing policy. The purpose of the policy is to provide ways for staff to raise concerns and receive feedback in a way that they will be protected for raising issues. The policy helps the council to ensure it meets appropriate standards of governance and accountability.
86. Overall, we found that arrangements for the prevention and detection of corruption in the council are satisfactory and we are not aware of any specific issues that we need to record in this report.

## Transparency

87. 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 – The council's unaudited accounts were made available on its website. The format and content are in line with requirements of the Code of Local Authority Accounting in the UK.
  - Budget and financial monitoring reports – These are generally comprehensive and well laid out.
  - Performance reporting – The council has a sound framework in place for monitoring and reporting performance against its priorities (see paragraph 110).
  - Registers of interest – These are available on the council's website.
  - Withholding information from public scrutiny – The council makes use of the Local Government (Scotland) Act 1973 to exclude the public from council and committee meetings during consideration of particular items of business. We found no evidence of the council using this exclusion to unjustifiably withhold information from public scrutiny.
  - Council and committee meetings – These are open for the public to attend. Audio castings of the meetings are also available online for members of the public to either listen live or at a later date.

88. Overall, we conclude that the council conducts its business in an open and transparent manner.

## Pickaquoy Centre Trust

89. The Pickaquoy Leisure Trust is one of the council's arm's length organisations. In March 2016, the Trust's business plan was considered by the Education, Leisure and Housing Committee. The plan submitted contained a number of uncertainties over the timing, income and expenditure of the trust's planned actions in 2016/17. For example, in nine out of 19 actions, information on income or costs was still 'to be confirmed' and 10 actions did not provide clarity over timescales.
90. The Service Agreement for the Trust covered the period 1 April 2012 to 31 March 2015. A review of the agreement by the council has not yet taken place although this was highlighted in the Trust's business plan. The council should undertake a review of the service agreement to ensure it is fit for purpose. As part of this, the council should outline their expectations about the financial, performance and business objectives of the Trust and reporting requirements.
- Appendix IV – action No. 7.**

## Freedom of Information requests

91. 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 requests to the senior management team every quarter. An annual briefing is

produced for elected members and heads of service which reports performance for the calendar year.

92. The council received 971 FOI requests during 2015, answering 97 per cent of these within the 20 working day timescale. This represents an excellent performance from the council, particularly as the number of requests increased from 954 in 2014, where a 92 per cent response rate was achieved. The Scottish Information Commissioner rated the council's performance in responding to FOI requests in 2015 as 'excellent'.

## Orkney College

93. In Orkney, further and higher education is provided by Orkney College. The college is funded by the Scottish Funding Council and through grants claimed from outside bodies. It is also an academic partner of the University of the Highlands and Islands.
94. The college is responsible for managing its own finances and aims to achieve a surplus each financial year. For a number of years now, the college has not achieved this and relies on financial support from the council's reserves. In 2015/16, support from the council amounted to £0.110 million.
95. During 2015/16, a review of Orkney College's business units took place with initial findings reported to the Monitoring and Audit Committee in June 2016. Further findings, along with specific actions are expected during 2016/17 with the aim of helping the college to operate on a self-financing basis. The council has no obligation to fund the college and although the college assumed a

balanced budget for 2016/17, their recent history of poor financial results suggests the council may be expected to provide further financial support.

96. If the council intends to provide further financial support to Orkney College, they should agree a framework for how this will operate. This should include a review of the viability of the college's business units. The implications can then be reflected in future council budgets and financial performance information. This reiterates our recommendation from our 2014/15 Annual Audit Report. **Appendix IV – action No. 8**

