



SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW



Orkney Islands Council

Annual Report to Orkney Islands Council and the Controller of Audit 2008/09

September 2009



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Executive Summary

Financial statements

We are pleased to report that our independent auditors' report expressed an unqualified opinion on the financial statements for the year ended 31 March 2009. We also certify that the accounts have been properly prepared in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

During the year, the Council reviewed its accounting treatment of investments managed by external managers and concluded that they should be accounted for as 'fair value through profit and loss'. As this was a change in accounting policy, prior year comparators have been restated. The main impact is on the Council's harbour authority account fund balance which reduced by £15 million. This includes the movement in fair value of these investments during the year.

Use of resources

The Council achieved a general fund surplus of £1.354 million in 2008/09. The general fund balance brought forward of £17.398 million at 1 April 2008 increased to a cumulative net surplus balance of £18.752 million at 31 March 2009. Of this balance, £2.811 million has been earmarked for specific purposes, which leaves an unallocated general fund balance of £15.941 million. This is greater than the Council's policy to maintain a minimum general fund balance of £8 million to meet unforeseen contingencies. This positive situation arises from the ability of the Council to achieve delivery of surpluses on its budget in the past two financial years without the need to draw on the use of the general fund balance. The growing level of the general fund balance will be taken account of in the review of the Medium Term Financial Strategy (MTFS).

The Council has agreed that £11.617 million of its 2008/09 capital programme be carried forward to future years. The capital budget for 2008/09 for general fund projects was £26.4 million. A further £3.617 million is to be carried forward on the Council non general fund capital programme. In an attempt to better manage the capital programme and reduce the level of slippage, budgets for the forthcoming years have been re-profiled.

There is scope for improvement in the Council's arrangements relating to asset management, procurement and managing people. Actions to improve performance in these areas are incorporated into the Council's corporate improvement plan.

The Council's Joint Working in Orkney Programme is an ambitious programme which covers Shared Services Projects, Joint Build Projects and Joint Health and Social Care Services. Significant work has been carried out to progress this programme. The Public Sector Reform Programme Board has had to work through a range of legal and procurement issues affecting shared services. It is recognised, based on the work carried out to date, that there are further complex and sensitive issues that will need to be addressed if shared support services are to be progressed.

Performance

The Council has made real progress in addressing most of the areas included within its audit improvement plan. The Best Value audit identified the Council's performance management arrangements as an area that required particular improvement. Corporate and service performance reporting arrangements have been significantly improved. Six monthly reports to service committee bring together the overall performance of the core services as included in the services' balanced scorecard, single outcome agreement objectives, service improvement action plans and service best value recommendations. Work however is still ongoing with regard to the management of people.

In May 2009, the Council approved its Single Outcome Agreement (SOA) in conjunction with its Community Planning Partners. We are pleased to note that the service level balanced scorecards now incorporate actions from the SOA and monitoring therefore falls within the Council's performance monitoring framework.

Governance

We have reviewed the Council's corporate governance arrangements in relation to its systems of internal financial control and standards of conduct including the prevention and detection of fraud and corruption. Our review confirmed that the Council's governance arrangements are, in general, satisfactory.

The Council continues to make progress in developing its risk management arrangements. Risk management is being embedded into service practices through the development of risk registers. Risk registers are now in place at a corporate and service level. There is however scope for further improvement in this area.

The most recent National Fraud Initiative was launched during 2008/09. We were disappointed to report that the Council failed to meet the original deadline to submit the required data. We also note that limited progress has been made to review and follow up data matches in certain service areas.

Looking forward

Uncertainty exists as to the impact any reduction in the Scottish Government budget will have on local authorities. Orkney Islands Council has however started to consider the possible range of outcomes on its 2010/11 budget. It has also recognised that the majority of commitments to be delivered under the Concordat will fall in 2010/11. Work is ongoing to refine the costs involved in delivering these commitments.

The Council has set itself a challenging programme of work over the coming years. This includes, for example, the Joint Working in Orkney Programme noted above. The Council has also developed a house build programme which will see 125 new council houses built over the next three years. To fund this investment programme (~£17 million), which includes bringing its existing stock up to the Scottish Housing Quality Standard by 2015, the Council is exploring the option of increasing housing rents.

In September 2007, the Council submitted a part 2 STAG report to the Scottish Government which contained a programme for replacement vessels and terminal upgrades on the inter-isles ferry services. This bid was unsuccessful. A working group has since developed a programme that will maintain the existing internal ferry system. The estimated cost of the programme is £81.3 million with a completion date mid/late 2015.

From 2009/10 there is a significant change to the Statutory Performance Indicator Direction. The level of reporting that will be involved to meet the requirements of the Direction has not yet been determined by the Council but is in progress.

Over the last year, the Council has reviewed the governance arrangements over Orkney College and has established a College Management Council. The Council has also agreed to the full integration of Orkney Ferries Limited, Orkney Towing Company Limited and the Department of Harbours into a unified Marine Service within Orkney Islands Council. This integration process will be carried out over three phases, with full integration by March 2011.

Conclusion

This report concludes our audit of Orkney Islands Council for 2008/09. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with the Chief Executive and members of the Council's management team. We would like to thank all members of Orkney Islands Council's management and staff who have been involved in our work for their co-operation and assistance during our audit visits.

Scott-Moncrieff
September 2009

Introduction

- 1 This report summarises the findings from our 2008/09 audit of Orkney Islands Council. The scope of the audit was set out in our External Audit Annual Plan, which was presented to the Monitoring and Audit Committee on 18 February 2009.
- 2 The main elements of our audit work in 2008/09 have been:
 - Audit of the financial statements, including a review of the Statement of Internal Financial Control
 - Review of corporate governance arrangements
 - Review of internal financial controls and financial systems
- 3 The key issues arising from our work during the year is summarised in this annual report.
- 4 Our findings are drawn together within four sections:
 - **Financial Statements:** summarises the key outcomes from our 2008/09 audit of Orkney Islands Council's financial statements.
 - **Use of Resources:** covers how Orkney Islands Council is managing its finances, workforce and assets.
 - **Performance:** covers the Council's performance management arrangements and statutory performance indicators
 - **Governance:** covers a summary of Orkney Islands Council's corporate governance arrangements
- 5 The report is addressed to Orkney Islands Council and the Controller of Audit and will be published on Audit Scotland's website, www.audit-scotland.gov.uk.

Financial Statements

Introduction

6 Financial statements are an essential means by which an organisation accounts for its stewardship of the resources available to it. In this section we summarise the key outcomes from our 2008/09 audit of Orkney Islands Council's financial statements.

Our Responsibilities

7 We audit the financial statements and give an opinion on:

- whether they give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2008 – A Statement of Recommended Practice (the SORP), of the financial position of the Council and its income and expenditure for the year then ended; and
- whether they have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

8 We also review the Statement on the System of Internal Financial Control by considering the adequacy of the process put in place by the Director of Finance to obtain assurances on systems of internal control. We assess whether disclosures in the statement are consistent with our knowledge of Orkney Islands Council. (paragraph 26)

Independence

9 International Standard on Auditing 260 – Communication of Audit Matters with those Charged with Governance – requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence.

10 We provided no additional services to Orkney Islands Council during the year and can confirm that we have complied with the Auditing Practices Board Ethical Standard 1 – Integrity, Objectivity and Independence. In our professional judgement the audit process has been independent and our objectivity has not been compromised.

Legality

11 We have planned and performed our audit recognising that non-compliance with statute or regulations may materially effect the financial statements. Our audit procedures included the following:

- Reviewing minutes of relevant meetings;
- Enquiring of senior management and the organisation's solicitors the position in relation to claims and assessments; and
- Performing detailed testing of transactions and balances.

- 12 We are pleased to report that we did not identify any instances of concern with regard to the legality of transactions or events.

Responsibility for the Statement of Accounts

- 13 It is the responsibility of the Council and Director of Finance to prepare the financial statements in accordance with the proper practices set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the SORP). This means:
- acting within the law and ensuring the regularity of transactions;
 - maintaining proper accounting records; and
 - preparing financial statements which present fairly the financial position of the council and its expenditure and income for the period ended 31 March 2009.

Overall conclusion

- 14 Our audit report is included on page 66 of the annual accounts and is addressed to members of Orkney Islands Council and the Accounts Commission for Scotland. The report was issued on 30 September 2009 and is unqualified. We also certify that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
- 15 Orkney Islands Council is required under Regulation 4 of the Local Authority Accounts (Scotland) Regulation 1985 to submit a copy of an abstract of their accounts to the Controller of Audit by 30 June. We can confirm that Orkney Islands Council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June.
- 16 The quality of the financial statements prepared by the Council is of a satisfactory standard. Our initial review of the accounts noted a number of points which required clarification or amendment. We believe there is scope to further improve the quality of the financial statements.

Action Plan Point 1

- 17 Our thanks go to staff at Orkney Islands Council for their assistance with our work.

Format of the Accounts

- 18 The financial statements should be prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2008 (the SORP). The SORP specifies the principles and practices of accounting required to prepare a Statement of Accounts which give a true and fair view of the financial position and transactions of a local authority and to prepare group financial statements where they have material interests in subsidiaries, associates or joint ventures.
- 19 In Scotland, the SORP constitutes proper accounting practice under section 12 of the Local Government in Scotland Act 2003, under the statutory framework established by the Local Authority Accounts (Scotland) Regulations 1985; and, for the audit of those accounts, by section

99 of the Local Government (Scotland) Act 1973 and section 12 of the Local Government in Scotland Act 2003.

- 20 As part of our 2008/09 audit we considered the arrangements Orkney Islands Council had in place to ensure compliance with the requirements of the SORP. Overall we concluded that the Council has complied with the requirements of the SORP.

Audit Adjustments

- 21 We identified no major errors or weaknesses during our audit. The main adjustment made to the financial statements is explained below:
- 22 The Council employs external fund managers Schroder Investment Management Limited and M&G Investments to manage its strategic reserve fund portfolio. As at 31 March 2009 the fair value of this fund was £134 million (2007/08 £148 million). During the year the Council concluded that the investments within this portfolio are being held for trading. As a result the Council restated this portfolio as 'fair value through profit and loss'. The portfolio had previously been classified as 'available for sale'. Due to a change in the Council's accounting policy, the prior year figures have been restated. The main impact on the 2008/09 financial statements has been on the harbour authority fund account. The decrease in fair value of the Council's strategic reserve fund portfolio during the year has reduced the harbour authority account fund balances to £166 million (2007/08 £182 million). The former available for sale reserve has also been restated to a nil balance.
- 23 All adjustments have been agreed with the Director of Finance and Housing and the financial statements have been amended to reflect these adjustments. All immaterial unadjusted errors have been reported to the Director of Finance and Housing and are disclosed in the letter of representation.

