

Orkney Islands Council

2019/20 Annual Audit Report



 AUDIT SCOTLAND

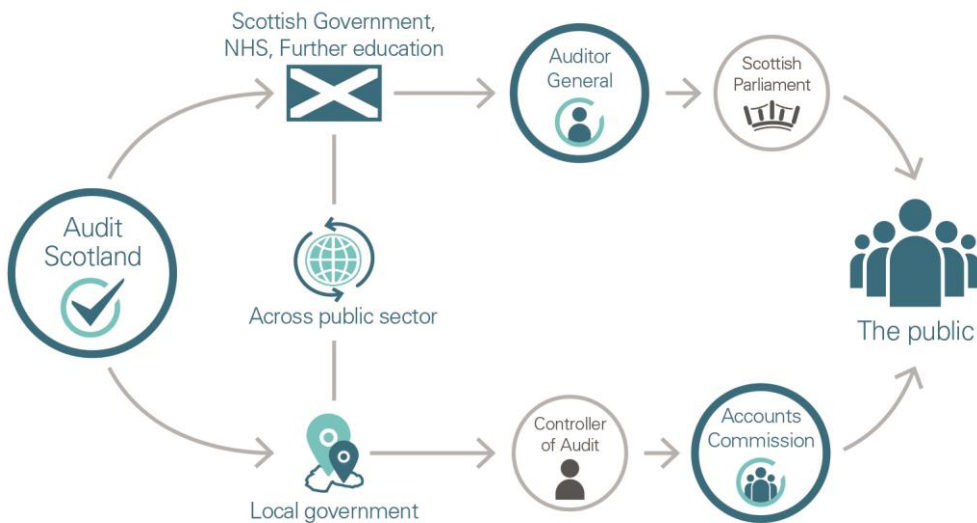
Prepared for the Members of Orkney Islands Council and the Controller of Audit

26 October 2020

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Key messages

2019/20 annual accounts

- 1** The annual accounts of the council, its group and the section 106 charity administered by the council give a true and fair view and were properly prepared.
- 2** The audited part of the remuneration report, management commentary and annual governance statement are all consistent with the financial statements and prepared in accordance with proper accounting practices.
- 3** Submission of the annual accounts for audit was in line with original timescales and the revised Scottish Government timelines have been met.
- 4** A prior year adjustment of £29.9 million has been posted to the 2018/19 accounts, resulting in a reduction to the Strategic Reserve Fund, from £247.8 million to £218.0 million. This relates to recognising that the council has a contractual obligation to contribute a set amount towards the decommissioning costs for an oil terminal.

Financial management

- 5** Financial management is effective with a budget process focussed on the council's priorities.
- 6** On the basis of audit work undertaken, we concluded that appropriate and effective internal controls were in place for the key financial systems we reviewed.
- 7** The council continues to have significant levels of slippage against capital programmes. There is an ongoing risk that strategic priorities are not delivered timeously as a result of delays within the capital programme.

Financial sustainability

- 8** The Covid-19 pandemic had a significant impact on the short-term finances of the body and the impact of this on medium/longer term planning is still to be evaluated.
- 9** The council has a longer-term financial strategy covering the 10 year period to 2029/30. This identifies a cumulative funding gap of £65.7 million based on realistic assumptions. The council should now consider options for long term savings options.
- 10** Application of the Strategic Reserve Fund has been council policy in ensuring the council can maintain its current service provision. A long term financial plan for the Strategic Reserve Fund should be developed to ensure the funds will be used to achieve strategic aims and benefit the people of Orkney.

Governance and transparency

- 11** The council has appropriate and effective governance arrangements in place that support the scrutiny of decisions made by the council.
- 12** The Covid-19 pandemic had a significant impact on governance arrangements from March 2020. We consider the measures taken by the council to be appropriate and to support good governance and accountability.

Best Value

- 13** The council continues to progress actions outlined in the Best Value Assurance Report. The council will wish to ensure it can demonstrate what difference they are making in respect of these improvements.
- 14** Performance management arrangements were refreshed in 2019/20. However, the monitoring of performance was adversely impacted by the Covid-19 pandemic.

Introduction

1. This report summarises the findings arising from the 2019/20 audit of Orkney Islands Council (the council) and its group.

2. The scope of the audit was set out in our 2019/20 Annual Audit Plan presented to the February 2020 meeting of the Monitoring and Audit Committee. This report comprises the findings from:

- an audit of the annual accounts
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

Exhibit 1 Audit dimensions



Source: *Code of Audit Practice 2016*

3. The main elements of our audit work in 2019/20 have been:

- an audit of the annual accounts of the council and its group including the statement of accounts of the section 106 charity administered by the council and the issue of independent auditor's reports setting out our opinions
- a review of the council's key financial systems
- audit work covering the council's arrangements for securing Best Value
- consideration of the four audit dimensions.

4. Subsequent to the publication of the Annual Audit Plan, in common with all public bodies, the council has had to respond to the Covid-19 pandemic. This impacted on the final month of the year and will continue to have significant impact into financial year 2020/21. This has had significant implications not least for the services it delivers, and the suspension of non-essential activities. Our planned audit work has had to adapt to new emerging risks as they relate to the audit of the financial statements and the wider dimensions of audit.

Adding value through the audit

5. We add value to the council through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- sharing intelligence and good practice through our national reports ([Appendix 4](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

6. Taking this together, we aim to help the council promote improved standards of governance, better management and decision making and more effective use of resources.

Responsibilities and reporting

7. The council has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with proper accounting practices.

8. The council is also responsible for compliance with legislation, and putting arrangements in place for governance, propriety and regularity that enable it to successfully deliver its objectives.

9. Our responsibilities as independent auditor appointed by the Accounts Commission are established by the Local Government in Scotland Act 1973, the [Code of Audit Practice 2016](#) and supplementary guidance, and International Standards on Auditing in the UK.

10. As public sector auditors we give independent opinions on the annual accounts. Additionally, we conclude on:

- the effectiveness of the council's performance management arrangements
- the suitability and effectiveness of corporate governance arrangements, and financial position
- the arrangements for securing financial sustainability and
- Best Value arrangements.

11. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

12. This report raises matters from our audit. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its

responsibility to address the issues we raise and to maintain adequate systems of control.

13. Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and the steps being taken to implement them.

Auditor Independence

14. Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2019/20 audit fee of £190,990 (including £1,000 for the audit of the charitable trust) as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

15. This report is addressed to both the council and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course. We would like to thank the management and staff who have been involved in our work for their cooperation and assistance during the audit.

Part 1

Audit of 2019/20 annual accounts

Main judgements

The annual accounts of the council, its group and the section 106 charity administered by the council give a true and fair view and were properly prepared.



The audited part of the remuneration report, management commentary and annual governance statement are all consistent with the financial statements and prepared in accordance with proper accounting practices.

Submission of the annual accounts for audit was in line with original timescales and the revised Scottish Government timelines have been met.

A prior year adjustment of £29.9 million has been posted to the 2018/19 accounts, resulting in a reduction to the Strategic Reserve Fund, from £247.8 million to £218.0 million. This relates to recognising that the council has a contractual obligation to contribute a set amount towards the decommissioning costs for an oil terminal.

The annual accounts are the principal means of accounting for the stewardship of resources and performance.

Our audit opinions on the annual accounts are unmodified

16. The accounts for the council and its group for the year ended 31 March 2020 were approved by the Monitoring and Audit Committee on 26 October 2020. As reported in the independent auditor's report;

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- the audited part of the remuneration report, management commentary and the annual governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant regulations and guidance.

17. We have nothing to report in respect of misstatements in the information accompanying the financial statements, the adequacy of accounting records or the information and explanations we received during the audit.