## Integration of health and social care

97. The Public Bodies (Joint Working) (Scotland) Act 2014 sets out an ambitious programme of reform affecting most health and social care services. The scale, pace and complexity of changes anticipated are significant, with a focus on changing how people with health and social care needs are supported.
98. The Act creates new partnerships, known as integration authorities, with statutory responsibilities to coordinate local health and social care services. The delegation of functions from Orkney Islands Council and NHS Orkney to the new Orkney Integration Joint Board were effective from 1 April 2016.
99. In October 2015, a Scheme of Integration was developed and subsequently approved by Scottish Ministers on 6 February 2016. This sets out the framework for how the council will work with NHS Orkney in establishing the IJB. The Act also places a duty on IJBs to
- develop a strategic commissioning plan for the integrated functions and budgets that they control. In March 2016, Orkney IJB approved its plan (endorsed by both the council and the health board) which sets out how they will plan and deliver services over the medium term. It also provides a high-level outline of how they plan to use their integrated budget (£33 million in 2016/17), over the period 2016/17 to 2018/19, formed of funding from Orkney Islands Council, NHS Orkney and the Scottish Government.
100. New governance arrangements for the IJB have been established including the development of a performance framework, financial regulations and risk management strategy. The council has worked well with its partners, NHS Orkney and the IJB to ensure these early milestones were delivered. It remains too early to comment on the effectiveness of these arrangements. However, it is clear that all partners will need to ensure that constructive working relationships exist to ensure that any cultural or organisational differences do not adversely impact on the successful delivery of health and social care services in Orkney.
101. In December 2015, we published our first in a series of reports on [Health and Social Care Integration](#). The report identified a range of risks for partners, including difficulties in agreeing budgets, uncertainty about longer-term funding, complex governance arrangements and workforce planning issues. The report's recommendations included the need for partners to set out clearly how governance arrangements will work in practice, what resources are needed and develop financial plans that clearly show how

resources will be used to provide more community-based and preventative services.

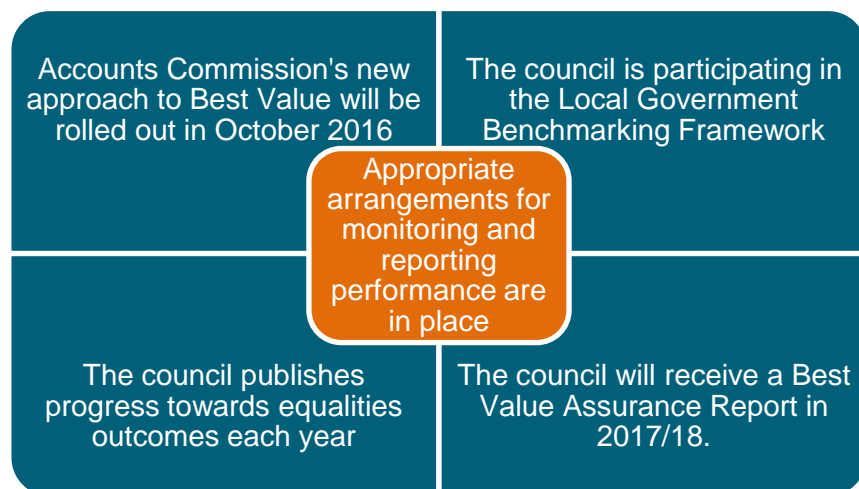
## Local scrutiny plan 2016/17

102. The 2016/17 Local Scrutiny Plan (LSP) prepared by the Local Area Network of scrutiny partners for the council was submitted to Orkney Islands Council on 11 March 2016.
103. The LSP highlighted three main areas where we plan to carry out scrutiny work during 2016/17. We will undertake performance audits on early learning and childcare, equal pay and a follow-up audit on self-directed support.
104. The LSP also identified work by Education Scotland, working in partnership with councils, to carry out a validated self-evaluation (VSE) of educational psychology services across all councils over a two-year period. In addition to scrutiny work identified in the plan, an integrated inspection of joint services for older people in Orkney was also undertaken by the Care Inspectorate and Healthcare Improvement Scotland.
105. To assess the risk to social landlord services the Scottish Housing Regulator (SHR) reviewed and compared the performance of all Scottish social landlords to identify aspects of landlords' services that require improvement. It found that Orkney Islands Council was in the bottom quartile for all social landlords in relation to completing emergency and non-emergency repairs on time, its performance in collecting gross rent arrears and the speed of re-letting void properties. SHR also found that the council did not provide them

with reliable data in their Annual Return on the Charter (ARC) in 2014/15. The council has since taken steps to rectify these errors and put in place a more robust process for future submissions. SHR will engage with the council in relation to all these areas during 2016/17.

106. The 2016/17 shared risk assessment concluded that the majority of areas of the council did not require any additional scrutiny beyond statutory and on-going work. However, the LAN recommended that the council should receive some best value audit work, early in the new audit appointment cycle (2016/17 – 2021/22), given the length of time since the last best value audit report to the Accounts Commission in 2008 (see paragraph 118).

# Best Value



- 107.** 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.

