Item: 3

Monitoring and Audit Committee: 21 September 2023.

Annual Accounts – Update.

Report by Corporate Director for Enterprise and Sustainable Regeneration.

1. Purpose of Report

To consider the progress of the External Auditor's Annual Audit to those charged with governance of the Council's Financial Statements.

2. Recommendations

The Committee is invited to note:

2.1.

The requirement, in terms of the Local Authority Accounts (Scotland) Regulations 2014, for a local authority, or a committee of the authority, whose remit includes audit or governance functions:

- To consider and approve the audited Annual Accounts for signature no later than 30 September immediately following the financial year to which the accounts relate.
- To publish the accounts on a website by 31 October 2023.

2.2.

That challenges faced by the external auditors have resulted in the audit not being completed in line with the 2014 Regulations.

2.3.

That, in order to enable KPMG to complete the audit, a revised timetable has been agreed in that the signed Annual Accounts, together with an appropriate audit certificate, will be presented to the next meeting of the Monitoring and Audit Committee, scheduled for 16 November 2023, and published thereafter.

3. Background

3.1.

A requirement exists for each local authority to prepare an annual set of accounts which are to be lodged with Audit Scotland by 30 June each year. The accounts are then subject to an external audit verification process which concludes with an independent opinion being expressed on the accuracy and/or quality of the financial statements themselves. The statement of accounts, together with an appropriate audit certificate, should then be available for publication by 30 September each year.

3.2.

The purpose of the annual statement of accounts is to demonstrate proper stewardship of the Council's financial affairs.

4. External Audit Annual Plan

4.1.

The external audit annual plan, which was considered by the Monitoring and Audit Committee on 8 June 2023, outlined the work the external auditors required to undertake as part of the annual audit of the Council for the period 1 April 2022 to 31 March 2023.

4.2.

In terms of Regulation 10 of the Local Authority Accounts (Scotland) Regulations 2014, a local authority, or a committee of the authority whose remit includes audit or governance functions, must meet to consider the audited Annual Accounts; and aim to approve those accounts for signature no later than 30 September immediately following the financial year to which the accounts relate. The committee must consider whether the Annual Accounts should be signed, having regard to any report made on the accounts and any advice given by the proper officer or the auditor.

4.3.

The unaudited annual accounts were submitted to Audit Scotland on 30 June 2023 in line with the agreed audit timetable.

4.4.

On 31 August 2023, the Monitoring and Audit Committee scrutinised the draft Annual Accounts and subsequently approved, in terms of delegated powers, the Annual Governance Statement, together with the draft Annual Accounts for financial year 2022/23.

4.5.

Due to challenges faced by the external auditors, the audit has not been completed in accordance with the 2014 Regulations. Appendix 1, attached to this report, provides a status update from KPMG on the audit, including on page 2 a summary of the challenges faced. On enquiry with Audit Scotland, they confirmed that:

- "[They] have been in regular contact with KPMG and all auditors to monitor progress with the 22/23 audits. The local government target dates for completion have been moved forward from 31 October last year to 30 September this year, and with delays to completing many of last year's audits and the handover of auditors, we knew that this would be a challenging year for auditors. Based on our current information, we are expecting more than half of councils and a third of pension funds to be signed off after 30 September".

- "We have consistently emphasised that auditors should aim to deliver a high-quality audit, even if this results in them being unable to meet the target dates. We recognise that a delayed audit is an inconvenience to you as the preparer of the accounts and I am confident that KPMG are doing all they can to minimise the delay."

4.6.

The signed Annual Accounts, together with an appropriate audit certificate, will be presented to the next meeting of the Monitoring and Audit Committee on 16 November 2023, and published as soon as practical thereafter.

5. Corporate Governance

This report relates to the Council complying with its financial processes and procedures and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

6. Financial Implications

Existing staff resources are deployed as part of the annual financial year end closedown process to prepare the annual accounts for the Council. Extending the closedown period will put an additional strain on staff, and limit other work the team are able to undertake.

7. Legal Aspects

7.1.

Section 95 of the Local Government (Scotland) Act 1973 states that every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer has responsibility for the administration of those affairs.

7.2.

The requirement for a local authority to keep accounts is established in Section 96 of the 1973 Act.

7.3.

The Accounting Code constitutes proper accounting practices in terms of Section 12 of the Local Government in Scotland Act 2003, under the statutory framework provided by the Local Authority Accounts (Scotland) Regulations 2014.

8. Contact Officers

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9. Appendix

Appendix 1: Audit Status Update.

Appendix 1

KPMG

Orkney Islands Council

Audit status update

For Monitoring and Audit Committee

21 September 2023

Purpose of the report and background

Purpose of this report

- To provide an update to members of the Monitoring and Audit Committee of the current status of the external audit.
- Highlight **draft** conclusions and matters arising to date.

Background

The Local Authority Accounts (Scotland) Regulations 2014 require a Local Authority, or a committee of that authority whose remit includes audit or governance functions to meet to consider the audited Annual Accounts and aim to approve those accounts by 30 September and subsequently publish by end October. The Council planned to approve the Annual Accounts for the year ended 31 March 2023 for signature at this meeting however while significant audit progress has been made in a number of areas, including significant risk areas, there are aspects ongoing including important audit queries and areas of auditor challenge.