The annual accounts were signed off in line with the timescales permitted to reflect Covid-19

18. The Scottish Government has advised that it considers the provisions made in Schedule 6 of the Coronavirus (Scotland) Act 2020 to be sufficient to allow each local authority to determine its own revised timetable for the Annual Accounts.

19. We received the unaudited annual report and accounts in accordance with our original audit timetable. While the unaudited annual accounts provided for audit

were complete and working papers were of a good standard, we noted that there was a higher incidence of presentational and disclosure issues than in prior years.

20. There were challenges experienced by the accounting team due to working from home and the physical limitations on access to records and systems.

21. The impact of the Covid-19 pandemic was also a factor for the audit team who had to adapt to new ways of working and conducting an audit remotely which resulted in some loss of productivity. In addition, we found that audit queries took longer to resolve than when we were on site. We will work with the council finance team to explore lessons learned with regards to remote working for the 2020/21 audit.

22. Although later than planned, the annual accounts were signed off on 26 October 2020, in line with the revised timetable permitted to reflect the impact of the Covid-19 pandemic. The accounts were published prior to 31 October 2020, meeting the requirements of section 11 of The Local Authority Accounts (Scotland) Regulations 2014.

Our audit opinions on Section 106 charities were unmodified

23. Due to the interaction of section 106 of the Local Government in Scotland Act 1973 with the charities legislation, a separate independent auditor's report is required for the statement of accounts of each registered charity where members of Orkney Islands Council are sole trustees, irrespective of the size of the charity.

24. Our duties as auditors of the Charitable Trust administered by Orkney Islands Council are to:

- express an opinion on whether the charity's financial statements properly present the charitable trust's financial position and are properly prepared in accordance with charities legislation
- read the trustees' annual report and express an opinion as to whether it is consistent with the financial statements
- report on other matters by exception to the trustees and to the Office of the Scottish Charity Regulator.

25. We received the Charitable Trust's accounts in line with the agreed timetable and after completing our audit we issued unqualified audit opinions in respect of the 2019/20 financial statements.

Objections

26. The Local Authority Accounts (Scotland) Regulations 2014 require local government bodies to publish a public notice on their website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period. The notice for Orkney Islands Council was published on its website and complies with the regulations. No objections were received in relation to the Orkney Islands Council annual accounts.

Whole of Government Accounts

27. In accordance with the government measures to support local authorities during the Covid-19 pandemic, the timetable for the Whole of Government Accounts submissions in 2019/20 has been extended. The revised deadline for submission of the audited Whole of Government Accounts return is 4 December 2020. The council has arrangements in place to ensure the revised deadline is met.

Applying the concept of materiality

28. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

29. Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit. We assess the materiality of uncorrected misstatements both individually and collectively in forming our opinions on the financial statements.

30. On receipt of the unaudited annual accounts we reviewed our planning materiality calculations and concluded that they required to be slightly revised. The revised materiality figures are shown in [Exhibit 2](#).

Exhibit 2 Materiality values

Materiality level	Amount
Overall materiality	£1.650 million
Performance materiality	£0.825 million
Reporting threshold	£17 thousand

Source: Audit Scotland

Risks identified at the planning stage and our audit work to address these

31. [Appendix 2](#) provides our assessment of risks of material misstatement in the annual accounts and any wider audit dimension risks. These risks influence our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the team were directed. The appendix identifies the work we undertook to address these risks and our conclusions from this work.

32. We identified six significant risks of material misstatement in relation to the financial statements in 2019/20 at the planning stage. At the conclusion of our audit we have no issues to report from our work on the risks of material misstatement and we have gained sufficient assurance to support our audit opinions.

Significant findings to report on the annual report and accounts

33. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. We have included significant findings to report on the qualitative aspects covering accounting policies, accounting estimates and financial statements disclosures.

34. The significant findings are summarised in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the action plan in [Appendix 1](#) has been included.

Exhibit 3

Significant findings from the audit of the financial statements

Issue	Resolution
<p>1. Material uncertainty in the valuation of property</p> <p>The council holds a significant value of investment property either directly (£19.7 million) or through its investment portfolio (£22.0 million). The Covid-19 pandemic has meant that the property sector was faced with an unprecedented set of circumstances and this has created challenges when making judgements about the value of investment property.</p>	<p>At the valuation date the council considered information from its appointed valuer and the fund manager. The council included additional narrative in the 'Critical judgement in applying accounting policies' and the 'Financial instruments' notes to disclose material valuation uncertainty.</p> <p>We requested that further information on the fund manager qualification was included as part of our review of disclosures. The council have included revised wording in the audited accounts.</p> <p>We concluded that the council disclosures were appropriate and provided sufficient explanation of the uncertainty.</p>
<p>2. Accounting policies</p> <p>We review accounting policies as part of our standard audit procedures, including consistency with prior year and accounting standards. While we did not identify any issues with regards to consistency of application or non-compliance with accounting standards, we identified some areas where clarity could be improved (for example policies over Council Tax and Non-Domestic Rates Income) and other areas where disclosures could be more concise (for example Property, Plant and Equipment).</p>	<p>The council made some changes in year to improve disclosures, including the addition of a policy for Council Tax and Non-Domestic Rates income. The council plan to conduct a further review of accounting policies as part of an overall review of the annual accounts in 2020/21.</p>
<p>3. Harbour authority ear marked balance</p> <p>We highlighted in our plan that the council had ear marked a proportion of the Harbour Reserve to ensure it can meet its contractual obligation to contribute a set amount towards the decommissioning costs of the Flotta Oil Terminal.</p> <p>As part of a review in 2019/20 the council considered the decommissioning agreement and the fact that there was a legal obligation for the council to contribute a set amount to the decommissioning costs. The council's contribution to the decommissioning costs is based on the legal agreement in 1999 outlining an obligation to pay £16.4 million uprated annually for inflation. The balance of the costs of decommissioning is to be met by the operator.</p> <p>In preparing the 2019/20 accounts the council recognised its contractual obligation to contribute a set amount towards the costs associated with the decommissioning of the Flotta Oil Terminal as a provision, in line with IAS 37.</p> <p>A prior year adjustment of £29.9 million has been posted to the 2018/19 accounts, including a</p>	<p>We are satisfied that the estimated provision is reasonable and accounted for in line with accounting standards. We did however request modifications to the annual report to make the correction more transparent to a reader of the accounts.</p> <p>The council should consider the lessons from this to ensure where there is a contractual liability it is identified and correctly accounted for from the outset.</p> <p>At all times the council should remain alert to the ability of third parties to fulfil their obligations, for example were economic conditions to change. The council should therefore consider implementing annual procedures to evaluate the level of provisions, including the continued viability of key third party operators.</p> <p> Recommendations 1 and 2 (refer appendix 1, action plan)</p>

Issue	Resolution
reduction to the Strategic Reserve Fund, from £247.8 million to £218.0 million.	
<p>4. Remuneration Report</p> <p>Our audit procedures identified that four individuals within the remuneration report's salary information did not agree to underlying records from the payroll system.</p>	<p>Management reviewed the disclosures within the remuneration report and have updated the disclosure to align to the payroll information.</p> <p>We are satisfied that the revised remuneration report reflects appropriate information for all listed individuals.</p>
Source: Audit Scotland	

Identified misstatements of £1.2 million were adjusted in the accounts

35. Total adjusted misstatements identified were £1.2 million, which did not impact the net expenditure position. These mainly consist of classification errors between categories of assets or liabilities, for example between short and long term borrowing. The most significant adjustment related to the classification of a new vessel which was included as vehicles, plant and equipment. As the vessel was not sea worthy at 31 March 2020 this was adjusted to be included in assets under construction.