## Procurement

- 108.** In July 2015, the Scottish Government introduced the Procurement and Commercial Improvement Programme (PCIP) to replace the former Procurement Capability Assessment (PCA). The PCIP focuses on the policies and procedures that underpin procurement performance and the results they deliver. Due to the Procurement

Reform (Scotland) Act 2014, and the requirement upon local authorities to prepare a procurement strategy in line with this legislation, the PCIP has been postponed into 2017. The council plans to discuss the key elements of PCIP and their applicability to island authorities with Scotland Excel.

## Following the public pound

- 109.** Local authorities have a statutory responsibility to comply with the Accounts Commission/COSLA Code of Guidance and funding external bodies and following the public pound. When agreeing to transfer funds to an external body councils must be clear about their reasons for doing so. Proper considerations should always apply and the prime purpose of involvement with external bodies should be the achievement of the council's objectives in the most effective, efficient and economic manner and not the avoidance of controls or legal restrictions which are designed to secure probity and regularity in the use of public funds. We are not aware of any significant matters of the council's non-compliance with the Code.

## Performance management

- 110.** Following a mid-term review of the Council Plan 2013-18, the Council Delivery Plan 2015-18 was published in December 2015 and is consistent with Orkney's Community Plan 2015-2018. New service plans for 2016-19 were presented to council committee meetings in June 2016 covering Chief Executive's Service, Corporate Services, Education, Leisure and Housing, and

Development and Infrastructure. All services plans are revised on an annual basis.

111. Performance against the Council Delivery Plan 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 to support scrutiny.
112. The council publishes an annual performance report (APR), which is available on its website. The APR shows the council's performance towards meeting the targets set out in its council plan. It also outlines how well the council performed against the national Local Government Benchmark Framework (LGBF) indicators.
113. In June and July 2016, the council carried out a public survey with local residents, to find out their views on the usefulness of the Council's approach to public performance reporting (PPR). The plan is that the survey results will inform the council's approach to PPR in the future, to help improve its PPR arrangements and, in particular, the content of its PPR webpages. The results of the survey are to be reported to the Monitoring & Audit Committee in September 2016.

### Statutory performance indicators (SPIs)

114. 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.

115. For 2015/16 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 Local Government Benchmarking Framework.

### National performance audit reports

116. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were published which are of direct interest to the council. These are outlined in [appendix III](#). The council has processes in place to ensure that all national reports and their impact on the council are considered by Members.

### Equalities

117. 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 every two years, public bodies must publish a report on the progress made to achieve the quality of outcomes it has set. The council published an Annual Equality

Report in 2016. The report explains how the council promotes and integrates equality into its work and what progress it has made towards achieving its equality outcomes.

## Auditing Best Value

118. In December 2014, the Accounts Commission concluded its review of Best Value and set out principles for a new approach to auditing Best Value. These principles include the need for more frequent assurance on Best Value across all 32 councils, integrating the audit processes, an increased emphasis on driving improvement, and a strong focus on the quality of service experienced by the public and the outcomes achieved.
119. The new approach will be rolled out from October 2016 but will continue to evolve. It will include an assessment of aspects of Best Value as part of an integrated annual audit and a public report, (Controller of Audit report to the Accounts Commission) for each council at least once in a five-year period. The report will bring together an overall picture of the council drawn from a range of audit activity.
120. Orkney Islands Council's last Best Value audit was in 2008. In March 2016, the Local Area Network concluded that the council should be recommended for early Best Value activity as part of Audit Scotland's new approach. In June 2016, the Accounts Commission agreed plans to publish a Best Value Assurance Report on the council during 2017/18.
121. A key objective of the new approach is to allow the Commission to provide more regular assurance to the public about how councils are performing in relation to their Best Value statutory duties. We will do this by requiring the Controller of Audit to submit a Best Value Assurance Report (BVAR) on each council at least once during the five-year audit appointment. These reports will differ from the current Best Value reports in that they are not audit reports produced directly at the end of an intensive period of specific BV audit work. Instead, they will provide a more longitudinal perspective, contain broader coverage across BV characteristics and a more rounded picture on the performance of the council concerned. They will aggregate the conclusions from a range of audit and other scrutiny work over time. Commission members will consider these reports in public, and decide what action to take.
122. The new Best Value Assurance Reports will sit alongside existing published reports that councils will be familiar with. These include the annual Local Government Overview Report, Performance Audit Reports and the How Councils Work series. The Controller of Audit will continue to issue Statutory Reports where considered necessary, and submit these to the Commission. These cover issues in individual councils that raise significant concern and public interest. They will also, under the new approach, be the route for additional reports on Best Value where specific risks have been identified and targeted work is considered proportionate and appropriate.