Internal Audit

- 24 Effective co-ordination between internal audit and external audit is essential in order to minimise duplication of effort and maximise the benefits of audit. As required by the Code of Audit Practice, we have established appropriate working arrangements with the Council's internal audit function.
- 25 We have reviewed the Council's internal audit arrangements to ensure that the work of internal audit is of sufficient quality and volume and complies with best practice. In carrying out our review we have assessed internal audit against the standards within the Code of Practice for Internal Audit in Local Government in the United Kingdom (the 2006 Code). Our review concluded that the Council maintains an effective internal audit function and is fully compliant across many of the Code's requirements. We were able to place reliance on their work, in 2008/09, in the following areas:
- Cash receipting and banking
 - Non Domestic Rates

- Officers Travel and Subsistence
- Statutory Performance Indicators

Statement of Internal Financial Control

- 26 Local authorities are required to include within their Statement of Accounts a statement on the system of internal financial control. This statement sets out the framework within which financial control is managed and reviewed and the main components of the system, including the arrangements for internal audit. Where the council is in a group relationship with other entities and undertakes significant activities through the group these activities should be encompassed within the statement of internal financial control.
- 27 Orkney Islands Council has published a group statement on the system of internal financial control in its 2008/09 Statement of Accounts. The statement provides an overview of the key elements of the Council and its group governance arrangements and systems of internal financial control.
- 28 As part of our audit work we review the information disclosed in the statement of internal financial control and assess whether the Council's opinion on the effectiveness of internal financial controls and governance arrangements is consistent with our understanding of the Council's internal financial control framework.
- 29 To inform our understanding of the system of internal financial control we have reviewed a number of specific areas during our 2008/09 audit. Our assessment of the Council's corporate governance arrangements included consideration of the authority's risk management system and its mechanism for the prevention and detection of fraud. We also carried out system reviews in the following areas:
- Non Pay Expenditure
 - Pay Expenditure
 - Treasury Management
 - Housing Rents
- 30 As highlighted in paragraph 25, we have also relied on the work of internal audit to support our work. Overall we found the systems of internal financial control reviewed to be of a good standard with controls operating at an adequate or effective level.
- 31 The Council's review of the effectiveness of the governance and internal financial control procedures is informed by the views of the Chief Internal Auditor, the Assistant Directors of Finance and managers within the group entity. The results of this work allow the Council to conclude that the system of internal financial control is largely effective. We did however note that assurance statements are not provided by Service Directors at the Council.

Action Plan Point 2

- 32 Overall we concluded that the Council's statement on the system of internal financial control is consistent with our knowledge and understanding of the financial control framework operating at the Council.

Group Accounts

- 33 In 2007/08, Orkney Islands Council classified its interests in four companies as subsidiaries, with a further three companies/trusts as associates. The Council's interests in the three Joint Boards were also classified as associates. The Council's interest in the Valuation Joint Board was classified as a joint venture.
- 34 During 2008/09, the Council carried out a review to determine whether those organisations within its group should continue to be disclosed in the group financial statements. The Council applied the flow chart documented within the SORP. The flow chart is used to determine whether the Council has an interest in subsidiaries, associates and joint ventures for the purposes of financial reporting. The deciding factor applied by the Council was materiality. Materiality, as defined by the SORP, should not be based purely on a quantitative basis but also should include qualitative judgements. The primary consideration should be the effect on the users of the financial statements in relation to their ability to see the complete economic activities of the Council and its exposure to risk through interests in other entities and participation in their activities (2008 SORP).
- 35 As a result of this exercise, the Council no longer includes the following bodies within its group accounts:
- Weyland Farms Ltd (former subsidiary)
 - Orkney Islands Property Development Ltd (former subsidiary)
 - Orkney Meat Ltd (former associate)
 - Orkney Herring Company Ltd (former associate)
 - Orkney and Shetland Valuation Joint Board (former Joint Venture)
 - HITRANS (former associate)
- 36 Overall we concluded that the Council's approach was consistent with the requirements of the SORP and that the appropriate disclosure has been made in the 2008/09 financial statements.

Fixed Assets

- 37 Orkney Islands Council's balance sheet includes a portfolio of tangible fixed assets which, as at 31 March 2009, was valued at over £214 million. During the course of our audit we carry out detailed testing to determine whether the assets of the Council are fairly presented and accounted for in accordance with the SORP. Whilst we concluded that the Council's financial statements are free from material misstatement we did note the following areas for scope for improvement in relation to accounting for tangible fixed assets:

Recognition of capital expenditure

- 38 Expenditure on existing fixed assets should be capitalised in only two circumstances:

- Where the expenditure represents an enhancement
- Where part of the asset is replaced which has been treated as separate component and depreciated over its own useful economic life

- 39 Expenditure incurred on fixed assets that does not meet the definition of capital expenditure as set out in the SORP cannot be added to the value of the asset or otherwise capitalised. It is therefore revenue expenditure.
- 40 A common risk area is repairs and maintenance work which is intended to ensure that a fixed asset maintains its previously assessed standard of performance. This work represents revenue expenditure and should therefore be charged to services as it is incurred. Where revenue expenditure is capitalised incorrectly, a council may write it off in full as it does not add any value.
- 41 Different parts of an asset may have significantly different useful lives and it may be preferable to treat each part as a separate component for depreciation purposes. Where a fixed asset is not treated as several different components, the cost of replacing parts of the asset is not added to the value of the fixed asset. Instead it should be treated as revenue expenditure unless it can be demonstrated that it is enhancement expenditure.
- 42 In 2008/09, Orkney Islands Council reported over £12 million of additions to fixed assets. £3.8 million of these additions however were impaired immediately on recognition in the balance sheet. The Council had concluded that this expenditure was enhancement expenditure which did not add value to the existing asset.
- 43 During the course of our testing we identified a number of transactions which were viewed by the Council as capital expenditure yet, in our opinion, would have been more appropriately accounted for as revenue expenditure. These largely related to the refit, refurbishment, replacement or restoration of buildings. When these assets were initially recognised in the balance sheet, a value was provided on the overall asset rather than a separate valuation being placed on each individual component. As a result any subsequent expenditure incurred in replacing or renewing individual components of these assets is not deemed to add value. Instead this should be accounted for as revenue expenditure.
- 44 Whilst this issue has not resulted in a material misstatement to the financial statements we would strongly recommend that the Council revisit its approach to accounting for expenditure on fixed assets to ensure full compliance with the SORP. This should include the introduction of component accounting where possible.

Action Plan Point 3

Investment Properties

- 45 Non operational assets are those not used in the direct delivery of services. This includes investment properties. Investment properties are defined as those assets which do not support

the service or strategic objectives of the Council and the rental income is negotiated at arms length. Investment properties are included at current value (market value) on the balance sheet.

46 As at 31 March 2009, Orkney Islands Council investment properties were valued at approximately £21 million. During our audit we noted two areas where there is scope for improvement in the accounting treatment of investment properties:

- The SORP does not require depreciation to be provided on investment properties. We noted during our review however that there was accumulated depreciation on investment properties (~£330,000).
- SSAP 19, Accounting for Investment Properties, states that an investment property is an interest in land and/or building in respect of which construction work and development has been completed. Our audit testing identified instances where the Council has classified assets under construction as investment properties.

Action Plan Point 4

Financial Instruments

47 A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another. The term 'financial instrument' covers both financial assets and financial liabilities and includes both the most straightforward financial assets and liabilities such as trade receivables and trade payables and the most complex ones such as derivatives and embedded derivatives.

48 As at 31 March 2009, Orkney Islands Council had total investments of £163 million. Of this, the Council's investments held in the strategic reserve fund (£134 million) are managed by external managers; Schroder Investment Management Limited and M&G Investments. During the year the Council concluded that the investments within the portfolio are being held for trading. As a result the Council restated this portfolio as 'fair value through profit and loss'. The portfolio had previously been classified as 'available for sale'. Due to a change in the Council's accounting policy, the prior year figures have been restated.

49 Local authorities sometimes give financial guarantees that require them to make specified payments to reimburse the holder of a debt if the debtor fails to make payment when due in accordance with the terms of the contract. Orkney Islands Council has given a financial guarantee to Orkney Towage Company in relation to the Naval Pension Scheme. In previous years the pension actuaries have calculated the liability on the pension fund and each body has a payment plan to cover this liability. The Council believes that the probability of the liability being called in is negligible as the Orkney Towage Company has met all payments due and has sufficient funds to meet the outstanding liability. An actuarial valuation is due on the pension fund in 2009/10. It is envisaged that this will increase the pension liability and the payment plan for Orkney Towage. As a result the financial guarantee given by the Council will need to be revisited.

Action Plan Point 5

Lease and Contract Commitments

- 50 The SORP requires disclosure in the Council's financial statement on leases. This includes, for example, disclosure on the amounts of any finance and operating leases paid to a lessor in the year. Different accounting treatment is applied depending on whether the lease arrangement is classified as a finance or operating lease.
- 51 The Council has not reported any lease disclosures in its financial statements where the Council is the lessee. During our audit however we identified two lease agreements where the Council is a lessee. We were unable to determine the extent of these arrangements and therefore whether these agreements had been correctly classified and disclosed in the financial statements. Assurance has been obtained through the Director of Finance and Housing that there are no further lease agreements which would impact on the financial statements.

Action Plan Point 6

Common Good

- 52 Local authorities are required to administer common good funds under Section 15 of the Local Government (Scotland) Act 1994. The purpose of common good funds is to provide a benefit to the population of the area either through the financial disbursement of funds, securing assets for the ongoing use of the population or contributing to specific local projects/initiatives.
- 53 In previous years we have commented on concerns that the list of assets recorded within the common good register was incomplete, that existing descriptions within the register did not enable the Council to readily identify the asset being referred to and that some of the properties recorded in the register no longer existed. In particular we have commented on the need to clarify the ownership of St Magnus Cathedral and to ensure that the accounting records reflect these findings.
- 54 In 2007 the Local Authority Scotland Accounts Advisory Committee, responsible for issuing proper accounting guidance in Scotland, issued a report on accounting for the common good fund. The guidance recommended that by 31 March 2009 all Scottish local authorities who administer common good funds should have an asset register of common good assets in place. Orkney Islands Council has made reasonable progress in implementing this guidance.
- 55 In order to confirm the heritable land and buildings belonging to the common good, the Council allocated resources from legal services to firstly review and agree title deeds for all common good properties and thereafter for this to be extended to all properties of the Council. Legal services are liaising with corporate property services to agree the boundaries for each title deed and with finance to ensure the asset register records this correctly. At the 31 August 2009, titles had been identified for all properties currently shown on the common good asset register. The boundaries and extent of some of the properties on the list however are still in the process of being defined. The review has recognised that there may be other areas of land that form part of the common good. As a result the value to be included in the common good balance sheet for these assets has yet to be determined.

- 56 It will not be possible to confirm with full certainty that the common good asset register is complete until other property within the Council asset register is considered to ensure it has been correctly classified.
- 57 Whilst the Council has made considerable steps to improving the accuracy of its common good property records, this work remains in progress. Additional work will also be required to confirm that all moveable assets are properly recorded on the common good asset register. We will therefore revisit this area as part of our 2009/10 audit.

Charitable Trusts

- 58 Local authorities with registered charitable bodies are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006. For each trust fund, the Regulations require a full set of financial statements to be prepared and submitted to the Office of the Scottish Charity Regulator (OSCR). OSCR has however deferred this requirement until 2010/11. In 2008/09, reliance can be placed on the existing disclosures for trust funds in the Council's financial statements, supplemented by appropriate working papers. As at 31 March 2009, the Council administered 45 trust funds, of which 26 are registered charities.
- 59 OSCR reviewed the quality of information provided by each local authority in 2007/08. They classified each local authority under five headings, ranging from 'poor' to 'fully compliant'. Orkney Islands Council was classified as 'below average'; one heading above 'poor'.
- 60 OSCR has indicated that local authorities should strive to comply with the middle category, 'above average'. This requires the following minimum filing requirements:
- Council's financial statements for 2008/09, including the audit certificate which covers the full financial statements and notes
 - Separate accounts for each registered charity in line with the format for receipts and payments account as set out in the Accounts Regulations 2006
 - A Trustees Annual Report covering each registered charity including all required elements under the requirements for receipts and payments accounts under the Regulations.