36. In addition to the adjusted errors above we identified two misstatements totalling £0.12 million. It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected although the final decision on making the correction lies with those charged with governance considering advice from senior officers. Management have not adjusted for the items in [Appendix 3](#), on the grounds of materiality.

37. We have concluded that the misstatements identified arose from issues that have been isolated and identified in their entirety and do not indicate further systemic error.

Financial and performance reporting in the Management Commentary requires further improvement

38. The Management Commentary that accompanies the financial statements should clearly explain how the council has performed against its budget and how this is reconciled to the financial statements.

39. Our 2018/19 annual audit report highlighted that there was scope for improvement in the council's management commentary. In 2019/20 the council reviewed their management commentary to make improvements in line with Audit Scotland's Good Practice Note: Management Commentaries.

40. Our review of the revised accounts noted some improvements including the use of infographics to improve clarity. However, there is further scope to ensure the management commentary meets the needs of users. We will work with the council in 2020/21 to ensure the accounts tell a single story which is clear and concise.



Recommendation 3

Management should review the management commentary for the 2020/21 accounts to identify areas which could be improved further.

Reasonable progress was made on prior year recommendations

41. The council has made reasonable progress in implementing our prior year audit recommendations. For actions not yet implemented and where we have not commented on progress within our report, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).

Part 2

Financial management

Main judgements



Financial management is effective with a budget process focussed on the council's priorities.

On the basis of audit work undertaken, we concluded that appropriate and effective internal controls were in place for the key financial systems we reviewed.

The council continues to have significant levels of slippage against capital programmes. There is an ongoing risk that strategic priorities are not delivered timeously as a result of delays within the capital programme.

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively

The 2019/20 budget included planned savings and contributions from reserves to address the funding gap.

42. The council approved its 2019/20 budget in March 2019. The budget was set at £84 million with a funding gap of £6.5 million. The budget was based on 3% real terms raise in council tax and included savings of £0.4 million. The council also identified the need to transfer £6.1 million from reserves in order to achieve a balanced budget position.

43. During the year, further cost pressures of £2.6 million were identified to bring the overall general fund budget to £86.6 million and an additional £1.3 million was transferred from reserves to meet the additional costs with the balance met from additional revenue support grant.

Financial performance in 2019/20

44. The council reported a surplus of £3.997 million against the general fund budget in 2019/20. This was primarily as a result of a decision to maintain a contingency in non-earmarked general fund reserves to meet the unexpected costs of the Covid-19 pandemic and consequently additional advanced debt repayments which were planned for 2019/20 were not made.

45. The council conducts a range of trading activities outside the general fund including the housing revenue account, the harbour authority account and Orkney College. When considering the financial position of the council it is important to reflect on the performance of the trading areas outside the general fund. The overspend on non-general fund areas was £16.2 million. This overspend was primarily attributable to the unrealised losses recognised on Strategic Reserve Fund investments at 31 March 2020.

46. The more significant under and overspends are summarised in [Exhibit 4](#).

Exhibit 4

Summary of significant under / overspends against budget

Area	£m	Reason for variance
Underspends		
Other services	£3.86	The variances have arisen as a result of corporate contingency funds not being used and a reduction in the planned level of accelerated debt repayments in order to build resource for the Covid-19 pandemic response.
Harbour authority - Scapa Flow Oil Port	£1.11	The income from harbour dues was £0.82 million higher than anticipated due to increased activity and there was slippage in the capital programme.
Overspends		
Harbour authority - Strategic Reserve Fund	£17.67	The overspend relates to losses on investments in the Strategic Reserve Fund partially offset by a reduction in expenditure on strategic projects.

Source: Orkney Islands Council Revenue Outturn Reports

47. The council has a history of delivering services within the agreed budget, which is dependent on in year transfers from the Strategic Reserve Fund. This is in accordance with the Strategic Reserve Fund strategy described in our financial sustainability section at paragraph 102.

Planned efficiency savings were achieved

48. With constraints on funding from government and increased demand for services, efficiency savings are an important means of bridging the gap between funding received and spending commitments.

49. The Policy and Resources Committee routinely receives budget monitoring reports including savings plans which have been risk assessed. The council planned to secure efficiency savings of £0.4 million in 2019/20 and the target was achieved in year. The efficiency savings were lower in 2019/20 than in previous years and the achievement of further savings is likely to be challenging.

Housing revenue account operated within budget

50. The council is required by legislation to maintain a separate housing revenue account and to ensure that rents are set to a level which will at least cover the costs of its social housing provision.

51. The housing revenue account delivered a balanced budget in-year and reserves were maintained at £0.5 million (£0.5 million as at 31 March 2019).

52. The housing revenue account reported total underspends of £0.2 million in 2019/20 with the majority of this relating to reduced repairs and maintenance costs. The reduction of repairs and maintenance totalled £0.1 million and was due to

fewer reactive repairs being carried out and some roofing contract work being postponed.

53. The council agreed to use the surplus of funds to accelerate loan charges for outstanding debt. Using the surplus funds for this purpose is considered prudent by the council as it will reduce interest payments over the remaining period of the debt. However, this has to be weighed up against slippage in both the repairs and maintenance of housing stock as well as slippage in the house build programme.

The uncommitted balance on the general fund increased to allow flexibility when responding to Covid-19

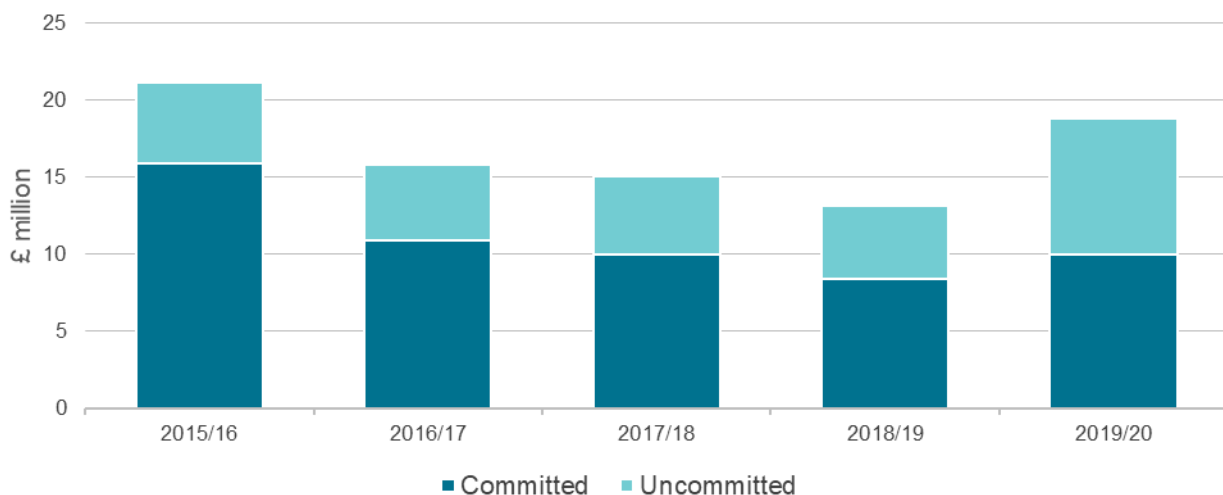
54. The general fund is a key usable reserve for managing the council's financial position. The purpose of the general fund is to earmark funding for planned future liabilities and to provide a contingency fund to meet unexpected expenditure, avoid unnecessary borrowing and cushion the impact of uneven cashflows.

55. The balance on the general fund has been decreasing year on year since 2015/16 ([Exhibit 5](#)), and a revised reserves strategy was approved in February 2020 to reduce the non-earmarked element of the general fund further. The non-earmarked reserve was planned to reduce from £4.9 million to £3.4 million. This would leave the non-earmarked balance at 4 per cent of the council's net budgeted expenditure and allow the council to make additional early repayments on capital debt.