# 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
<b>Risk of material misstatement</b>		
<p><b>Risk of management override of control</b></p> <p>As stated in ISA 240, management is in a unique position to perpetrate fraud because of its 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"> <li>Detailed testing of journal entries.</li> <li>Review of accounting estimates for bias.</li> <li>Evaluating significant transactions that are outside the normal course of business.</li> </ul>	<ul style="list-style-type: none"> <li>Journals - a sample of 47 journal entries was tested as part of year-end journals (29), debtors (8) and creditors (10) testing. We found no evidence to suggest that management were overriding controls.</li> <li>Estimates - based on testing of debtors, creditors and provisions/contingencies, we found no evidence of bias in accounting estimates.</li> <li>Significant transactions - based on our work on the annual accounts, we did not find any evidence of transactions outwith the scope of the council.</li> <li>No fraud concerns identified in respect of management override of controls.</li> </ul>
<b>Risks identified from the auditor’s wider responsibility under the Code of Audit Practice</b>		
<p><b>Governance</b></p> <p>We reviewed a number of documents obtained</p>	<ul style="list-style-type: none"> <li>Reviewed of updated documentation.</li> </ul>	<p>During our audit work we found that the following documents are updated:</p>

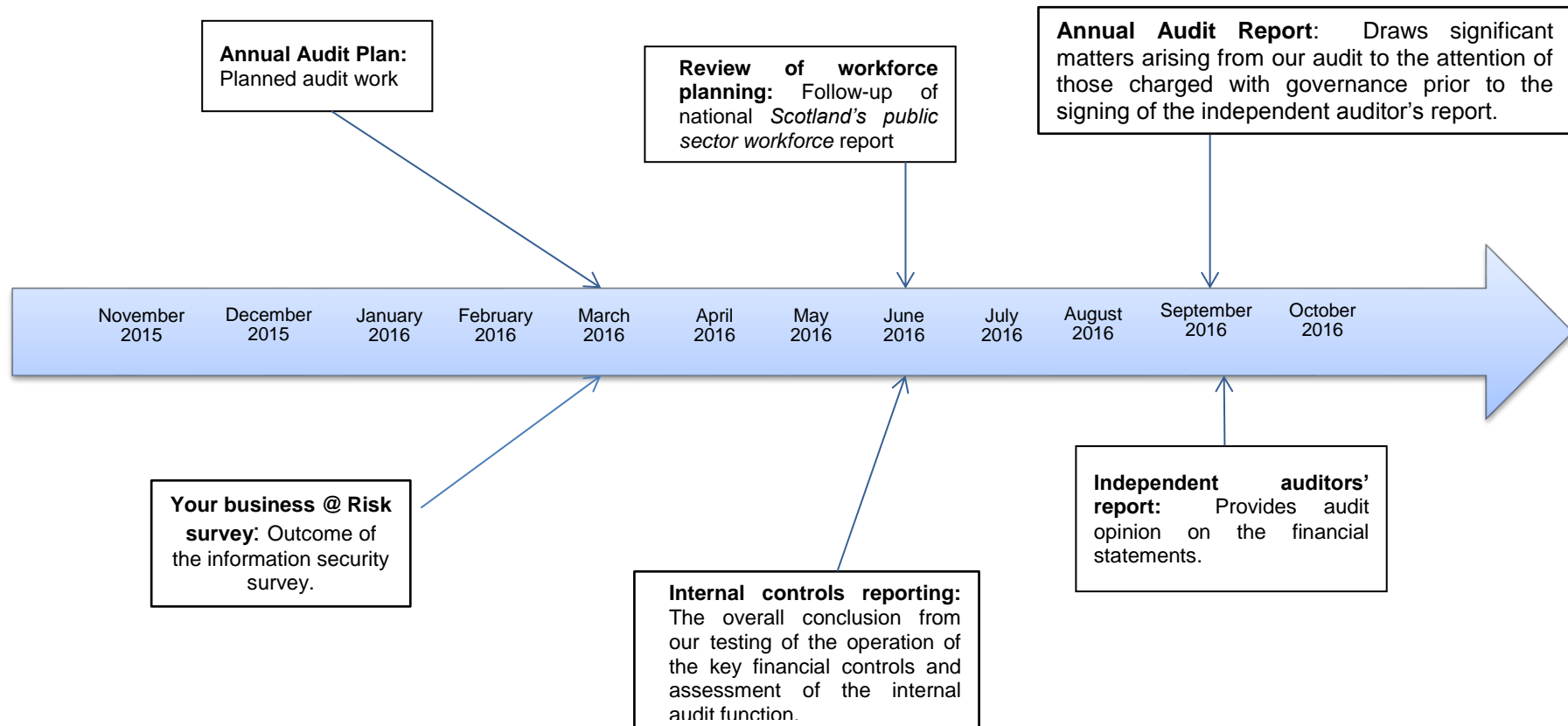


Audit Risk	Assurance procedure	Results and conclusions
<p>from the council's website. Some of the documents are no longer up-to-date and there is a risk that stakeholders and members of the public are provided with incorrect information</p>		<ul style="list-style-type: none"> <li>• Financial Regulations, April 2016</li> <li>• Standing orders reviewed and updated, but no date on document when this took place.</li> <li>• Staff code of conduct not updated.</li> <li>• Contract standing orders reviewed June 2016.</li> <li>• Scheme of Administration and Scheme of Delegation to Officers still dated 2012.</li> <li>• None of the documents reviewed had a target next review date included. This would be helpful to ensure tracking of continuous changes in the administrative and financial environment.</li> </ul>
<p><b>Change programme and financial planning</b> The council's Change Programme has been tasked with delivering options for bridging an anticipated funding gap of £9.5 million over the 4 years to 2019/20. Despite the main focus for activities associated with the Change Programme so far consisting of enabling activities, savings of £0.5m have been proposed to 2016/17 with a further £1.5 million identified as potential savings options from 2017/18 onwards. There is a risk that the</p>	<ul style="list-style-type: none"> <li>• Review and assess the savings programmes in place.</li> <li>• Report on progress in the annual audit report.</li> </ul>	<ul style="list-style-type: none"> <li>• During the year we held interviews with officers involved in the change programme and reviewed documentation provided.</li> <li>• The findings of our work are included in this report.</li> </ul>