Action Plan Point 7

- 61 In February 2009, a paper was presented to the Council's Policy and Resources Committee which proposed, subject to OSCR approval, a Deed of Trust (The Orkney General Charitable Trust) be created which would re-organise the Council's charities and bequests into one single charity. The draft Deed also proposed that the Trustees comprise the Convenor, Vice Convenor and the Chief Executive and the Director of Finance and Housing of the Council as ex officio.
- 62 However, despite the prospect of a favourable response, OSCR has since rejected this Deed as it would not pass its 'charity test'. One concern raised by OSCR is over the naming of the trustees of the charity. OSCR has expressed a preference that independent trustees are also appointed. Negotiations with OSCR on this matter are still in progress.

Significant Trading Operations

- 63 Section 10 of the Local Government in Scotland Act 2003 requires local authorities to maintain and disclose trading accounts for significant trading operations (STOs). Each STO is required to breakeven over a rolling three year period. Under the terms of the Act the identification of significant trading operations is the responsibility of individual authorities. The Council applies a number of tests to determine the trading status of each activity and its level of significance.
- 64 Since 2006/07 the Council has not reported any STOs in its financial statements. This has been based on a review which was carried out in February 2007. At that time, of the sixteen trading operations identified, the Council concluded that they do not have any significant trading operations. The assessment also concluded that both waste disposal and quarries are provided for on the basis of recharge of cost and therefore should not be classified as trading operations. We confirmed during our audit that Orkney Islands Council's assessment is reasonable. We would however encourage the Council to perform this assessment on a more frequent basis.

Action Plan Point 8

Looking Forward

- 65 In 2008 the CIPFA/LASAAC local authority SORP board confirmed that from 2010/11 all local authority accounts will be prepared in accordance with International Financial Reporting Standards (IFRS). This change will bring local government bodies into line with other UK public sector bodies. It is essential that the Council starts the transition period. A comparative balance sheet as at 1 April 2009 will be required.
- 66 The Scottish Public Pensions Agency are consulting on the possibility of introducing changes to the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998 and the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008. The proposed amendment to the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 includes the requirement for each administering authority to prepare an annual pension fund report. The proposed content of this report includes the fund account and net asset statement with supporting notes and disclosure prepared in accordance with proper practices. The pension fund annual report would be published on or before the 1 December following the year end. The closing date for comments is 9 October 2009. We will continue to monitor developments in this area over the coming year.

Use of Resources

Introduction

67 In this section we summarise the key aspects of Orkney Islands Council's reported financial position and performance to 31 March 2009. We also consider and report on the Council's arrangements in place for workforce related issues, asset management and procurement.

Summary Financial Position

68 Orkney Islands Council achieved a general fund surplus of £1.354 million in 2008/09. The general fund balance brought forward of £17.398 million at 1 April 2007 increased to a cumulative net surplus balance of £18.752 million at 31 March 2009. Of this balance £2.811 million has been earmarked for specific purposes including, for example, devolved school management funds (£0.111 million), single status (£1.545 million) and its ALCO (Arms length council company) development fund (£0.365 million). It also includes the Orkney College accumulated deficit (£0.770 million), which is discussed at paragraph 73. This leaves an unallocated general fund balance of £15.941 million, which is greater than the Council's policy to maintain a minimum general fund balance of £8 million to meet unforeseen contingencies.

69 Exhibit 1 shows the balance in the Council's cash backed funds at 31 March 2009 compared to the previous year. Funds include the harbour authority account (paragraph 71), a capital fund which may be used to defray capital expenditure or repay loan principal, and a repair and renewal fund to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets. As at 31 March 2009, the Council had total cash-backed funds of £200 million, a decrease of £14.683 million on the previous year. This is largely attributable to the downward valuation in the Council's investment portfolio. (paragraph 93)

Exhibit 1: Orkney Islands Council cash-backed funds		
	2008/09	2007/08
	£ million	£ million
General Fund Balances	18.752	17.398
Harbour Authority Account Fund	166.450	182.614
HRA	0	0
Repair and Renewals Fund	8.752	8.535
Capital Fund	2.820	2.531
Capital Receipts Reserve	2.805	3.184
TOTAL	199.579	214.262

Source: Orkney Islands Council Statement of Accounts 2008/09

- 70 The Council does not retain a housing revenue account reserve. Instead any surplus is used to finance capital expenditure. In 2008/09, capital expenditure funded by the HRA amounted to £0.430 million (2007/08 £0.499 million).
- 71 The Orkney County Council Act 1974 authorises Orkney Islands Council to exercise harbour jurisdiction as a Competent Harbour Authority. The Act also requires the Council to keep separate accounts in respect of the harbour authority account. The trading position from the harbour operations is reflected within the Council's net cost of services.
- 72 The Council reported a net decrease in the harbour authority account fund balance in the year of £16.164 million (2007/08: net increase £8.524 million). As a result the fund balance brought forward of £182.614 million at 1 April 2008 decreased to a cumulative net surplus balance of £166.450 million at 31 March 2009. The main reason is due to the change in accounting treatment of the investments held in the strategic reserve fund (paragraph 22). In addition to this, both the deficit in year on the harbour services (paragraph 77) and the transfer to the general fund in the year was greater than in 2007/08. In 2007/08 the general fund transfer was £0.325 million compared to a transfer in 2008/09 of £4.177 million.
- 73 Orkney Islands Council also provides further and higher education provision through Orkney College. The College is funded by direct grant from the Scottish Funding Council (SFC). During the financial year 2008/09, the College generated a surplus of £0.168 million for the year, resulting in a decrease in the accumulated deficit position on the College to £0.770 million as at 31 March 2009. The surplus generated in the year was in part attributable to a transfer from Education Services (£0.250 million). The College also received £36,000 from the Harbour Authority Account Fund.
- 74 To ensure Orkney College is committed to managing its deficit position, the Council requires the College to budget for and realise an annual surplus on its activities on an ongoing basis. A range of measures recommended by a working group, established to explore options for improving the financial position of the College, were implemented during the year. While this meant in the short term that additional restructuring costs were incurred, the outcome from this process has been that the College is now able to budget to return a surplus on its activities.

Financial Performance

- 75 The budget set for 2008/09 was based on a Band D council tax level of £1,037. The Band D council tax level was frozen at 2007/08 levels. In comparison with the budget, the Council reported a favourable outturn position of £1.166 million (after adjusting for apportioned costs). Due to the under spend achieved against the budget, the contribution from the general fund balances (£1.3 million) was not required.
- 76 With the exception of Transportation and Infrastructure, all Service Committees reported under spends against approved budgets. The over spend in Transportation and Infrastructure was £6,000. The main under spend was reported under 'other services' (£1.506 million). Of this £1.3 million was set aside as part of the 2008/09 budget setting process within corporate contingency.

This was to be funded from the contribution from general fund reserves. As noted above, this allocation was not utilised during the year.

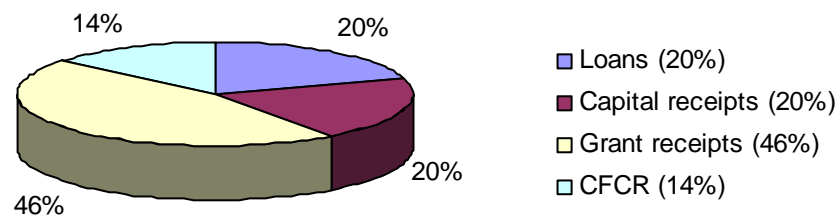
77 The Council also reported an over spend of £1.315 million against budget on its non-general fund services. Non general fund services comprise Housing Revenue Account, Scapa Flow Oil Port and Miscellaneous Piers. The over spend is attributable to the latter two as the Housing Revenue Account returns a balanced budget each year (paragraph 70). The main reasons for the over spend are:

- Towage Services (£0.670 million) – additional refit costs and redundancy costs
- Harbour Dues (£0.236 million) – reduction in tanker traffic
- Loans Charges (£0.455 million) – no budget was set in 2008/09 in respect of financing the capital programme through the revenue budget

Capital Performance

78 During the year the Council spent £12.026 million on capital expenditure. This was financed by internal borrowing, capital grants and capital receipts (Note: The Council borrowed from the harbour strategic reserve fund during the year).

Exhibit 2: Sources of Funding



79 A paper was presented to the Policy and Resources Committee in June 2009 advising of slippage in the Council's 2008/09 capital programme. The revised capital budget for 2008/09 for general fund projects was £26.4 million. Of this, £11.617 million is to be carried forward. A further £3.617 million is to be carried forward on the Council non general fund capital programme.

80 This under spend against the capital programme has been brought about by project development being significantly behind anticipated schedules. The main projects where slippage has occurred include:

- Accommodation for people with learning disabilities (£2.754 million)
- Kirkwall Care Facilities (£4.790 million)
- Stromness Academy Upgrade (£0.521 million)
- World Heritage Area (£0.569 million)

- Stromness Pierhead Regeneration (£1.053 million)
- Inner North Isles Ramps (£1.687 million)
- New replacement pilot boat (£1.224 million)

81 In an attempt to better manage the capital programme and reduce the level of slippage, budgets for the forthcoming years have been re-profiled (exhibit 3).

Exhibit 3: Orkney Islands Council Capital Programme 2009/10 onwards				
2009/10 £million	2010/11 £million	2011/12 £million	2012/13 £million	2013/14 £million
15.830	62.838 ¹	7.977	4.089	3.660
Source: Paper to Policy and Resources Committee 23 June 2009 – ‘Capital Slippage 2008/09’ ¹ – This includes the new Kirkwall Grammar School, Stromness Primary School, KGS Halls of Residence and the Leisure Pool (capital spend estimated at over £50 million)				

2009/10 Financial Position

82 In February 2009, the Council agreed that its revenue budget for the financial year 2009/10 be set at £82.064 million. The Council also agreed to freeze council tax at 2007/08 levels (i.e. Band D Council Tax levels were set at £1,037).

83 In setting its budget the Council agreed to the following:

- No contribution be made from the general fund reserve to balance the budget from the financial year 2009/10;
- A savings target of £1 million be set for 2009/10 and this to be incorporated into the overall budget. This was allocated across individual services (see paragraph 123,124);
- The level of interest earned from the Strategic Reserve Fund and made available to fund specific services and/or projects should remain at £4.76 million; and
- New and/or additional spending pressures totalling £2.219 million be incorporated into the 2009/10 budget.

84 As part of the budget setting process, service and spending pressure bids were received from Directors. These were subject to review by the Corporate Management Team and Finance Working Group. Elected members agreed on those that should be included in the 2009/10 budget. The £2.219 million approved includes:

- Pensions (£0.450 million)
- Fuel Price Pressures (£0.525 million)
- Social Work Cost Packages (£0.300 million)

85 In 2007, the Council agreed to develop a medium term financial strategy to be implemented from the 2008/09 budget round. At that time it was recognised that further work was required to develop this strategy. This remains the case. In setting the 2009/10 budget, it was recognised

that further work needs to be done before the medium term financial strategy is presented as a final draft. This includes, for example:

- Revisiting the policy on the use of reserve and use of interest earned on the reserves;
- Developing an asset management strategy and establishing the target receipt level for disposal of surplus assets; and
- To set out how, when and to what extent the Council will ensure that resources (people, property and money) are allocated to the priority areas of spending.