56. When considering the change to the general fund reserves strategy the council benchmarked its proposed balance against other councils across Scotland and considered the savings to be made from the reduction in interest payments.

Exhibit 5

Analysis of general fund balance over 5 years



Source: Orkney Islands Council Annual Accounts 2015/16 to 2019/20

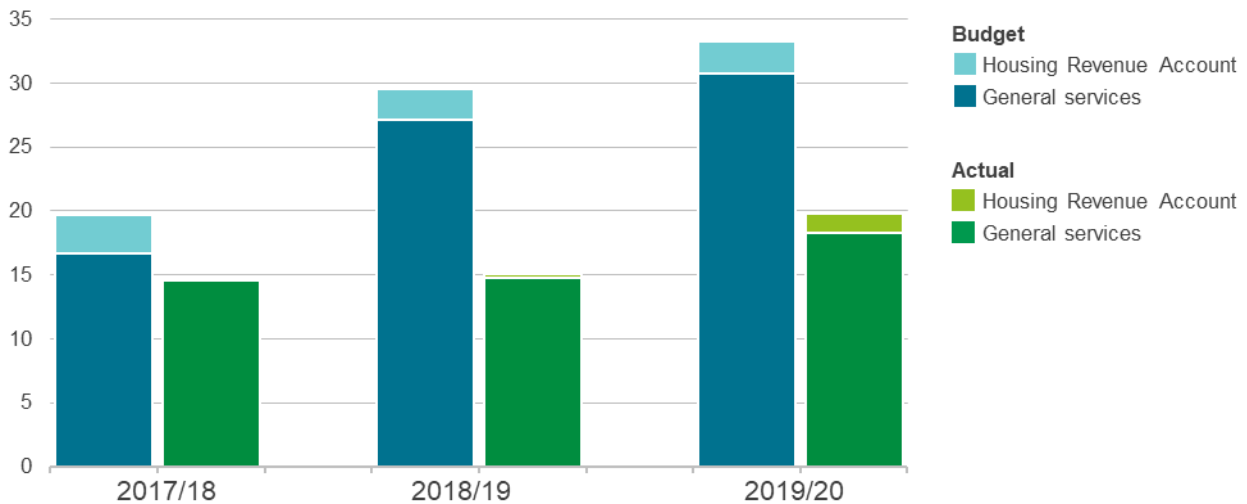
57. Following the emergence of the Covid-19 pandemic a decision was made to maintain a higher level of non-earmarked reserves to ensure the council was able to respond to increased demand on services quickly. The advanced payments on debt were postponed and the non-earmarked element of the general fund balance at 31 March 2020 was significantly higher than the policy baseline and previous years.

There was slippage against the capital programme in 2019/20

58. The council incurred total capital expenditure in 2019/20 of £19.9 million of which £18.4 million related to general services and £1.6 million related to the housing revenue account. As [Exhibit 6](#) demonstrates this continues a trend of slippage against the original budget.

Exhibit 6

Capital slippage compared to budget (non- HRA and HRA)



Source: Orkney Islands Council Annual Accounts 2017/18 to 2019/20

59. General services capital spend was £12.4 million (40%) below the original budget and the Housing revenue account was £0.9 million (38%) below the original budget.

60. The original capital budget of £33.3 million was adjusted in year for slippage brought forward from 2018/19 and slippage carried forward to 2020/21. Total slippage at 31 March 2020 was £14.4 million. The main areas of slippage into 2020/21 for general service were:

- replacement tugs (£2.4 million)
- the new care facility at Kirkwall (£4.2 million)
- the extension to St Andrews School (£1.4 million)
- the corporate improvement programme (£1.1 million).

61. In relation to the housing revenue account, £1.3 million was incurred for the Carness project with £1.1 million of planned slippage carried forward to 2020/21.

62. The council has indicated that while slippage on capital programmes can bring benefits in creating the ability to make early debt repayments, there is a risk of not delivering strategic priorities and incurring additional costs if it continues to under deliver against its capital programme on both HRA and other services.



Recommendation 4

The council should minimise slippage and re-profiling of capital projects through the use of historic experience to inform capital programmes and create realistic timelines for incurring capital spend.

63. In 2019/20, Internal Audit undertook two reviews of capital management at the request of the interim Chief Executive:

- Capital programme slippage
- Major capital projects.

64. The Capital programme slippage report gave the conclusion: adequate assurance and said that processes and procedures relating to the capital programme were well controlled and managed. Adequate assurance means that some improvements are required to enhance the framework of governance, risk management and control, however there no high priority actions identified.

65. The council updated their guidance on the capital appraisal and delivery process in 2019/20. The internal audit review of major capital projects highlighted that the majority of slippage in 2019/20 related to projects that were initiated prior to the council's guidance notes being produced.

Treasury management

66. The council has a significant portfolio of managed funds through the Strategic Reserve Fund. The total value of investments at 31 March 2020 was £210.6 million, a reduction of £12.1 million from the prior year.

67. The council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the council is relatively low in order to give priority to security of its investments.

68. In line with good practice the council reviews its treasury management strategy on an annual basis and prepare an annual investment strategy in line with the Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes'.

69. The performance of the Strategic Reserve Fund is measured against a range of indices with a target to outperform the benchmark over a rolling three year period.

70. At 31 March 2020 the Strategic Reserve Fund reported a return on investments of -6.9% against a benchmark of -3.3%. Over three years the Funds performed below the benchmark of 1.3%, reporting a return on investments of -0.1%. The significant underperformance in 2019/20 reflects the uncertainty in the market as a result of the Covid-19 pandemic and this has impacted the rolling three year performance.

Long term borrowing levels have increased in 2019/20

71. At 31 March 2020, long term borrowing stood at £35.1 million an increase of £10.0 million on the 2019 level of £25.1 million. During the same period, short term borrowing decreased from £5.5 million to £0.4 million, as a result of planned advanced debt repayments made early in 2019/20. The borrowing relates to balances held with the Public Works Loans Board to support the capital programme.

72. Total external debt, which includes the council's long-term liabilities, was within the authorised limit and operational boundary set by the Treasury Management strategy.

Budget process was appropriate

73. The council's budget is aligned to the council's priorities as set out in the Council Plan 2018 to 2023. This is consistent with good practice. The council has created a medium term resource strategy 2017-2022 which used scenario planning to calculate the estimated funding gaps. The medium term resource strategy informs the annual budgeting process.

74. The council has delegated overall scrutiny of financial performance to its Policy and Resources Committee which receives regular revenue and capital monitoring reports. The Policy and Resources Committee is supported by service committees who receive detailed budgets for their service area for scrutiny.

75. We observed that senior management and members receive regular and accurate financial information on the body's financial position. The body has appropriate budget setting and monitoring arrangements.

Financial systems of internal control operated effectively

76. As part of our audit we identify and assess the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that the body has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

77. Our findings were included in our management report that was presented to the Monitoring and Audit Committee on 4 June 2020. We concluded that the key controls were operating effectively. No significant internal control weaknesses were identified which could affect the council's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

Internal audit

78. The council's internal audit function is provided by the Internal Audit Section of Orkney Islands Council. Each year we consider whether we can rely on internal audit work to avoid duplication of work. When we plan to place reliance on internal audit work, we carry out an assessment of the internal audit function to ensure that it is sufficient in terms of documentation standards, reporting procedures and quality, and is performed in accordance with Public Sector Internal Audit Standards (PSIAS).

79. We reviewed the council's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent we can rely on the work of internal audit. We have placed reliance on the work of internal audit in 2019/20 for our review of statutory performance indicators.