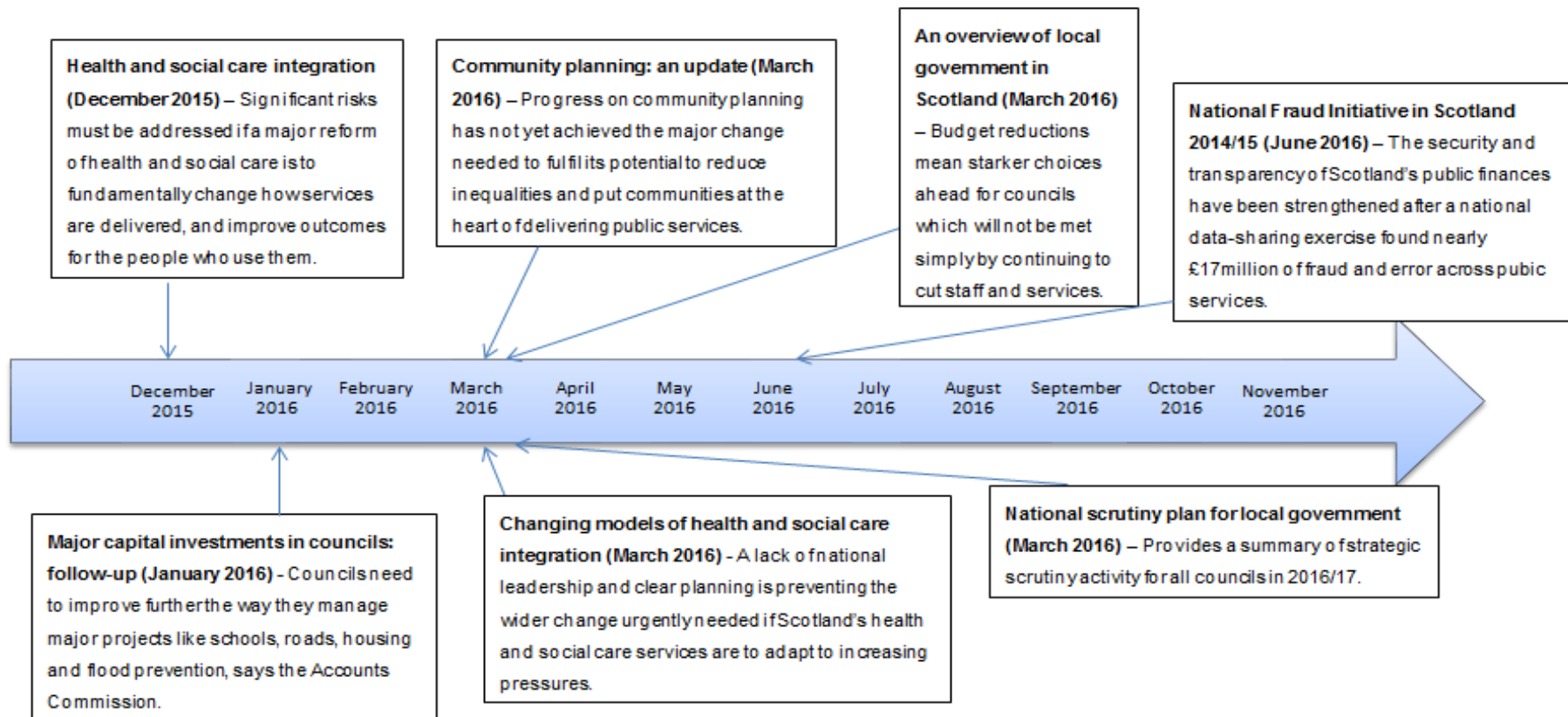
Audit Risk	Assurance procedure	Results and conclusions
<p>council will not be able to achieve its savings targets, and has to lean more heavily on its considerable reserves.</p>		
<p><b>Orkney College</b> Orkney College returned a deficit at the end of 2014/15, due to the losses incurred by its business units. As in previous years, mid-year outturns show that the college expects to break even for 2015/16 the year-end outturn does not always manage to achieve this. There is a risk that the council will be required to fund the deficit run by the college from its reserves.</p>	<ul style="list-style-type: none"> <li>Review of minutes and discussion with officers on the actions taken to mitigate the impact of losses on council reserves.</li> </ul>	<ul style="list-style-type: none"> <li>We reviewed the Orkney College Account and minutes of the College Management Group.</li> <li>We held discussions with Internal audit about their work on the Orkney College Business Units and reviewed their report.</li> <li>The findings of our work are included in this report.</li> </ul>
<p><b>Workforce planning</b> The council's workforce planning framework is in the early stages of development. There is a risk that with an ageing workforce and continued pressure on resources, skills and experience will be lost.</p>	<ul style="list-style-type: none"> <li>Follow-up review of Audit Scotland's report <i>Scotland's Public Sector Workforce</i>.</li> </ul>	<ul style="list-style-type: none"> <li>We carried out a review of the council's workforce planning arrangements in the spring of 2016.</li> <li>The results of the review were reported to Monitoring &amp; Audit Committee in June 2016.</li> </ul>
<p><b>Your Business @ Risk – Information security</b> The Corporate Services risk register highlights concerns raised about the staff awareness of information security, particularly data protection matters.</p>	<ul style="list-style-type: none"> <li>Reporting on the Audit Scotland hosted <i>Your Business @ Risk</i> information security survey.</li> </ul>	<ul style="list-style-type: none"> <li>We carried out the Your Business @ Risk survey in November 2015 and reported on this in February 2016.</li> </ul>