86 We noted that the Finance and Housing Services improvement plan includes an action to link the financial strategy to an overall resource management strategy. In the latest monitoring report (June 2009) this action has been assessed as amber (the performance indicator/agreed action is experiencing minor underperformance, with a low risk of failure to meet its target). We will continue to monitor the Council's progress in implementing this action over the coming year.

Treasury Management

87 During the year the Council appointed Sector Treasury Services Limited (Sector) to review its treasury management policies, practices and procedures. The report from Sector recommended that the Council consider the following:

- Externalise its internal borrowing position, thereby releasing reserves to generate investment returns in excess of the cost of borrowing; and
- Maintaining a larger temporary loans portfolio in-house for cash management purposes, rather than paying external fund managers to manage cash portfolios.

88 At the time, the Council was debt free and used its reserves to finance its capital spending plans. In addition, the Council's Treasury Management Practices did not permit the Council to borrow in order to finance its capital finance requirement.

89 A paper was presented to the Council in December 2008 which recommended that the Treasury Management Practices were revised to allow the Council to borrow. Following approval of this recommendation, the Council borrowed £10 million from the Public Works Loan Board (PWLB) in December 2008. A further £10 million was borrowed from the PWLB in January 2009.

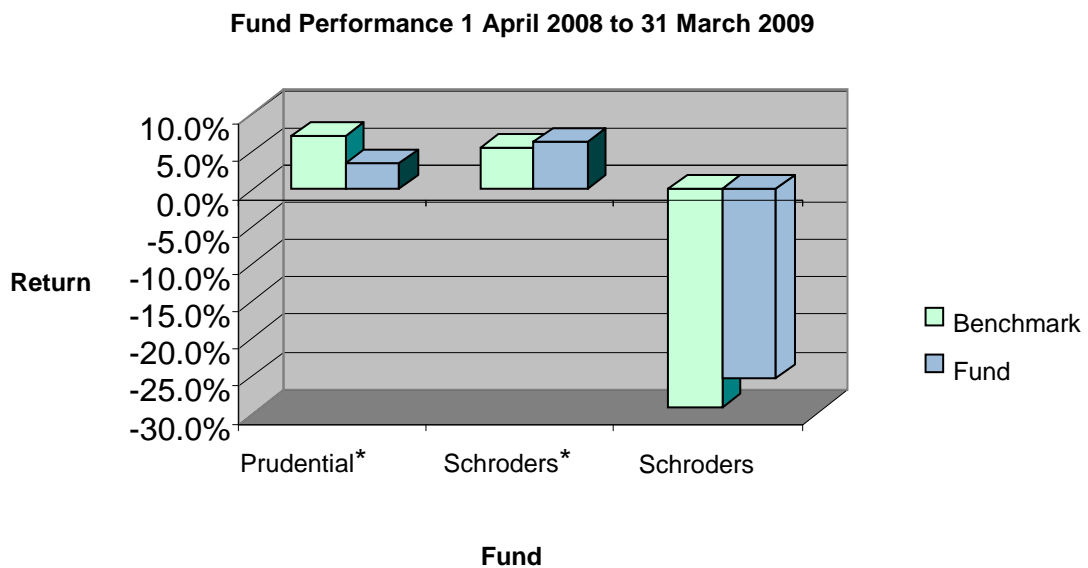
90 The CIPFA Prudential Code is clear that local authorities must not borrow more than or in advance of needs purely in order to profit from the investment of extra sums borrowed. Authorities are required to demonstrate that net external borrowing does not, except in the short term, exceed the total capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. An authority should be able to demonstrate that the savings expected to accrue from borrowing at an advantageous rate outweigh the costs of borrowing early.

91 Based on the approved capital programme for the period 2008-11, the Council identified a capital financing requirement of £73.6 million. The borrowing transactions noted above do not exceed the Council's capital financing requirement. This position will be reviewed on a regular

basis as part of the Council's overall treasury management strategy, including any associated impact on both the Council's short and long term investments.

- 92 Section 69(2) of The Orkney County Council Act 1974 permits “any monies standing to the credit of the Reserve Fund to be invested in any securities in which trustees are for the time being authorised to invest trust monies.” The Council employs external fund managers Schroder Investment Management Limited and M & G Investments to manage its strategic reserve fund portfolio. Short term deposits are managed by the Council's finance department. The performance of the investment managers is monitored through quarterly performance reports. These reports provide an analysis of performance against agreed benchmarks.
- 93 Exhibit 4 illustrates the performance of the external managed funds for the year against the agreed benchmarks. The current economic climate has impacted on the overall performance of these funds. Equity investments held by Schrodgers Equity Investments generated negative returns. The total value of the fund reduced by £14 million over the year. This consisted of a significant fall in the valuation of the Schrodgers Equity Investment Fund, offset by an increase in the value of Cash and Bond portfolios.

Exhibit 4: Performance of external managed funds against agreed benchmarks



Source:

* = Prudential and Shrodgers funds were held in Cash and Bond portfolios.

Pension Fund

- 94 The Orkney Island Council Pension Fund provides pensions and other benefits to local government members and their beneficiaries. The Fund is part of the Local Government Pension Scheme and is a multi-employer scheme.

- 95 On an annual basis the fund's actuary Hymans Robertson carries out a valuation of the scheme under Financial Reporting Standard 17 (FRS 17). This valuation is incorporated into the financial statements of the Council. The following table summarises the actuary's FRS 17 valuation:

	31 March 2009 £million	31 March 2008 £million
Fair value of employer assets	83.95	99.79
Present value of funded liabilities	(97.15)	(97.95)
Present value of unfunded liabilities	(7.00)	(6.63)
Net liability	(20.20)	(4.79)

- 96 Whilst funded and unfunded liabilities have stayed relatively constant from the previous year, the fair value of employer assets has fallen significantly due to the fall in equity values.
- 97 The FRS 17 valuation is based on methods and assumptions specified within the financial reporting standard. Its results reflect a snap-shot of the position at 31 March 2009. To assess the extent to which the Council's funding objectives are being met and to identify the contributions payable by the Council in future to meet the funding objectives, a full actuarial valuation is carried out every three years. The most recent full actuarial valuation was carried out at 31 March 2008 and was reported to the Council in March 2009.
- 98 In assessing whether the funding objectives are being met the actuary assesses whether the fund has sufficient assets to meet the assessed cost of members' past service benefits. This is referred to as the funding level. A funding level of 100% would correspond to the assets being exactly sufficient to meet the cost of members past service benefits. At 31 March 2008 the funding level for the Orkney Islands Council Pension Fund was 86% with the shortfall of assets to the assessed cost of members' benefits amounting to £17.6 million. This compares to a funding level of 87% at 31 March 2005.
- 99 The actuary has confirmed that based on the this funding position, employer contribution rates will need to increase to 18.1% of pensionable pay from 1 April 2009 with a further 3.3% additional contribution payable for 20 years to recoup the existing funding deficit. The additional 3.3% contribution relating to the funding shortfall can be phased in over 3 years. The 20 years used to spread the impact of the existing deficit funding is an increase from the previous period of 16 years used following the 2005 valuation. The 20 years currently being used is the maximum length of time over which such a deficit could be spread. Extending the funding period any further is unlikely to be an option to the council in future.
- 100 The increase in the employer contribution rates is due to the maturing of the employee membership, changes in the scheme benefits and falls in real gilt yields. This has been partially offset by greater than expected investment returns. The actuary has however noted that since 31 March 2008 there have been significant falls in equity markets and yields available on government bonds. Indeed if the market conditions of March 2009 had been applied to the

March 2008 valuation the shortfall in assets versus benefits would have been in excess of £30 million rather than the £17.6 million reported above. This would represent a funding level of 77%.

- 101 Given these serious concerns over the funding position of the scheme we would endorse the actuary's recommendation that the financial position of the fund is monitored through interim funding reviews. It is also important that the fund identifies funding strategies which meet its objectives whilst recognising the implications in terms of prudence, affordability, stability and stewardship.

Action Plan Point 9

Asset Management

- 102 Asset management can be defined as the activity that ensures that the asset portfolio is making the maximum possible contribution to achieving the Council's objectives. This will involve strategic considerations, including for example, what number, type and location of assets are required to meet Council objectives. It also involves the day to day maintenance and running of the assets. The annual running costs associated with managing and financing assets tend to constitute the second highest element of revenue budgets after employee costs.
- 103 The appropriate use of assets in the right location can make the difference between good and poor service delivery. Good asset management helps to ensure that services are delivered in the most efficient and effective way. It can also reduce the opportunity cost of money associated with surplus property and reduce the council's carbon footprint.
- 104 In May 2009 Audit Scotland published '*Asset management in local government*'. The overall aim of this study was to evaluate the extent to which councils manage their assets to ensure effective service provision and value for money. The national report found that councils could make significant improvements in their asset management arrangements and made a number of recommendations to councils.
- 105 This report has been presented to Orkney Islands Council's Monitoring and Audit Committee and is due to be presented to the Policy and Resources Committee in September. At the time of issue of this national report, the Council's internal auditors issued a local report on the Council's Corporate Property arrangements. The Council believe that implementing the recommendations raised in the internal audit report will address many of the improvement actions included in the national report.
- 106 Internal audit's review into Corporate Property at the Council considered the following:
- that there are effective procedures in place for managing and recording all Council owned properties,
 - that there are appropriate controls over the letting of Council owned properties,
 - that all Council owned properties are appropriately insured,
 - that all property disposals are approved and managed in accordance with agreed policy,

- that procedures are in place to ensure that the repairs programme is managed effectively and that Council properties are being maintained.
- that procedures are in place to ensure that the Corporate Property Improvement Programme is managed effectively.

107 The report made 29 recommendations, of which 9 were assessed as high priority. At the time the review was carried out, the Council had yet to approve a formal asset management strategy. It was noted that some of the recommendations raised would be implemented through the development of a formal asset management strategy.

108 A Property Asset Management Plan was presented to the Policy and Resources Committee in April 2009 and also adopted by full Council in the same month. This asset management plan is seen as a starting point in respect of formalising the Council's property management functions and activities. The Council acknowledge that significant work will need to be carried out in future years to ensure the fundamental principles of good asset management are established and disseminated across the Council.

Procurement

109 Orkney Islands Council is in the early stages of developing its procurement function. Procurement has traditionally been devolved to each Service Director and not as a corporate function. The Council appointed a Head of Procurement in September 2008 and to date this post remains the only corporate procurement resource within the Council.

110 During the year, the Council signed up to Procurement Scotland. The Council intends to procure the supply of electricity through Procurement Scotland. The Council has also considered becoming a member of Scotland Excel. This decision however has been deferred until a review of the risks and rewards of membership have been evaluated.