Standards of conduct and arrangements for the prevention and detection of fraud and error were appropriate

80. The body is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities. Furthermore, it is responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

81. We have reviewed the arrangements in place to maintain standards of conduct including the Code of Conduct for Members. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

82. Appropriate arrangements are in place for the prevention and detection of fraud, error and irregularities. We are not aware of any specific issues that we need to bring to your attention.

Arrangements for preventing fraud and corruption in the procurement function are appropriate.

83. The consideration of financial management includes evaluating the arrangements in place for fraud and corruption. Instances of fraud and corruption can be particularly prevalent in the procurement function. We carried out an assessment of the arrangements in place at the council to prevent fraud and corruption in the procurement function.

84. Our findings were included in our management report that was presented to the Monitoring and Audit Committee on 4 June 2020. We concluded that the key controls over the council's procurement process were satisfactory.

Part 3

Financial sustainability



Main judgements

The Covid-19 pandemic had a significant impact on the short-term finances of the body and the impact of this on medium/longer term planning is still to be evaluated.

The council has a longer-term financial strategy covering the 10 year period to 2029/30. This identifies a cumulative funding gap of £65.7 million based on realistic assumptions. The council should now consider options for long term savings options.

Application of the Strategic Reserve Fund has been council policy in ensuring the council can maintain its current service provision. A long term financial plan for the Strategic Reserve Fund should be developed to ensure the funds will be used to achieve strategic aims and benefit the people of Orkney.

Financial sustainability looks forward to the medium and long term to consider whether the council is planning effectively to continue to deliver its services or the way in which they should be delivered.

The financial impact of the Covid-19 pandemic will be significant and the longer term impact is still to be evaluated

85. The council approved a balanced general fund budget of £86.5 million for 2020/21 in March 2020, however, the balanced position could only be achieved through the application of efficiency measures totalling £1.0 million and a transfer from the Strategic Reserve Fund of £6.3 million.

86. A detailed analysis of the anticipated additional costs of Covid-19 across the 2020/21 financial year was presented to the Special General Meeting of the Council on 30 June 2020. This report noted that the latest financial projections show the impact of the Covid-19 pandemic to be a predicted operating deficit of £8.8 million across all council operations. The loss of income from cruise liners, wharfage and ferries is predicted to be £6 million and is the most significant source of financial pressure.

87. At 30 June 2020 the council was reporting an overall surplus against revised budgets of £11.2 million. The surplus comes from returns on investments within the Strategic Reserve Fund which are £13.3 million ahead of the budgeted position to date. However, the general fund is showing a deficit of £1.3 million and miscellaneous piers and harbours accounts are reporting a deficit of £1.6 million, due to loss of income.

88. The council has revised the general fund budget to £93.6 million as a result of the impact of Covid-19. The budget includes additional funding from the Scottish Government to support the Covid-19 pandemic costs of £1.583 million and £5.0 million from Council Reserves to support payment of the Council's Business Hardship Support Grants scheme.

89. The council does not currently have a financial recovery plan for meeting any additional costs and has noted that a contribution from the non-earmarked reserves of the general fund may be required to support the additional expenditure.

90. Further reports are to be presented to elected members to advise of progress in aligning 2020/21 spend levels more closely with the funding available.

91. It is too early to assess with any accuracy what the longer term impact on the council's finances will be, or what additional support may be provided to local authorities to offset these costs.

Medium and longer term financial plans are in place

92. Following our audit recommendation in 2017/18 the council prepared a long term financial plan for the period 2018/19 to 2029/30. The long term financial strategy identified a cumulative funding gap of between £23.6 million and £145.6 million based on a range of optimistic to pessimistic assumptions.

93. Historically, the council has met the funding gap through a combination of efficiency savings and transfers from the Strategic Reserve Fund. The long term financial plan includes an annual contribution of £4.4 million from the Strategic Reserve Fund to the General Fund to support ongoing service operations. If the council cannot identify savings there will be increasing pressure to draw more on reserves in order to meet the funding gap.

94. The long term financial strategy helps the council focus on the key risks it faces over the longer term. Detailed savings plans are, however, prepared on an annual basis and therefore the long term plans do not fully address how the council will continue to deliver services within the projected constraints nor identify savings options.



Recommendation 5

The council should consider creating a medium to long term approach for developing savings options.

95. The council has a Change Programme to help underpin the delivery of long term savings. The Change Programme is intended to drive an evaluation of key business processes, including a review of options for modernising and delivering frontline services more efficiently.

96. We reported in 2018/19 that the Change Programme has proved difficult to manage and there has been a delay in delivering the intended outcomes. There was no further reporting in 2019/20 and therefore it is not possible to conclude on the impact of the Change Programme. We have concluded that there has been limited progress in this area and recommend that the role of the Change Programme is considered when developing long term savings options.

The level of useable reserves has decreased in 2019/20

97. One of the key measures of the financial health of a body is the level of reserves held. The level of usable reserves held by the body decreased from £244 million in 2018/19 to £229.6 million in 2019/20. Usable reserves are those reserves the council is able to apply to fund expenditure or reduce taxation and comprise both capital and revenue reserves.

98. The council is in a very fortunate position of having additional usable reserves in addition to the general fund as shown in [Exhibit 7](#). The most significant usable

reserve is the Harbours reserve which had a balance of £199.3 million at 31 March 2020.

Exhibit 7

Summary of movement in usable reserves (>£1 million) in 2019/20

Usable reserve	Audited	Restated	2019/20 £ m
	2018/19 £ m	2018/19 £ m	
Harbour Funds (including Strategic Reserve Fund)	247.8	218.0	199.3
General Fund balance	13.2	13.2	18.8
Capital Receipts Reserve	2.6	2.6	3.1
Repairs and Renewals Fund	9.2	9.2	7.4
Total usable reserves (>£1 million)	273.8	242.9	228.6

Source: Orkney Islands Council 2019/20 unaudited annual accounts

99. The harbours fund accounts for 87 per cent of overall reserves and the majority of this fund is held in the Strategic Reserve Fund. A prior year adjustment of £29.866 million was posted to the 2018/19 accounts, which resulted in a reduction to the Strategic Reserve Fund, from £247.8 million to £218.0 million.

100. In 2019/20 the Strategic Reserve Fund had a balance of £174.7 million, a reduction of £20.3 million compared to 2018/19. The majority of the downward movement related to unrealised losses on investments as a result of the global coronavirus pandemic.

101. The purpose of the Strategic Reserve Fund is to provide for the benefit of Orkney and its inhabitants. The fund is used for projects and initiatives such as the development of industrial estates, harbour infrastructure, recreational projects, and supporting economic development activity across the council area, whilst having regard to the Fund's long-term commitments in terms of the decline and decommissioning of the Flotta Oil Terminal in the future.

102. For many years the Strategic Reserve Fund allocation to the general fund has been used as one of the funding sources for all general fund services, rather than direct contributions towards specific service functions on items of expenditure.

103. In 2019/20 the council proposed that going forward the Strategic Reserve Fund contribution should be attached to specific service areas of the general fund so the public can more readily see the benefit of the Strategic Reserve Fund and the additional services it allows the council to deliver.

104. The council has allocated £6.3 million from the Strategic Reserve Fund to specific general fund areas including the Pickaquooy Centre and library services. The allocations are in line with the Strategic Reserve Fund medium term financial plan presented to the Policy and Resources Committee in February 2019.

105. The council has an established policy on disbursements from the Strategic Reserve Fund which ensures that the value of the fund does not fall in real terms, measured against a minimum floor balance. In recent years Strategic Reserve

Fund investments have performed well with an overall increasing trend in value, however, in the current year performance at the year end was poor due to uncertainty in the market caused by the Covid-19 pandemic. The result of this is that the balance at the year end on the Harbours reserve was below the target minimum balance of £208.2 million, however, positive returns on investments in the first quarter of 2020/21 mean that the Strategic Reserve Fund is outperforming the budgeted level of income at 30 June 2020. The long term impact of Covid-19 on investments is still unknown and is a risk to the council.