Audit Risk	Assurance procedure	Results and conclusions
<p><b>Cyber security</b></p> <p>In the summer of 2015, the council experienced two cyber attacks, leading to unavailability of computing resources for a day each time. There is a risk that further outages become common unless cyber risks are appropriately recognised and managed.</p>	<ul style="list-style-type: none"> <li>Review of cyber risk awareness and mitigation strategies.</li> </ul>	<ul style="list-style-type: none"> <li>We carried out a review of the council's preparedness to deal with cyber attacks.</li> <li>Details of our findings can be found in paragraphs 80 and 81 of this report.</li> </ul>
<p><b>State Aid</b></p> <p>Orkney Islands Council, through its wholly owned subsidiary Orkney Towage Ltd (OTL) provides towage services to the Scapa Flow Oil Port. OTL charges a commercial rate to the council for its services, however, any remaining deficit is funded by a loan from the council against the Strategic Reserve Fund. The council needs to assure itself that these arrangements are consistent with European State Aid laws.</p>	<ul style="list-style-type: none"> <li>We will review the council's arrangements for monitoring compliance with State Aid regulations and report on this in our annual report on the audit.</li> </ul>	<ul style="list-style-type: none"> <li>Orkney Towage Ltd (OLTL) has been reorganised, and from 1 April 2016 the activities of the company have substantively moved back to the council as directly managed services.</li> <li>We have had discussions with officers and the council's Head of Legal Services.</li> <li>We have reviewed the new non-domestic rate relief forms, which include references to consideration of State Aid.</li> <li>We are satisfied that the council has taken appropriate action to mitigate any non-compliance of State Aid regulations.</li> </ul>