111 In 2009, Audit Scotland asked local authorities to complete a Local Government Procurement Information return. The aim of this return was to capture the information which is being used in local government to shape and improve procurement practices following the McClelland review. At a local level, Orkney Islands Council reported the following in its return:

- A corporate procurement strategy is in the process of being drafted. The Contract Standing Orders are also being updated.
- To date the Council has reported against 7 Best Practice Indicators (BPIs). This however was not achieved by 31 March 2009. Scottish Government guidance suggests that baseline information should have been uploaded by July 2008, followed by certain indicators being reported quarterly. The remaining indicators should be reported annually.
- The Council has agreed to sign up to the Suppliers Charter.
- The Council will shortly commence work on establishing a corporate contracts register.
- Internal audit carried out a review of the current procurement processes, procedures and function in 2008. Its findings highlighted the fragmented nature of procurement throughout

the Council and the need to introduce procedures and processes that formalise how the Council undertakes its procurement activities.

- 112 We would encourage the Council to develop an action plan to demonstrate how it intends to take these actions forward.

Action Plan Point 10

Managing People

- 113 The Council's best value report noted the following in terms of managing people:

The Council has a committed workforce but it is not making the most of the skills of its staff. It has a sound strategy for workforce planning and management but this has not been implemented. It needs to improve its management of sickness absence.

Source: The Audit of Best Value and Community Planning Orkney Islands Council – June 2008

- 114 As highlighted in the performance section of this report, this is an area where insufficient progress has been made. The performance monitoring reports for the quarter ending 31 March 2009 show that in most departments, sickness absence levels are considerably higher than the 4% target and that staff appraisal levels are unacceptably low.
- 115 In 2006/07, Orkney Islands Council made payment for all amounts due under equal pay legislation. These payments covered all liabilities due in the period to 31 March 2007. No cases have been submitted to an employment tribunal regarding equal pay claims.
- 116 In 2007/08 the Council finalised a single status agreement which took effect from April 2007. To reflect the costs of protection arrangements arising from single status a provision of £1.112 million was recognised in the 2007/08 annual accounts. This provision was fully utilised during the 2008/09 financial year, with payments being made to the majority of staff who were entitled to protection arrangements. A small number of payments have not been made, but are not considered to be significant, or likely to be taken to an employment tribunal. No further provision has been made in the 2008/09 accounts.
- 117 Over the period 2002/03 to 2007/08, budget provisions were set aside to cover future liabilities arising from the job evaluation process. These unapplied budget provisions totalled £1.599 million as at 31 March 2008 and were located in the annual accounts as the Single Status Fund.
- 118 From 2007/08 onwards the budget strategy saw £1.500 million being set as a permanent base budget increase based on the estimated increase in the General Fund pay bill. The provision of £1.112 million referred to in paragraph 116 above was set against this annual budget in 2007/08. It was only during the course of 2008/09, however, that the backdated payments were made to the majority of staff at an actual cost of £1.166 million, an increase of £0.054 million from the provision set aside. This reduced the value of the Single Status Fund by an equivalent amount,

with the closing balance as at 31 March 2009 standing at £1.545 million. The Fund will be reviewed as part of the revised Medium Term Financial Strategy.

Efficiency

- 119 In June 2004, the Scottish Executive launched the Efficient Government Initiative. The initiative aspired to achieve £1.5 billion of efficiency savings by 2007/08 and reported efficiency savings of £1.7 billion. In November 2007 the Scottish Government announced the Efficient Government Programme 2008/09 – 2010/11, setting set out its target to deliver cash-releasing efficiency savings amounting to £1.6 billion in 2010/11.
- 120 As part of Audit Scotland's performance audit programme a national study on the delivery of efficiencies within the Scottish public sector is being undertaken. The study will provide an overview of the Scottish Government's Efficient Government Initiative 2005/06 – 2007/08 and consider the extent to which public bodies are set up to deliver year on year efficiency savings.
- 121 To assess the readiness and ability of public sector bodies to deliver year on year efficiency savings Audit Scotland undertook fieldwork across central government, the NHS and councils, with five bodies being selected from each. Orkney Islands agreed to participate in the study.
- 122 The fieldwork assessed the arrangements for monitoring and measuring efficiencies and how public bodies seek to ensure that reported savings have are delivered without affecting service delivery. Audit Scotland's national report will be published in late 2009.
- 123 The expected level of efficiency savings to be met for the period 2008/09 – 2010/11 has been set at 2% per annum. To meet this target, Orkney Islands Council identified that savings of £1million would be required in 2009/10. This equates to 1% savings on all services plus retention of expenditure from services which under spent in previous years. In addition inflation in other non pay costs was restricted to 1.5%.
- 124 Efficiency savings are identified through the Council's budget setting process. Once the level of efficiency savings has been agreed each service is required to demonstrate how they will achieve these savings. The proposed measures are presented to the Council to ensure the Council's priorities are being achieved. At the time of our fieldwork, for the national report, services had yet to present their proposals for 2009/10 to the Council. Our fieldwork also highlighted that there is a lack of clarity throughout services over the definition of an efficiency saving compared to a saving arising from a cut in service.

Action Plan Point 11

- 125 Progress in achieving efficiency savings is monitored through the budget monitoring statements. We did however note that limited information is presented to committee on efficiency savings achieved through individual efficiency projects. We also noted that the Council does not currently have arrangements in place to demonstrate how its efficiency savings impact on service delivery.

Action Plan Point 12-13

126 At the year end, information is gathered at a service level on the level of efficiency savings achieved in the year. This is submitted to the Assistant Director of Finance who is responsible for preparing the Annual Efficiency Statement.

127 In 2008/09, Orkney Islands Council has reported efficiency savings in the following areas:

Exhibit 5: Extract from the Council's Annual Efficiency Statement				
	Cashable	Non-Cashable	Total 2008/09	Total 2007/08
	£'000	£'000	£'000	£'000
Better Procurement	148	0	148	22
Managing Absence	0	0	0	50
Asset Management	114	0	114	338
Other	155	377	532	770
Total	417	377	794	1,180
Source: Orkney Islands Council Annual Efficiency Statement 2008/09				

128 The £377,000 non-cashable savings includes savings due to specific measures implemented by services in 2008/09. This includes, for example, review of staffing levels, restrictions on low priority staff travel and the adoption of energy saving measures across the Council.

Joint Working in Orkney

129 No efficiency savings have been reported under the shared services heading in the last three years. This however is an area where significant work is being undertaken by the Council. Work in this area is referred to locally as the 'Joint Working in Orkney Programme'.

The effective delivery of public services and sustainability of public organisations in Orkney are vital to community and individual wellbeing. The Joint Working in Orkney Programme is about delivering better and more efficient services to families and individuals but it is also about recognising the role that public services play in sustaining communities, businesses and jobs in island economies.

Source: Paper to Policy and Resources Committee 'Shared Support Services' – June 2009

130 A Public Sector Reform Programme Board has been created to take this programme forward. Membership of this Board includes representatives from Orkney Islands Council, NHS Orkney, Voluntary Action Orkney, Scottish Government and the Improvement Service.

131 The projects are grouped into three categories; Shared Services Projects, Joint Build Projects and Joint Health and Social Care Services (exhibit 6).

132 Included within the shared service projects are projects supported by grant funding from the Scottish Government's Efficiency and Reform Fund. Those projects covered human resources,

information systems, procurement, joint transport, property management and maintenance and hotel services.

- 133 Funding for projects supported by the Efficient Government Fund finished at the end of March 2009. Reports have been prepared on these work streams which set out recommendations and actions for the Council and NHS Orkney to progress jointly and individually. For example, it is proposed that information services of both organisations will become one shared service from October 2009 (see exhibit 6).

Exhibit 6: Joint Work in Orkney Programme	
Shared Support Services	<p>Given the complex legal arrangements of the Council and NHS Orkney, the most efficient way to deliver shared support services is through a special purpose vehicle (SPV). The SPV - Orkney Public Services Ltd – would be a wholly publicly owned and controlled company.</p> <p>Orkney Public Services Ltd is due to begin operating a joint Information Service in 2010/11. Human Resources and some finance functions will also be phased into the SPV thereafter.</p>
Joint Build Projects	<p>There are three strands to this theme,</p> <ul style="list-style-type: none"> • Schools Investment Programme – building two replacement schools, halls of residence and a swimming pool using a hybrid PPP model. This will be procured by a wholly publicly owned and controlled Special Purpose Vehicle (SPV) – Orkney Infrastructure Ltd. The project is due to be completed by September 2012. • Replacement Hospital – a business case is being developed to replace the current Balfour Hospital and other NHS facilities. This is expected to be presented to the Scottish Government in early 2010. • Integrated Health and Care Facilities – two projects that will combine residential and high dependency care facilities on the Islands.
Community Health and Social Care Partnership	<p>A shadow partnership is now in place with an interim joint director. This is intended to be operating fully by April 2010. The aim is to deliver services that will support people in their own homes and communities, aiming to reduce emergency and repeat admissions to hospital as well as reducing the number of people who require to leave Orkney for long term care.</p>
Source: <i>Efficiency and Reform Fund Final Report, Scottish Government, June 2009</i>	

- 134 Significant work has been carried out to progress this ambitious programme. The Public Sector Reform Programme Board has had to work through a range of legal and procurement issues affecting shared services. For example, NHS Orkney required clarification over its power to participate in companies and the extent to which shared support services fell within the scope of

the National Health Service (Scotland) Act 1978. Confirmation has however been received that they can proceed. European Procurement rules also apply to shared services between public bodies.

- 135 It is recognised, based on the work carried out to date, that there are further complex and sensitive issues that will need to be addressed if shared support services are to be progressed.

Future Outlook

- 136 It is anticipated that real term reductions in the Scottish Government's budget will occur and these reductions will take place over a number of years. Initial projections, based on Treasury forecasts could mean a real term cut of at least 8.5% in the Scottish Budget between 2009/10 and 2013/14. Orkney Islands Council has begun to consider the impact this may have on the Council's future budgets. The speculative impact on the Council ranges from a £600,000 reduction to £1.45 million reduction in grant funding.
- 137 In setting its 2009/10 budget, the Council also recognised that the majority of commitments to be delivered within the grant settlement as set out in the Concordat will fall to be funded in 2010/11. Officers from the finance division are working with service directors to identify and further refine the information on the likely level of costs involved.
- 138 A paper on council house rents was recently presented to the Social Services and Housing Committee. The Council has developed a house build programme which will see 125 new council houses built over the next three years. It is anticipated that the cost of delivering these houses will be in the region of £13 million. In addition to building new houses, the Council is legally obliged to bring its existing stock up to the Scottish Housing Quality Standard by 2015. The cost of meeting and maintained the Standard is approximately £4 million. To fund this investment programme, the paper proposed that rents be increased by 8% (plus RPI) from April 2010, a further 6% (plus RPI) from April 2011 and a further 4% (plus RPI) from April 2012. The Director of Finance and Housing is due to consult with tenants on the proposed increases between September and December 2009.
- 139 In September 2007, the Council submitted a part 2 STAG report to the Scottish Government which contained a programme for replacement vessels and terminal upgrades on the inter-isles ferry services. This bid was unsuccessful. At the time the Council was also informed that no additional money would be available from the Scottish Government until the next spending period (from 2011). A joint officers working group (comprise of Scottish Government and Council officials) has been established to identify alternative options. The working group has developed a programme that will maintain the existing internal ferry system. The estimated cost of the programme is £81.3 million with a completion date mid/late 2015. The Scottish Government has indicated that it is the responsibility for funding the ferries and associated infrastructure rests with the Council. The Council are developing a submission to the Government Ferries Review and Cabinet Secretary for Finance and Sustainable Growth which includes a 25% contribution (£20 million) by the Council and Government supported borrowing for the balance at approximately £4.3 million per annum over 25 years.