106. The Strategic Reserve Fund's medium term financial plan highlights that over-reliance on the Strategic Reserve Fund as a means of balancing the general fund budget as part of a long-term financial strategy is not be considered best practice, particularly given the levels of volatility that may continue to impact adversely on investment returns. It is important that the council has a long term focus when applying the Strategic Reserve Fund to ensure it continues to be used to achieve long term objectives and benefits.



Recommendation 6

A longer-term financial plan for the Strategic Reserve Fund should now be developed to ensure the funds will be used to achieve strategic aims and benefit the people of Orkney.

The Islands Growth Deal

107. In November 2019, a bid was submitted to the UK and Scottish Governments by the three island councils in Scotland: Orkney, Shetland and Comhairle nan Eilean Siar. The Scottish and UK Governments announced in July 2019 that they would each commit £50 million of funding towards the Island Growth Deal, giving total funding of £100 million to invest in projects which will tackle economic barriers and drive economic growth.

108. The funding received is not sufficient to take forward all proposals included in the bid document and therefore the council have prioritised projects taking into account the objectives of the Council Plan 2018 - 2023. Strategic Outline Cases are due to be submitted to the Scottish and UK Governments by 16 October 2020 and, following this, the Head of Terms will be signed no later than March 2021.

Part 4

Governance and transparency



Main Judgements

The council has appropriate and effective governance arrangements in place that support the scrutiny of decisions made by the council.

The Covid-19 pandemic had a significant impact on governance arrangements from March 2020. We consider the measures taken by the council to be appropriate and to support good governance and accountability.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making and transparent reporting of financial and performance information.

Governance and transparency arrangements were appropriate

109. Our previous year's conclusion is still relevant, that overall the council has appropriate governance arrangements, as there has been no significant change during 2019/20, with the exception of specific comments below on the response to the Covid-19 pandemic outbreak in March 2020. The governance and transparency arrangements we consider include:

- council and committee structure and conduct
- overall arrangements and standards of conduct including those for the prevention and detection of fraud, error, bribery and corruption. This includes action in response to the National Fraud Initiative
- openness of council and committee meetings
- reporting of performance and whether this is fair, balanced and understandable.

110. We have concluded that the council has effective overarching and supporting governance arrangements which provide an appropriate framework for scrutiny of organisational decision making.

Governance arrangements were revised from March 2020 as a result of the Covid-19 pandemic

111. The impact of the Covid-19 pandemic from March 2020 has been set out in the annual governance statement in the annual report and accounts. This allowed the council to manage the unprecedented nature and scale of the threat to its communities and staff. A special general meeting of the council was held on 23 March 2020 to agree steps to allow the council staff to prioritise their response to the outbreak including:

- operation of Strategic and Tactical Incident Management Teams to update planning, response and business continuity arrangements
- meetings were no longer held in public in accordance with the council's legal duty to protect public health and comply with social distancing guidance, and meetings were held in a way which does not require members to physically meet
- general council meetings took place more frequently and the Standing Orders were altered to allow for remote attendance and speedier decision making
- all other committees and sub-committees were suspended, and all essential business was put through the full council. This arrangement was in place until the summer recess with standing committees operating again from August 2020.

112. We consider the measures taken by the council to be appropriate. The arrangements allowed for timely decisions to be made and communicated while continuing to support good governance and accountability.

Openness and transparency

113. There continues to be an increasing focus on demonstrating the best use of public money. Openness and transparency in how a body operates and makes decisions is key to supporting understanding and scrutiny. Transparency means that the public has access to understandable, relevant and timely information about how the body is taking decisions and using resources.

114. While public meetings have been suspended due to the Covid-19 pandemic, the council's commitment to openness and transparency is demonstrated by:

- agendas, papers and minutes of committee meetings are readily available on the council's website
- all special general council meetings were available to listen to via recordings on the council website
- the council made its annual accounts available on its website. These included a management commentary which provides details of performance against budget, information on the use of reserves and risks and uncertainties facing the council.

Changes in senior management

115. In June 2019 an Interim Chief Executive was appointed following the ill health related absence of the substantive Chief Executive. The substantive Chief Executive retired on grounds of ill health in 2019/20 and the interim arrangements were extended.

116. The recruitment process for a permanent replacement commenced in June 2020 and is currently ongoing. The interim Chief Executive plans to remain in post to allow for sufficient handover.

Part 5

Best Value



Main judgements

The council continues to progress actions outlined in the Best Value Assurance Report. The council will wish to ensure it can demonstrate what difference they are making in respect of these improvements.

Performance management arrangements were refreshed in 2019/20. However, the monitoring of performance was adversely impacted by the Covid-19 pandemic .

Best Value is concerned with using resources effectively and continually improving services.

The council is making good progress in securing Best Value

117. Best value is assessed over the audit appointment, as part of the annual audit work. In addition, a Best Value Assurance Report (BVAR) for each council is considered by the Accounts Commission at least once in this period. The BVAR report for the council was published in December 2017.

118. The council's response to the Accounts Commission's recommendations, in the form of the Best Value Response Plan, was approved in April 2018. We have followed up the council's progress in implementing our recommendations. [Exhibit 8](#) details the recommendations for improvement and progress reported by the council to date.

119. Overall, the council is progressing a number of activities in response to the Best Value Assurance Report recommendations. In several areas as progress against recommendations has been made, additional actions have been identified and work on these areas is ongoing. We will revisit progress against the recommendations again during the 2020/21 audit. The council will wish to ensure it can demonstrate what difference they are making in respect of these improvements.

Exhibit 8

Progress in implementing best value recommendations

BVAR Recommendation	Progress in implementing each recommendation
Developing a detailed workforce plan	The council's corporate workforce plan was approved by the Policy and Resources Committee on 23 April 2019. To support the Corporate Plan, more detailed Service Plans were created and approved by the relevant

BVAR Recommendation	Progress in implementing each recommendation
	<p>service committee in 2019. The Service Plans have outlined key actions in relation to workforce with delivery dates varying from 2022 to 2023. A key focus of the council should now be ensuring improvements are implemented in line with approved timescales.</p>
<p>Managing capital projects effectively to avoid slippage and the negative impact on delivering strategic priorities.</p>	<p>The Concerto project management system is now fully implemented and there is updated guidance on the capital project appraisal and delivery process. The improved processes have not yet made an impact on the management of capital budgets, with high levels of slippage reported in 2019/20.</p>
<p>Longer term financial planning to ensure the sustainability, feasibility and practicalities of current spending plans. This should be done with reference, also, to the Strategic Reserve Fund.</p>	<p>A long term financial plan covering the period to 2029/30 was approved in February 2019. The council should now consider its response to the identified funding gaps in future years.</p>
<p>The council must ensure it makes progress with the implementation of the IT Strategy and Digital Strategy, including the associated capital programme and completion of the review of capacity.</p>	<p>The council has made positive progress with the Digital Strategy Delivery Plan 2018-2020 and the IT Strategy Delivery Plan, with the majority of actions now complete.</p> <p>The Digital Strategy was due for review in June 2020, however, Covid-19 has changed the way the council operates and therefore the strategy review has been postponed allowing the implications of the pandemic to be included.</p>
<p>To support a culture of improvement, the council should build on the self-evaluation work already in place in services and further develop a corporate approach</p>	<p>The council undertook a self-assessment in early 2019 and reviewed responses through a Corporate Management Team workshop in August 2019. The results have been incorporated into Service Plans approved in September 2019. The council has identified 2 key areas for action:</p> <ul style="list-style-type: none"> • recruitment procedures, staff development and succession planning • developing information and services on the Orkney Islands Council digital platforms.
<p>The council should build on its good examples of community engagement and participation to improve consistency of approach across all the communities, including those that are 'hard to reach'</p>	<p>Orkney Opinions is the council's public consultation group and issues regular surveys to members. The pilot of the group has been completed and made permanent. It was noted in year that the membership was no longer be optimal, and a refresh of members took place in 2019/20.</p>
<p>The council should set out how its activities will contribute to improved outcomes for</p>	<p>The council created Service Plans covering the period 2019-2022 to support its Corporate Plan 2018-23. The Service Plans are focussed on</p>