# Appendix II: Summary of Orkney Islands Council local audit reports 2015/16



# Appendix III: Summary of Audit Scotland national reports 2015/16



## Appendix IV: Action plan

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	28	<p><b>Strynd Houses and Common Room</b></p> <p>In reviewing a sample of title deeds for property assets, we found that the council does not hold the title for seven properties, commonly referred to as the Strynd Houses and Common Room. These properties were obtained by Orkney Heritage Property Trust, a subsidiary of Orkney Heritage Society in the 1960s and 1970s. After refurbishment, the properties were transferred to the management of the council for housing purposes. There is no legal agreement in place that settles a lease or other type of arrangement for the properties.</p> <p><b>Risk:</b> Without a legal agreement in place there is a risk that ownership of the properties may be subject to dispute.</p> <p><b>Recommendation:</b> Council officers should take the necessary measures to ensure the appropriate legal terms for the continued use of the Strynd properties.</p>	<p>Agreed.</p> <p>Work has been underway for some months to establish a lease with OHPT for Strynd Houses and Common Room.</p>	<p>Head of Housing and Homelessness by 31 December 2016.</p>

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2.	35-39	<p><b>Capital programme</b></p> <p>The council continues to have problems with slippage in their capital programme. Recent changes to capital programme arrangements mean that improvement should be expected in 2016/17.</p> <p>In addition, the council does not have a long-term capital investment strategy that identifies the needs and constraints for local capital investment.</p> <p><b>Risk:</b> Ineffective direction and control of the capital investment programme may lead to further slippage in completion dates, overspends on projects or a reduction in the expected benefits from investment.</p> <p><b>Recommendation:</b> The council should ensure controls are in place to detect and manage slippage at an early stage. The council should also develop a long-term capital investment strategy (10 to 15 years) to help to set out the needs and constraints for local capital investment and to help maintain, direct and control their investment.</p>	<p>Agreed.</p> <p>We will implement procedures to identify potential slippage early in the financial year and take action to minimise its impact on individual projects or the programme as a whole.</p> <p>We will also develop a long-term capital investment strategy to outline the plans for investment over the next 10 to 15 years.</p>	<p>Head of Finance by 31 December 2016.</p> <p>Head of Finance and Head of Infrastructure Services by 31 March 2017.</p>

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3.	46-49	<p><b>Financial planning</b></p> <p>The financial settlement for Orkney Islands Council was a reduction of 3.9 per cent, significantly greater than the ‘worst’ case scenario of a 2.5 per cent reduction outlined in the medium term financial strategy. The strategy has not been updated in light of these reductions.</p> <p><b>Risk:</b> There is a risk that the council may take future spending decisions based on incomplete information.</p> <p><b>Recommendation:</b> The council should revise its medium-term financial strategy in light of known budget reductions. The council should also extend the period under which financial planning is considered, ideally between five and ten years in line with good practice. This will help the council clarify their financial sustainability over an extended period including the impact of any further settlement reductions on the council’s future spending plans and reserves.</p>	<p>Agreed.</p> <p>We will revise our medium-term financial strategy to reflect recent changes in the financial settlement and extend the period covered whilst also recognising that the council has been operating on single-year settlements.</p>	<p>Head of Finance by 31 December 2016.</p>



No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
4.	48	<p><b>Change programme</b></p> <p>The council's Change Programme aims to deliver significant savings towards the identified funding gap of £9.5 million between 2016/17 and 2019/20. To date, detailed proposals about how this target will be achieved remain outstanding. The success of the Change Programme is fundamental to how the council is able to respond to the financial challenges over the next few years.</p> <p><b>Risk:</b> There is a risk that the planned savings from the Change Programme will not be achieved by 2019/20.</p> <p><b>Recommendation:</b> The council should fully assess the costs and savings expected with each change review project.</p>	<p>Agreed.</p> <p>We will assess the costs and savings expected for each project within the Change Programme and outline how projects will contribute towards bridging the funding gap of £9.5 million estimated in the period to 2019/20.</p>	<p>Change Programme Manager</p> <p>By 31 December 2016.</p>