- 140 Local authority investment activity is regulated by statute. Provisions exist in the Local Government in Scotland Act 2003 for Scottish Ministers to introduce a new regulatory framework. Scottish Ministers are currently drafting regulations (The Local Government Investments (Scotland) Regulations) which will provide greater autonomy for local authorities in their investment activities. This will place greater responsibility on local authorities to act prudently with regard to their investment and treasury management activities. The draft regulations also propose an amendment to the Orkney County Council Act 1974 so that monies held in the harbour reserve funds may be invested in accordance with these Regulations.
- 141 At its meeting in September 2009, the Development Committee agreed to invest an initial £100,000, from the Council's reserve fund, to continue to promote Orkney's potential as a marine renewable industry centre. It is estimated that realising the potential of the renewable energy resources around the islands would be significant in terms of boosting the local economy and on a similar scale to the arrival of the oil industry in the 1970.

Performance

Introduction

142 An effective council is one which has a clear and ambitious vision for what it wants to achieve for its locality and communities and for securing high quality services and effective outcomes for local people. The vision should be promoted by elected members and senior officers of the council and supported by staff and partners. The vision should be supported by clear plans and strategies to secure improvement, with resources aligned to support their delivery. An effective council is one which has a performance management culture embedded throughout the organisation. The council's performance management framework should be integrated with service planning and delivery.

143 In this section we summarise how Orkney Islands Council manages its performance.

Best Value

144 In June 2008 the Controller of Audit published her report on Best Value and Community Planning at Orkney Islands Council. The main findings from this report were included within our 2007/08 Annual Report on the Audit. The Accounts Commission also identified a nine point improvement agenda as follows:

Exhibit 7: Orkney Islands Council improvement agenda

1. Develop a detailed programme with targets and timescales to support the council's improvement agenda
2. Work with partners to develop a strategy to address skills gaps through a structured training and development programme and by identifying where additional temporary capacity would be appropriate
3. Ensure that the new corporate plan contains clear targets and measures of success and is supported by a detailed action plan to support delivery of key objectives
4. Establish an effective corporate performance management system with measures of cost and quality across the range of council services, including measures of the cost and impact of sustaining fragile communities
5. Develop the role of elected members in leading Best Value, in particular through the scrutiny of performance
6. Develop the role of the CMT in providing strategic leadership and monitoring and driving performance improvement
7. Develop strategic resource management to ensure resources, including finance, assets, workforce and ICT, are focused on delivering key priorities
8. Increase the level of challenge to existing ways of doing things to ensure that services provide best value and are designed around the needs of users
9. With community planning partners establish a common set of corporate performance management arrangements to establish a monitoring framework for strategic objectives, ensuring that each partner's contribution is clearly specified and measured.

Source: The Audit of Best Value and Community Planning Orkney Islands Council – June 2008

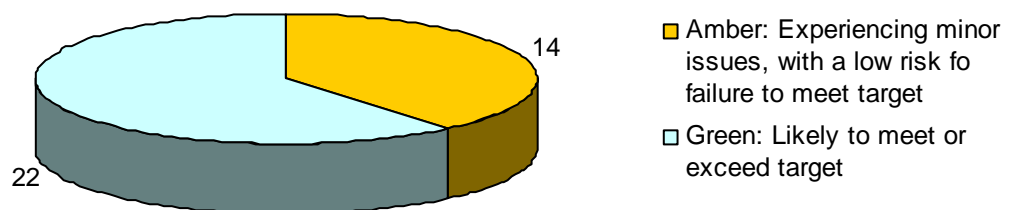
145 In September 2008 an audit improvement plan was approved by the council which linked detailed action points to the nine key areas for improvement. The points in this improvement plans were then built into either the corporate improvement plan or service improvement plans. These plans are monitored on a regular basis by the corporate and departmental management teams, and by the relevant service committee and Policy and Resources committee.

146 There has been real progress made by the council in addressing most of the areas included within the audit improvement plan. In particular we would highlight the following changes:

- Corporate and service performance reporting arrangements have been significantly improved. Six monthly reports to service committee bring together the overall performance of the core services as included in the services' balanced scorecard, single outcome agreement objectives, service improvement action plans and service best value recommendations. The Policy and Resources Committee receives six monthly reports on the council improvement plan. This report brings together the corporate priorities taken from the council plan, audit improvement plan, single outcome agreement and annual audit reports. Reporting uses a traffic lights system to assess progress being made. Departmental management teams meet more regularly to monitor performance.

Exhibit 8 shows the Council's progress against its corporate targets as at June 2009. This information was presented to the Policy and Resources Committee and shows progress against the Council Plan priorities as well other objectives/improvement activities from various sources, for example the best value improvement plan.

Exhibit 8: Achievement of Orkney Islands Council's targets 2008/09



- The performance reporting system now provides members and senior managers with much of the information necessary to allow them to acknowledge achievement and challenge under-performance. Continuous real improvements to service performance will be the key yardstick to judge whether improved performance reporting is driving change within the council.

- Training and support has been provided to elected members in areas such as scrutiny and best value. The Council is also taking forward leadership training for elected members and members of the corporate management team. The council has recently put in place some of the basic processes and strategies required to support best value for example an asset management strategy has been approved and an ICT strategy has also recently been finalised.
- Progress in relation to improving risk management arrangements has been slow but recent developments have seen the approval of an updated corporate risk register. Departmental risk registers are now in place and it is intended that departmental action plans should be put in place for all risks above a “risk tolerance level.” A number of departments have not yet prepared such action plans for example social services and housing. It is clear that risk management needs to become embedded within the operational activities of the Council so that the completion of action plans etc are not seen as a bureaucratic burden but are part of the day to day decision making process.

147 An area where further progress is required is in the council’s management of its people. The Best Value report noted that the Council’s management of staff required improvement. In particular systems in place for managing sickness absence were not being applied consistently across all areas and the council was unable to demonstrate whether staff appraisal processes were in place.

148 The performance monitoring reports for the quarter ending 31 March 2009 show that in most departments, sickness absence levels are considerably higher than the 4% target and that staff appraisal levels are still low. For example in the former department of technical services sickness absence for the quarter was 7.38% and only 13% of staff appraisals had been carried out during the year. The lack of staff appraisal and the generally poor absence performance will have a greater impact on an authority such as Orkney Islands Council which has difficulty building the capacity and staff skills necessary to support the changes required. The Council needs to build on the work already underway.

Action Plan Point 14

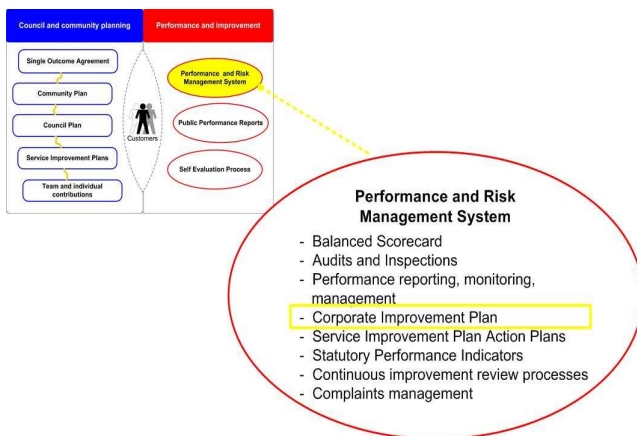
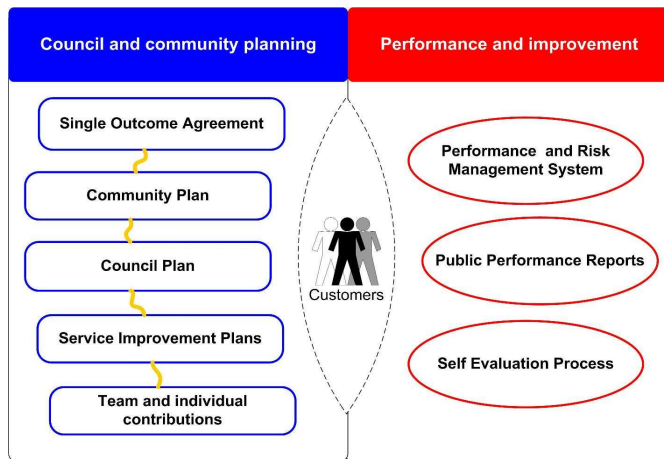
149 The Best Value report also recognised the significant work undertaken to support fragile island communities but noted that there were no mechanisms in place to record, monitor or measure the effectiveness of this activity. Nor were the costs of supporting various communities transparent. Work is underway to explore the cost differences in delivering services to the outer Isles and the mainland.

Performance Management and the SOA

150 The Best Value report commented that the council's performance management arrangements were weak. This was due to the lack of a structured, council-wide performance management framework to measure and monitor progress against objectives.

151 The strategic planning and performance framework now operating at the Council is summarised in the exhibit 9.

Exhibit 9: Orkney Islands Council's Strategic Planning and Performance Framework



Source: Orkney Islands Council

SOA was circulated and following feedback from the Scottish Government in May 2009 the SOA 2009 – 2011 was approved. The updated SOA drew upon guidance provided jointly by Audit Scotland the Scottish Government, SOLACE and the Improvement Service.

152 As outlined in paragraph 146 performance reporting incorporates at both service and corporate level approved performance measures and targets. The updated Single Outcome Agreement (SOA) measures also feature within the performance reporting framework. The original 2008 – 2011 SOA reflected a set of committed outcomes covering the Council and the Scottish Government.

153 The Council were required to develop 2009 SOA's in conjunction with community planning partnerships. The 2009 -2011 SOA therefore built-upon the previous SOA but also incorporated inputs from the Orkney Community Planning Partnership (OCPP). Following a joint seminar in November involving community partners a draft

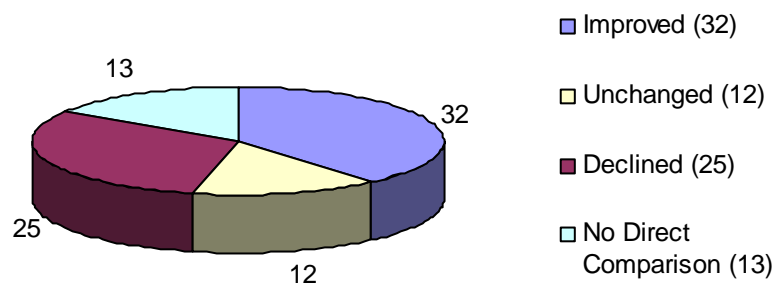
154 In our 2007/08 Report on the Audit we recommended that future performance reporting to members of progress against the SOA indicators should be consistent and complimentary to the performance management arrangements being put in place as part of the response to the Best Value and Community Planning Audit. We are therefore pleased to note that the service level balanced scorecards now incorporate actions from the SOA and monitoring therefore falls within the framework outlined above. Formal progress against the SOA requires to be reported to the

Scottish Government in September 2009. The Council's public performance reporting arrangements will incorporate the reporting of progress in achieving SOA outcomes.