BVAR Recommendation	Progress in implementing each recommendation
<p>communities so that it can evidence and monitor the impact.</p>	<p>outcomes and set clear targets for improvement over the period to 2022.</p>
<p>The council and its community planning partners should ensure clear performance management arrangements are in place to demonstrate that they are making progress towards delivering positive outcomes for the community.</p>	<p>A revised Strategic Planning and Performance Framework was approved by the Monitoring and Audit Committee in September 2019. Performance reports are presented on a six monthly basis to relevant service committees, however, due to changes in governance arrangements arising from Covid-19 the June update did not take place in 2020.</p>
<p>The council should consider how it can enhance its councillor training and development programme and encourage better uptake by councillors of personal development opportunities.</p>	<p>A review of the induction programme for Councillors was completed in 2018/19. The council are now focussed on creating an ongoing training and development programme which is included in the Chief Executive Service Plan and is due for completion in 2022.</p>
<p>Source: Audit Scotland</p>	

Appropriate arrangements are in place for following the public pound

120. Local authorities have a statutory responsibility to comply with the Accounts Commission / COSLA Code of Guidance on funding external bodies and following the public pound.

121. The council's financial regulations contain a specific section on following the public pound. These emphasise that services must adhere to the council's guidance for allocating funds to external organisations. The guidance applies where funding is provided, or transferred, to arm's length bodies such as companies, trusts and voluntary organisations.

122. Formal reporting and monitoring arrangements have been put in place for each of the subsidiaries, with Orkney Ferries being monitored through the Development and Infrastructure Committee, and the Pickaquoy Centre Trust being monitored through the Education, Leisure and Housing Committee.

123. We have concluded that the council has appropriate arrangements for ensuring compliance with the Code of Guidance on funding external bodies and following the public pound. The monitoring of Orkney Ferries could be improved by reviewing financial performance on an annual basis in line with the process undertaken for the Pickaquoy Centre Trust.



Recommendation 7

Following the public pound arrangements for Orkney Ferries should include an annual review of the financial position.

Performance management arrangements were updated in year, but monitoring of performance has been adversely impacted by the Covid-19 pandemic

124. The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The commission does not prescribe how councils should report this information but expects them to provide the public with fair, balanced and engaging performance information.

125. The Accounts Commission issued a revised 2018 Statutory Performance Information Direction in December 2018 which requires a council to report:

- its performance in improving local public services provided by the council (on its own and with its partners and communities), and progress against agreed desired outcomes
- its own assessment and independent audit assessments of how it is performing against its duty of Best Value, and how it plans to improve these assessments and how it (with its partners where appropriate) has engaged with and responded to its diverse communities

126. The council's performance management arrangements were considered in our BVAR issued in December 2017. We identified that the council has an established performance management framework that managers and councillors clearly understand. The performance framework was updated in August 2019 through the Strategic Planning and Performance Framework.

127. The Strategic Planning and Performance Framework covers performance management in three key areas:

- Orkney Community Plan 2018 to 2021
- Orkney Council Plan 2018 to 2023
- Service Plans 2019 to 2022.

128. The performance monitoring arrangements across the Corporate Plan and Service Plans includes a six monthly review by the relevant service committee. Performance reports are sufficiently detailed to support scrutiny.

129. Due to the revised governance arrangements for the Covid-19 pandemic the May/June committees at which the performance monitoring reports are usually considered were cancelled. The scrutiny of performance in 2019/20 has therefore been adversely impacted and as a result the council will present up to date performance information to the November 2020 service committees.

130. It is likely the emergence of the Covid-19 pandemic will have a significant impact on performance measures overall. A significant proportion of performance measures relate to services which were temporarily suspended, operated at a reduced level, or which have changed as a result of the pandemic.

Overview of performance targets

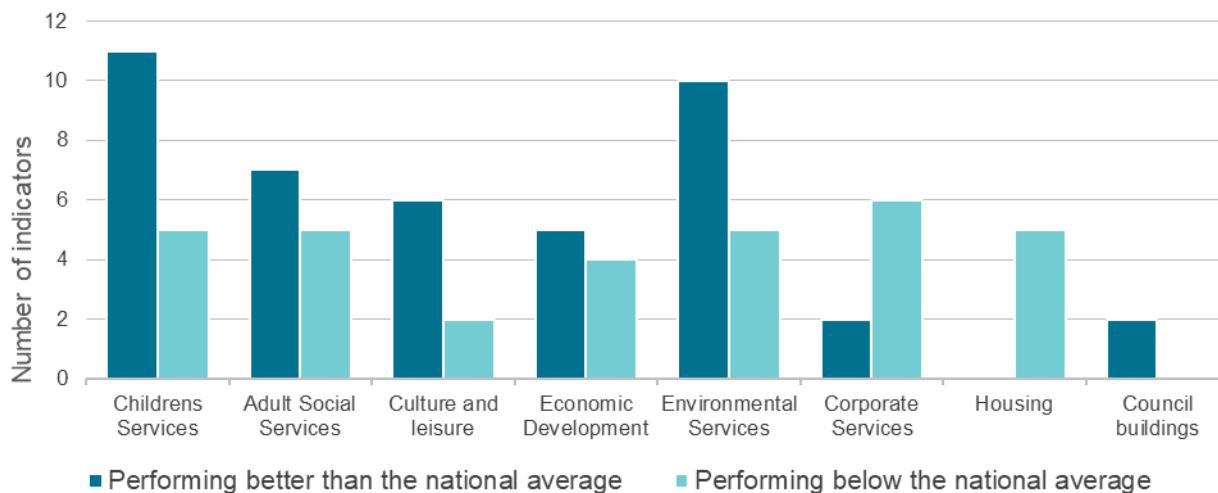
131. The council participates in the [Local Government Benchmarking Framework](#) (LGBF). The framework aims to bring together a wide range of information about how all Scottish councils perform in delivering better services to local communities, including the cost of services and how satisfied citizens are with them.

132. The most recent [National Benchmarking Overview Report 2018/19](#) by the Improvement Service has been analysed and a paper on the council's performance published on the website. Due to the Covid-19 pandemic and revised governance

arrangements the paper has not yet been presented to the Policy and Resources Committee.

133. As [Exhibit 9](#) demonstrates the council's performance continues to be mixed against peers.

Exhibit 9 Council performance compared to Scottish average



Source: Orkney Islands Council analysis of LGBF results 2018/19

134. The council are performing above the national average in 57 per cent of the indicators and 40 per cent are among the top quartile of councils. However, 34 per cent of indicators are among the bottom quartile indicating performance is significantly below the national average. Areas where the council is reporting performance in the bottom quartile include:

- the cost per primary and secondary school pupils
- cost per dwelling of collecting council tax
- the proportion of care services rated 'good' or 'better' in Care Inspectorate inspections.

Care Inspectorate Report

135. In February 2020 the Care Inspectorate published [Report of a joint inspection of services for children and young people in need of care and protection in Orkney](#). The report highlighted a number of areas requiring improvement with regards to child protection.

136. As reported in the annual governance statement the council has created an improvement plan which is monitored by the Chief Officer Group. We will monitor progress in implementing the actions as part of our 2020/21 audit work.