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
5.	54-55	<p><b>Asset Management</b></p> <p>The council's Corporate Asset Management Plan (2013-18) highlighted plans to develop detailed asset management plans across six main asset types. At the time of our audit, only three were complete.</p> <p><b>Risk:</b> There is a significant risk that the council is unable to gain a comprehensive understanding of the condition and maintenance requirements of its estate. The council may also be unable to meet the objectives of their Corporate Asset Management Plan without detailed plans in place.</p> <p><b>Recommendation:</b> With only two years to go until the current Corporate Asset Management Plan expires, it is important that the council develops suitable asset management plans for the remaining asset types. The plans should assess carefully what can be realistically achieved within the remaining time of the corporate plan as well as identifying longer-term objectives.</p>	<p>Agreed.</p> <p>We will develop asset management plans for the three remaining asset types. These will be clearly linked to the Corporate Asset Management Plan and other asset type plans to give a comprehensive assessment of asset management across the council.</p> <p>Finalise ICT Asset Management Plan</p> <p>Develop Open Spaces and Heritage Asset Management Plan</p> <p>Develop Roads and Infrastructure Asset Management Plan</p>	<p>Head of Buildings and Facilities by 31 March 2017</p> <p>Head of Leisure and Lifelong Learning by 31 March 2017</p> <p>Head of Roads and Environmental Services by 31 March 2017</p>

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
6.	56-60	<p><b>Workforce planning</b></p> <p>As reported to the Monitoring and Audit Committee in June 2016, the council does not have an organisation-wide workforce plan in place, but work on developing service workforce plans is underway. The council's HR strategy 2014/18 outlines the priorities for workforce planning but does not consider workforce needs reflecting financial constraints and skills.</p> <p><b>Risk:</b> Lack of workforce planning means that the council will find it difficult to identify and address its future staffing and skills needs as well as deliver planned workforce savings.</p> <p><b>Recommendation:</b> The council should prepare an organisation-wide workforce plan.</p>	<p>Agreed.</p> <p>Once we have the service workforce plans completed we will use them to inform the creation of an organisation workforce plan.</p>	<p>Head of HR and Performance</p> <p>31 January 2017</p>

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
7.	88-89	<p><b>Pickaquooy Centre Trust</b></p> <p>The Service Agreement for the Trust covered the period 1 April 2012 to 31 March 2015. A review of the agreement by the council has not yet taken place.</p> <p><b>Risk:</b> There is a risk that the existing, expired agreement no longer meets the requirements of the council.</p> <p><b>Recommendation:</b> The council should undertake a review of the service agreement to ensure it is fit for purpose. As part of this, the council should outline their expectations about the financial, performance and business objectives of the Trust and reporting requirements</p>	<p>Agreed.</p> <p>We undertook an internal audit of the current arrangements between the council and the Trust. The findings of this audit will now inform the review of the service agreement for the Trust.</p> <p>As part of this, we will review and agree the business objectives and the financial, performance and reporting requirements of the Trust.</p>	<p>Head of Leisure and Lifelong Learning</p> <p>By 31 March 2017.</p>

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
8.	93-96	<p><b>Orkney College</b></p> <p>The college is responsible for managing its own finances and aims to achieve a surplus each financial year. For a number of years now, the college has not achieved this and relies on financial support from the council's reserves. In 2015/16, support from the council amounted to £0.110 million. The council has no obligation to fund the college and although the college assumed a balanced budget for 2016/17, their recent history of poor financial results suggests the council may be expected to provide further financial support.</p> <p><b>Risk:</b> There is a risk that the council may be expected to provide further financial support which could be significant.</p> <p><b>Recommendation:</b> If the council intends to provide further financial support to Orkney College, they should agree a framework for how this will operate. This should include a review of the viability of the college's business units. The implications can then be reflected in future council budgets and financial performance information.</p>	<p>Agreed.</p> <p>We will undertake a review of the viability of the college's business units.</p> <p>We will use the findings to establish a clear framework for how the council may provide future financial support to the college.</p>	<p>Orkney College Principal / Head of Leisure and Lifelong Learning.</p> <p>By 31 March 2017.</p>
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