Statutory Performance Indicators

- 155 The Local Government Act 1992 sets out the requirement for councils to prepare and publish performance indicators. As external auditors, we have a statutory duty to ensure that the Council has made such arrangements for collecting, recording and publishing statutory performance indicators (SPIs) by reviewing and examining evidence that is relevant to these arrangements.
- 156 In 2008/09, 58 SPIs were required to be published. We reported 2 as unable to report¹ and a further 1 as unreliable.
- 157 We marked the indicator on sickness absence as unreliable. The definition of the indicator changed in 2008/09 and required that sickness levels were measured as a proportion of the full time equivalent workforce. Due to the systems in place at the Council the information on the full time equivalent workforce was not readily available. The format and late submission of supporting information left us unable to conclude on the reliability of the indicator.
- 158 The SPIs provide a consistent form of measurement for councils to review their performance over time and to make comparisons with other councils. Exhibit 10 demonstrates where Orkney Islands Council's performance has improved or declined in comparison with Audit Scotland's 2007/08 published profile for Orkney Islands Council.

Exhibit 10: Changes demonstrated by SPIs in 2008/09



- 159 The current economic climate has impacted on a limited number of related SPIs during the year. Collection rates of Council Tax have fallen in comparison to 2007/08 from 97.7% to 97.4%. The proportion of tenants that are leaving their tenancy when in arrears has risen from 33.9% to 38.8%.

¹ All 32 local authorities were unable to report two indicators on benefits administration.

- 160 Performance improvements were noted in a number of indicators (in comparison with 2007/08). Several of these were in the Education Service. For example, the percentage of staff working in residential accommodation with the appropriate qualification has increased from 39% to 56%.

Equality and Diversity

- 161 In 2008, Audit Scotland published a study examining how councils responded to their race equality duty, "*The impact of the race equality duty on council services*". This study found that all councils have developed policies and processes on race equality. A number of initiatives are in place to meet the diverse needs of local communities, such as the provision of interpretation and translation services, and information packs for recent migrants. However, councils lack information about minority ethnic communities, their needs and experiences. Councils are also unable to show how race equality is routinely built into the design and delivery of services.
- 162 Orkney Islands Council adopted its Race Equality Scheme and Action plan in November 2008. The action plan incorporates some of the recommendations made by Audit Scotland in their national report. The outstanding recommendations will be considered when the Race Equality Scheme is updated in 2011. The Council note that given the small population in the Orkney Islands, minority groups tend to be smaller and not in established communities as seen in larger local authority areas. For this reason, a number of the recommendations made by Audit Scotland are not considered practical/applicable.
- 163 Given the population size, equalities work that has been undertaken has focussed on the community as a whole, rather than minority communities. An equalities officer has recently been appointed.
- 164 An Equalities Impact Assessment (EIA) form has been introduced to be used in all services across the Council. This will aid services in assessing the impact of planned change in function or policy. Since 2008 all reports that are submitted to committee include an Equalities Impact Assessment. During the year training in equality, consultation arrangements with ethnic communities and publishing information on minority ethnic communities has been offered to elected members.

Future Outlook

Statutory Performance Indicators

- 165 The Accounts Commission has made a significant change in its approach to statutory performance indicators (SPIs). From 2009/10, the SPI Direction incorporates two main requirements:
- That councils reports a range of sufficient information to demonstrate best value in relation to corporate management (SPI 1)
 - That councils report a range of information sufficient to demonstrate best value in relation to service performance (SPI 2)

- 166 In reporting against SPI 1 and SPI 2, all councils will be required to report performance against 25 specific indicators defined by the Accounts Commission. These indicators have been selected from previously reported SPIs.
- 167 Orkney Islands Council has taken this opportunity to review their performance reporting arrangements. All 25 indicators will now form part of their balanced scorecards. Corporate indicators, for example sickness absence, will be reported at a service level as well as at a corporate level.
- 168 The level of reporting that will be involved to meet the requirements of SPI 1 and SPI 2 has not yet been determined by the Council but is in progress. Refreshed scorecards were developed by each service in July 2009 taking account of new Council generic indicators and the scorecards will be confirmed at service level in September 2009. All of the indicators that the Council decides to use will be included in a data dictionary, which will contain background information and rationale of the indicator as well as details of the calculations required. This should ensure that each service calculates corporate indicators consistently, and demonstrates that service indicators have also been calculated on a consistent basis.
- 169 The arrangements described above however should include procedures for independent verification of indicators.

Action Plan Point 15

Shared Risk Assessment

- 170 The Crerar report on the independent review of regulation, audit, inspection and complaints handling of public services in Scotland contained a series of recommendations designed to streamline the scrutiny landscape in Scotland. In their response to the Crerar report in June 2008, Scottish Ministers asked the Accounts Commission to put in place arrangements to reduce the burden of scrutiny for local authorities by establishing a single audit framework. A more co-ordinated approach to the audit and inspection regime is anticipated in the future.
- 171 Work has begun across four development sites to pilot a shared risk assessment. The intention is to develop a single corporate assessment and shared risk assessment for each local authority. From this an assurance and improvement plan would be prepared which would cover all scrutiny activity over a three year period for each council. The assurance and improvement plan would be a product of a collaborative approach of the scrutiny bodies, including for example, Audit Scotland, HM Inspectorate of Education, Scottish Housing Regulator and the Social Work Inspection Agency.

Best Value 2

- 172 Audit Scotland is currently developing its approach to best value 2 (BV2) by working with five pathfinder councils. Details of the new approach can be found at www.audit-scotland.gov.uk/BV2 . From April 2010, this approach will be rolled out across all 32 local authorities. The timing of a BV2 audit will be determined by a risk assessment as described above.

Governance

Introduction

- 173 Governance is about direction and control of organisations. It is concerned with structures and processes for decision making and accountability. Good governance can be defined as *“the way a local authority operates is based on sound decision-making and effective processes are in place to support these decisions”*.
- 174 We have reviewed the Council’s corporate governance arrangements during the year. Our detailed findings were reported to management separately in our Corporate Governance report. This was presented to the Monitoring and Audit committee 16 April 2009. This section sets out the main findings from our review.

Overall Governance Arrangements

- 175 Orkney Islands Council operates through a committee based structure, with seven committees covering all the main services across the Council. A cycle of meetings involving each of the committees takes place five times a year. Once a cycle has been completed, a meeting of the full council is held. All 21 councillors take part and make final decisions on the recommendations made by the committees. There is limited delegation to service committees with the exception of the Development Committee (applications to approved schemes of assistance) and the Environment, Planning and Protective Services Committee (planning applications).
- 176 We understand that the Council is currently reviewing the roles and responsibilities of its committees. A paper is due to be reported to the Policy and Resources Committee during the next round of committee meetings. We will consider this over the coming year.
- 177 In December 2008, the Council agreed to implement a revised organisational structure. The revised structure included a reduction in the number of Directorates from seven to six and directorates were in future to be referred to as ‘services’. A second tier of senior management, namely assistant directors, has also been introduced across all services.
- 178 Orkney Islands Council delivers further and higher education services through Orkney College. During the year, the Council agreed that the existing governance arrangements be disestablished and that an Orkney College sub-committee, to be known as the “College Management Council”, should be established. The role, responsibilities and constitution of this sub committee were approved by the Council on 3 March 2009.
- 179 The College Management Council comprises elected members along with business community representatives and community representatives, each with one vote. Each member of the College Management Council will be entitled to vote on the recommendations to be made to the Education, Recreation and Cultural Services Committee. The College Management Council will

not have formal decision making powers. It is the full Council who will decide on whether to accept the recommendations made by the Education, Recreation and Cultural Services Committee.

180 The Council has also agreed to the full integration of Orkney Ferries Limited, Orkney Towage Company Limited and the Department of Harbours into a unified Marine Service within Orkney Islands Council. This integration process will be carried out over three phases, with full integration by March 2011. We understand that Orkney Ferries Limited and Orkney Towage Company Limited will continue to operate until such time as all sea staff are integrated into Marine Services.

181 The Council has yet to assess its own governance arrangements against the CIPFA/SOLACE publication "Delivering Good Governance in Local Government: A Framework". We understand that the planned review was delayed. It is however included in the Chief Executive's departmental action plan.

Action plan point 16

Political Scrutiny at Orkney Islands Council

182 Political scrutiny of decision making at Orkney Islands Council operates at various levels. All major policy and expenditure decisions by service committees are required to be approved by full Council. This means that there is a built in quality check on decision making. In addition it was agreed during the year that all members would also be members of the Council's Policy and Resources committee. This means that decisions with a financial impact by service committees will already be subject to a further level of scrutiny.

183 The Monitoring and Audit committee also has an important scrutiny role in the Council. The committee's remit incorporates the following scrutiny responsibilities within it:

- To assess the adequacy and effectiveness of the Council's strategic planning and performance management arrangements, as outlined in the Strategic Planning Framework
- To provide an overview of scrutiny implementation and performance management for the Council

184 The committee is independent from decision-making and is apolitical. It is also able to utilise the services of internal audit as an independent resource to support reviews. The Monitoring and Audit Committee in developing its programme of work consults with all members, the corporate management team and service departments. The programme also includes a contingency element to allow issues which may arise during the year to be scheduled in.

185 We noted that the Monitoring and Audit Committee is well attended and in overall terms its remit and working practices are in accordance with good practice principles (exhibit 11):

Exhibit 11: Monitoring and Audit Committee – areas of good practice

As part of our review of the Council's corporate governance arrangements we assess the effectiveness of the audit committee arrangements in place within the Council. In doing this we consider the audit committee arrangements against publications which illustrate best practice including for example:

- Audit Committee Principles in Local Authorities in Scotland – a Guidance Note (CIPFA)
- Audit Committees – Practical Guidance for Local Authorities (CIPFA)
- The Smith Report

Overall we concluded that Orkney Islands Council's arrangements were largely able to deliver the audit committee principles set out in the CIPFA guidance and have had a positive impact on the Council's overall corporate governance framework. In particular, we noted:

- The committee's terms of reference overall complies with best practice guidance
- Committee members have received training specific to their role as an audit committee member.
- The committee considers internal and external audit plans and respective reports issued by internal and external audit; including annual reports
- The committee reviews the financial statements along with our annual audit report prior to the accounts being signed.

186 The Monitoring and Audit Committee's terms of reference state that the committee will "assess the adequacy and effectiveness of the Council's risk management strategy and associated procedures". Due to the progress made by the Council in implementing its risk management arrangements, the Monitoring and Audit Committee has been unable to provide sufficient challenge and/or review of these arrangements (paragraph 196-202).

187 Best practice guidance suggests that audit committees conduct an annual review of their work (Smith Report). The review at the Council is being led by the Assistant Director of Legal and Administration and is due to be implemented by November 2009.

Governance and Accountability

188 Elected members are central to good governance and the success of their council. Key elements of their role include: providing leadership and direction; representing wards and constituents; and scrutinising policy direction and the performance of services. They also perform key roles in making choices between competing priorities, setting objectives to meet the needs of communities and ensuring that the Council fulfils its statutory duty to achieve best value.

189 To enable elected members to fulfil their responsibilities, it is important that training and support is readily available. This should include access to key information of suitable quality, provision of professional advice and support to develop their knowledge and skills.