Continual enhancement of audit quality, changes in audit standards and expectations of the audit profession as a whole, together with the additional requirements of a first year audit, have contributed to the extended timeline being experienced across a number of local government and other audits.

We would like to acknowledge our thanks and appreciation for the engagement and support of Council officers in progressing the audit to date.

This report provides an update in respect of audit progress and does not represent final conclusions.

Status update

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Status update

Significant risk	The risk	Response and findings
Financial statement risk		
Fraud risk from management override of controls	Professional standards require us to communicate the fraud risk from management override of controls as significant. Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit.	- Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we have evaluated the design and implementation of the controls in place for the approval of manual journals posted to the general ledger to ensure that they are appropriate. - We have selected a sample of all journals to asses our High Risk Criteria, testing is on going. - We have assessed the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates. - We have assessed the controls in place for the identification of related party relationships and test the completeness of the related parties identified. We will verify that these have been appropriately disclosed within the financial statements. - Work is ongoing and at this time no issues have been identified

Status update

Significant risk	The risk	Response and findings
Financial statement risk		
Fraud risk from income and expenditure recognition	Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. This requirement is modified by Practice Note 10, issued by the FRC, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. *Income* We consider that the Council's significant income streams, which include taxation and non-specific grant income are likely to be free of management judgement or estimation. At the planning stage, we do not consider recognition of the remaining income sources to represent a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised, and these are not likely to be materially inappropriate. We have considered the risk of revenue fraud and have rebutted the presumed risk for revenue due to the nature of the grants and taxation income and also the types of commercial income *Expenditure* We consider that there is not a risk of improper recognition of expenditure in respect of payroll costs (including pension adjustments), financing and investment expenditure, or depreciation. These costs are routine in nature and are at less risk of manipulation. This relates to a significant proportion of council expenditure. We have not rebutted the assumed risk in respect of the remaining expenditure and consider the risk will be most likely to arise in respect of cut-off of expenditure around year-end, which we consider could result in a risk around the completeness (understatement) of accrued expenditure and payables.	— We are have selected the samples and received supporting documentation for most items which is currently being considered. — Our tests of expenditure cut-off and search for unrecorded liabilities are complete and no issues of fraudulent expenditure recognition have been identified. — Testing of year end accruals are ongoing.

Status update

Significant risk	The risk	Response and findings
Financial statement risk		
The carrying amount of land and buildings differs materially from the fair value	The value of the Council's Other Land and Buildings at 31 March 2022 was £306.7m, and Investment Property was £19.8m. The Code requires that where land and buildings are subject to revaluation and Investment Properties, their year end carrying value should reflect the fair value at that date. Any asset valuation carries with it risks of estimation uncertainty. The size of the land and buildings balance relative to our expected materiality means that the risk of a material difference between carrying value and fair value is increased. The Council commissioned a full revaluation of its land and buildings and Investment Properties, excluding infrastructure assets.	Our Valuation specialists have received the valuation report from the Council Valuer. We selected samples of assets from the main categories to test and understand the methodology used to estimate the value. Our specialists have had a number of calls and communications with the Council's specialist valuers which have included: - Consideration of the experience and skills of the valuers - The approach and valuation methodologies adopted for varying categories of assets - Specific consideration of the assumptions, method and calculation of valuation of a sample of assets We continue to query certain aspects of the above.

Status update

Significant risk	The risk	Response and findings
Financial statement risk		
An inappropriate amount is estimated and recorded for the defined benefit obligation	The valuation of the Local Government Pension Scheme (Orkney Pension Fund) relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation. There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions should be derived on a consistent basis year to year, or updated to reflect any changes. There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements. Pension Funds in surplus pose an additional risk to Councils, as the entity will need to assess the level of surplus that it can recognise. This will need to be assessed each year, and the conclusion can change from one year to the next based on facts and circumstances for each participation. *We do not consider there to be a significant level of estimation uncertainty over the valuation of the LGPS assets in year end valuation on the basis that this calculation is completed using an appropriate roll forward method. As a result procedures performed over this element of the valuation are not detailed in our audit plan.*	Our actuarial specialists have reached draft conclusions that the assumptions used in the estimation of the defined benefit obligation are balanced. We have identified one adjustment that is required to the accounts which reflects the actual rate of return on assets as against the initial estimate made by the Actuary. We have confirmed that the entries and disclosures in the Annual Accounts are in line with the actuarial report and fairly stated. We have considered the recognition of the pension surplus.

Status update

Other audit risk	Summary	Response and findings
Financial statement other audit risk		
The carrying amount of the Provision for de-commissioning of Flotta Oil Terminal.	The value of the Provision for the de-commissioning of the Flotta Oil Terminal as at 31 March 2022 was £32.2m This provision has been recognised to reflect the ongoing liability that the Council and its Partners will have to pay for the de-commissioning of the Flotta Oil Terminal. The provision is based on a Council Assessment of the liability that the Council should recognise to cover the costs of de-commissioning aligned alongside its partners.	We have reviewed the contract that the Council entered into in 1999 which gives rise to a contractual liability (annually increased by inflation). Based on our assessment and audit challenge to date, we are satisfied with the recognition of the provision and disclosures in the annual accounts. We have considered and challenged whether other provisions require to be recognised.

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the auditing *Code*").

This report is for the benefit of Orkney Islands Council and is made available to Audit Scotland and the Controller of Audit (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scoping and purpose section of this report.

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