- 190 The importance of training and support to elected members was emphasised in the Scottish Local Authorities Remuneration Committees second report "Review of Implementation of Remuneration Arrangements for Local Authority Councillors and Annual Review of Remuneration Levels". The majority of the recommendations relating to training which were raised in this report were accepted, or agreed in principle, by the Scottish Government.
- 191 The Accounts Commission report, "*Overview of Local Authorities 2008*" also commented the importance of elected member training and development. The Commission's findings noted "*personal development is now established as essential to support elected members in carrying out their demanding and complex roles. All councillors should have a personal development plan which sets out training needs and progress*".
- 192 Structured training sessions were held on a range of issues following the 2007 elections and training continues to be offered to elected members. For example, in 2008, a session on scrutiny was held for all members. This session was facilitated by CIPFA. Members of the Monitoring and Audit Committee also received training on their role as members of this committee. The Council is currently developing a training programme for elected members. As part of this programme, processes will be established for evaluating the training attended by elected members. We also noted that job descriptions for elected members were approved by the Council in 2009.

Following the Public Pound

- 193 Orkney Islands Council works with a number of companies, trusts and other external organisations to deliver a range of services, such as leisure services. The 'Code of guidance on funding external bodies and following the public pound' (the Code) underlines the need for good governance and clear accountabilities.
- 194 In 2007/08 we carried out a detailed review to establish the extent to which Orkney Islands Council had embraced the principles set out in the Code. Our review drew upon the work of internal audit in this area. The internal audit review concluded that whilst the Council had complied with, and implemented many of the requirements of the Code, improvements were necessary with respect to the monitoring of the funding agreements. Our findings supported these conclusions.
- 195 Since our review in 2007/08, the Council has revised its policy on following the public pound. Where applicable, the Council has incorporated both external and internal audit recommendations into the revised policy. Work is ongoing to address the outstanding audit recommendations, including:
- Review of all member and officer involvement on Boards of arms length external organisations (ALEOs);
 - Training for all members and officers;
 - Ensuring agreements are in place where funding exceeds £10,000; and

- Ensuring that where monitoring conditions are included in the agreements, these are complied with.

Risk Management

- 196 An important feature of a robust system of internal control is a developed and integrated approach to risk management. Effective risk management will deliver an appropriate balance between risk and control, more effective decision making, better use of limited resources and greater innovation.
- 197 The Council appointed Zurich Municipal to assist in the development of a strategic risk register. This was presented to the Council's Policy and Resources Committee on 23 September 2008. At the time work was ongoing to embed risk management into every day practices through corporate and departmental action planning.
- 198 The Council continues to implement risk management arrangements, at both a strategic and service level. There has not however been significant progress in implementing these arrangements since we reported in 2007/08.
- 199 As part of the service restructure, a Corporate and Community Resilience team has been created. This section is responsible for updating the risk management strategy and identifying training needs and guidance for staff.
- 200 The Chief Executive, directors and heads of service for each service attended workshop sessions, facilitated by Zurich Municipal. The purpose of the workshops was to develop departmental risk registers all services. Risk registers are now in place and it is intended that departmental action plans should be put in place for all risks above a "risk tolerance level". A number of departments however have yet to prepare such action plans.
- 201 The corporate risk register has also been reviewed by the Corporate Management Team. The 2009/10 Corporate Risk Register was presented to the Policy and Resources Committee in June 2009. The revised risk register identifies 15 corporate risks, of which 11 have been assessed as high risk areas.
- 202 A number of the recommendations we raised in our previous two corporate governance reports have still to be implemented. At the time of our last review, we agreed with management that these actions would be implemented by December 2008. These recommendations were raised again in our Corporate Governance Arrangements Report presented to the Monitoring Committee in April.

Prevention and Detection of Fraud and Irregularity

- 203 The integrity of public funds is at all times a matter of concern. As external auditors we are required to consider the arrangements made by management for the prevention and detection of fraud and irregularities.

- 204 At a corporate level, the Council has appropriate arrangements in place to help prevent and detect fraud and irregularity. These arrangements include, for example, a fraud policy and codes of conduct for elected members and staff.
- 205 Overall we concluded that arrangements at Orkney Islands Council were generally satisfactory to prevent and detect fraud and other irregularities. We did however note that the Council's register of interests for both elected members and chief officers had not been refreshed for a number of years. The Council, at the time of our audit, was due to commence an exercise to update this register.

Action Plan Point 17

National Fraud Initiative

- 206 The National Fraud Initiative (NFI) in Scotland is Audit Scotland's data matching exercise that brings together data from councils, police and fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. This exercise runs every two years. The previous Audit Scotland exercise (NFI 2006/07), reported by Audit Scotland in May 2008, identified at least £9.7 million of outcomes (fraud, error, overpayments and forward savings). Including all previous exercises the cumulative outcomes were now approximately £37 million. Across the UK, the cumulative outcomes from NFI exercises now exceed £450 million.
- 207 The most recent NFI exercise commenced in October 2008 and the national findings are expected to be published in May 2010.
- 208 In our 2008/09 Corporate Governance Report we reported that the Council had not met the deadline (October 2008) for submission of all mandatory datasets. The information was submitted by the Council in February 2009. The results of a second data matching run were released in June 2009.
- 209 Work has been carried out by the benefit fraud team to review and investigate matches relating to housing benefit and council tax benefit. This has resulted in a number of overpayments being identified. We are disappointed to note, however, that limited progress has been made with the match reports for other areas. In some cases we were unable to confirm the key contact due to changing job roles and responsibilities.

Action Plan Point 18

Action Plan

Our action plan details the key weaknesses and opportunities for improvement that we have identified during this review. To assist the Council in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. Our rating structure has been revised to ensure consistency with the structure/terminology used by internal audit.

The rating structure is summarised as follows:

Priority 1	<ul style="list-style-type: none">• Key control absent or inadequate;• Serious breach of regulations;• Significantly impairs overall system of internal control;• No progress made on implementing control;• Requires urgent management attention.
Priority 2	<ul style="list-style-type: none">• Element of control is missing or only partial in nature;• Weakness does not impair overall reliability of the system;• Recommendation considered important in contributing towards improvement in internal controls;• Management action required within a reasonable timescale.
Priority 3	<ul style="list-style-type: none">• Control exists or on target to be implemented within timescales;• Minor weakness, does not compromise overall system control;• To be considered by management within a reasonable timescale.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

Action Plan Point	Para Ref	Recommendation and Rating	Management comments	Responsible Officer	Agreed Completion Date
1	16	Whilst we noted that the quality of the financial statements prepared is of a satisfactory standard we would encourage the Council to put in place arrangements to demonstrate continuous improvement in this area. Priority 3	Will be included in departmental service plan	Assistant Director - Accountancy	By end June 2010
2	31	The Director of Finance and Housing should consider requesting that all service directors provide assurance statements on the internal financial controls operating in the year. Priority 2	Already raised with members of the CMT	Assistant Director – Accountancy/CMT	By end June 2010
3	44	We would strongly recommend that the Council revisit its approach to accounting for expenditure on fixed assets to ensure full compliance with the SORP. This should include the introduction of component accounting where possible. Priority 1	Further internal guidance will be prepared and the implementation of the guidance will be discussed with CMT	Assistant Director – Accountancy/CMT	By end June 2010

Action Plan Point	Para Ref	Recommendation and Rating	Management comments	Responsible Officer	Agreed Completion Date
4	46	The Council should ensure, going forward, that depreciation is not charged on investment properties. In addition, the Council should review those assets classified as investment properties to ensure correct disclosure in the financial statements. Priority 3	This will be progressed with corporate property section involvement as necessary	Assistant Director – Accountancy/Corporate Property	By end June 2010
5	49	The Council should ensure it revisits its financial guarantee with Orkney Towage Company following receipt of the actuarial valuation on the pension fund. Priority 3	Agreed	Assistant Director - Corporate	By end June 2010
6	51	The Council should ensure it reviews all lease agreements to ensure appropriate disclosure in the financial statements. We would also recommend that a central register is held for all such lease agreements. Priority 2	Agreed	Assistant Director - Accountancy	By end of June 2010
7	60	The Council should ensure arrangements are in place to comply with OSCR filing requirements in 2008/09. Priority 2	Agreed	Assistant Director - Accountancy	By end of June 2010

Action Plan Point	Para Ref	Recommendation and Rating	Management comments	Responsible Officer	Agreed Completion Date
8	64	We would encourage the Council to perform its assessment to identify significant trading operations on a more frequent basis. Priority 3	Agreed	Assistant Director - Corporate	By end of June 2010
9	101	We endorse the actuary's recommendation that the financial position of the fund is monitored through interim funding reviews. It is also important that the fund identifies funding strategies which meet its objectives whilst recognising the implications in terms of prudence, affordability, stability and stewardship. Priority 2	Agreed already	Assistant Director - Accountancy	Ongoing
10	112	We would encourage the Council to develop an action plan which demonstrates how it will progress with developing its procurement function. Priority 2	Agreed	Head of Procurement	March 2010

Action Plan Point	Para Ref	Recommendation and Rating	Management comments	Responsible Officer	Agreed Completion Date
11	124	Services should be more involved in collating information on efficiency savings. Guidance should be issued to services to enable this information to be collated. Priority 2	Already provided	Assistant Director - Accountancy	Completed
12	125	We would encourage more information to be presented to committee on efficiency savings achieved through individual efficiency projects. Priority 2	Agreed	Assistant Director – Accountancy/CMT	March 2010
13	125	Arrangements should be put in place to demonstrate how efficiency savings impact on service delivery. Priority 2	Agreed	Assistant Director Accountancy/CMT	March 2010
14	148	The Council should build on the work already underway to address the performance issues on workforce related issues. In particular with regard to managing sickness absence and staff appraisals. Priority 1	Being progressed as part of the performance management arrangements.	Head of Personnel/CMT	March 2010

Action Plan Point	Para Ref	Recommendation and Rating	Management comments	Responsible Officer	Agreed Completion Date
15	169	It is essential that the Council develops arrangements to ensure compliance with the 2009 Statutory Performance Indicators Direction. This should include arrangements for independent verification of the reliability and accuracy of the information to be reported. Priority 2	Agreed	Assistant Director of Strategy and Improvement	December 2009
16	181	The Council should assess its own governance arrangements against the CIPFA/SOLACE publication "Delivering Good Governance in Local Government: A Framework". Priority 2	Agreed	Assistant Director of Law and Administration	December 2009
17	205	The Council should ensure that the register of interests for both elected members and chief officers is updated. Priority 2	Agreed	Assistant Director of Law and Administration	December 2009

Action Plan Point	Para Ref	Recommendation and Rating	Management comments	Responsible Officer	Agreed Completion Date
18	209	<p>The Council should ensure arrangements are in place to review and investigate, where appropriate, each of the match reports arising from the NFI exercise. Key contacts should be assigned responsibility for this review.</p> <p>Priority 2</p>	<p>Key contacts have been assigned responsibility for the review and investigation of NFI match reports. The difficulty identified by External Audit in confirming key contacts is believed to have arisen through a secondment of the key contact within Legal and Administration Services and that persons line manager being absent on long term sick leave. The Assistant Director of Finance – Corporate Finance as Key Contact for NFI has not appreciated the implications of these staffing difficulties and the impact on the NFI exercise.</p> <p>Key Contacts will be reviewed to ensure they are still the appropriate people to hold responsibility for the review and investigation of NFI match reports.</p>	<p>Assistant Director of Finance – Strategic Finance</p> <p>(Responsibility for the NFI Key Contact has recently passed between Assistant Directors in Finance & Housing Services)</p>	<p>31 October 2009</p>



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