National performance audit reports

137. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2019/20, Audit Scotland published a number of reports some of which may be of interest to the council. These are outlined in [Appendix 4](#).

138. Relevant national reports continue to be routinely presented to committees throughout the year. The council has well established and effective arrangements in place to ensure that our national reports and their impact on the council are considered by members.

Appendix 1

Action plan 2019/20



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p>Harbour Authority earmarked balance</p> <p>The council previously reported that responsibility for decommissioning costs of the Flotta Oil Terminal rested with the operator, however a review of legal documents highlighted that the Council has a contractual obligation to contribute a set amount towards these costs.</p> <p>Risk - there is a risk that miscommunication between the legal department and the financial department could result in further provisions being missed.</p>	<p>The council should consider the lessons learned from the identification of Flotta Oil Terminal provision and implement controls procedures as appropriate.</p>	<p>The Heads of Service noted below will arrange to have a review of Agreements and Contracts that might give rise to possible provisions.</p> <p>Head of Finance and Head of Legal Services and Head of Marine Services and Transportation</p> <p>31 March 2021</p>
2	<p>Ongoing risks associated with the Flotta Oil Terminal provision</p> <p>The council have included a provision for the contribution towards the decommissioning costs of the Flotta Oil Terminal in line with the decommissioning agreement. The decommissioning agreement outlines an index-linked, capped amount which the Council will contribute, with the balance being the responsibility of the operator.</p> <p>Risk - Economic conditions and oil terminal operations can change significantly in a short period of time and there is a risk that the operators experience financial difficulty and not meet their share of the liability.</p>	<p>The council should implement annual procedures to evaluate the level of provision required including a review of the ongoing viability of the operator.</p>	<p>The Council will continue to evaluate the level of provision required in accordance with the Decommissioning Agreement. An updated estimate of the full terminal decommissioning costs will also be sought from the Terminal Operator.</p> <p>An annual review of the ongoing financial viability of the Terminal Operator will be conducted.</p> <p>Effective communication is being maintained with the Terminal Operators regarding repurposing and extension of the Terminal operating life</p> <p>Head of Finance and Executive Director Development & Infrastructure</p> <p>31 March 2021</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
3	<p>Management commentary</p> <p>The management commentary that accompanies the financial statements should explain the results in simple terms and provide clarity to readers in order to help them understand how the council and its group has performed against budget.</p> <p>The council revised the management commentary in 2019/20 and made improvements but there is scope for further refinement.</p> <p>Risk - the performance of the council and its group may not be transparent, and the reader may not fully understand key messages.</p>	<p>Management should review the management commentary for the 2020/21 accounts to identify areas which could be improved further.</p>	<p>The Management Commentary for 2020/21 will be further revised to try and improve clarity and understanding for the reader of the accounts.</p> <p>Head of Finance</p> <p>30 June 2021</p>
4	<p>Capital slippage</p> <p>The original approved limit for capital expenditure during 2019/20 was £33 million. Capital slippage in 2019/20 amounted to £18 million due to weaknesses in forward planning arrangements.</p> <p>Risk – capital slippage might impact on strategic priorities that are dependent on capital projects being completed on time.</p>	<p>The council should minimise slippage and re-profiling of capital projects through the use of historic experience to inform capital programmes and create realistic timelines for incurring capital spend.</p>	<p>Action to improve Capital Programme delivery is being undertaken, including the reprofiling of the programme with more realistic delivery timescales. The 2020 lockdown has however further delayed programme delivery as contractors have lost several months over the spring and summer and further slippage on original timescales is therefore a strong possibility.</p> <p>The Senior Management team and Capital Programme Manager</p> <p>Ongoing</p>
5	<p>Longer term savings options</p> <p>The council improved their approach to financial sustainability through the development of a long term financial strategy. The strategy identified a cumulative funding gap of £65.7 million based on realistic assumptions but there are currently no options developed to allow the council to</p>	<p>The council should consider creating a medium to long term approach for developing savings options, building upon the original intention of the Change Programme.</p>	<p>The Council's Senior Management Team has agreed a number of savings proposals that it intends to work up to provide a range of options/choices for members to consider. These will provide a range of short, medium and long terms savings options.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>close the gap, and there has been a lapse in monitoring the Change Programme.</p> <p>Risk – there is a risk that the council does not take a long term view when creating savings plans.</p>		<p>Senior Management Team 30 June 2021</p>
6	<p>Longer term financial planning -Strategic Reserve Fund</p> <p>The high level of reserves supports the need for long term financial planning to ensure the funds will be used to achieve strategic aims and benefit the people of Orkney.</p> <p>Risk – the reserve balances may not support strategic aims.</p>	<p>A longer-term financial plan for the Strategic Reserve Fund should now be developed to ensure the funds will be used to achieve strategic aims and benefit the people of Orkney.</p>	<p>A ten year projection for the Strategic Reserve Fund was reported to the Policy and Resources Committee in February 2020 when the Council agreed the contribution from the Strategic Reserve Fund to the General Fund Budget for 2020/21. This will be updated for 2021/22.</p> <p>Head of Finance 31 March 2021</p>
7	<p>Review of the financial performance of all subsidiaries</p> <p>The council has subsidiaries including Orkney Ferries. The financial performance of these subsidiaries is not monitored by the council's committees.</p> <p>Risk – there is a risk the council is not aware of any significant financial issues at its subsidiary bodies.</p>	<p>Following the public pound arrangements for Orkney Ferries should include an annual review of the financial position.</p>	<p>An annual report on the Financial Performance of Orkney Ferries will be reported to the Development and Infrastructure Committee.</p> <p>Executive Director of Development and Infrastructure/Head of Finance.</p> <p>31 August 2021</p>
Follow up of prior year recommendations			
8	<p>Annual Budget</p> <p>The council continues to approve contributions from the SRF to supplement its funding from the Scottish Government and local taxes raised through council tax and non-domestic rates.</p>	<p>The council needs to consider reducing the level of General Fund expenditure to bring it into line with the financial support received</p>	<p>In progress</p> <p>The council has agreed a Strategic Reserve Fund Strategy which supports the use of reserves to support specific services. We therefore accept there will be use of the reserves to support service priorities, however, this makes it increasingly important that</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
9	<p data-bbox="260 394 619 689">Risk - over-reliance on the SRF as a means of balancing the General Fund budget as part of a long-term financial strategy is not considered good practice, particularly given the levels of volatility that may continue to impact adversely on investment returns.</p> <p data-bbox="260 730 624 1234">Expenses Our financial statements audit work included testing of 30 officers' expense claims. We found a number of instances where insufficient checks had been carried out prior to approving claims. Some claim forms did not have receipts attached, four claims had credit card receipts attached instead of detailed receipts, and there were instances where it was unclear if expenditure represented value for money.</p> <p data-bbox="260 1249 624 1339">Risk – Expenses claimed may not comply with agreed procedures.</p>	<p data-bbox="659 779 986 869">All claims should include detailed receipts to support items of expenditure</p>	<p data-bbox="1058 394 1393 510">there is a long term strategy on the use of the Strategic Reserve Fund. See recommendation 6</p> <p data-bbox="1058 730 1417 1077">In progress The Council has implemented the recommendation in 2019/20, however, due to the Covid-19 pandemic travel restrictions we were unable to review hard copies of receipts supporting expenses claims. We will verify the action has been completed as part of our 2020/21 audit procedures.</p>
10	<p data-bbox="260 1379 632 1816">Change programme The Change Programme is intended to drive an evaluation of key business processes, including a review of options for modernising and delivering frontline services more efficiently. The Change Programme, which has been in place since 2011, has proved difficult to manage and there has been a delay in delivering the intended outcomes.</p> <p data-bbox="260 1832 632 1921">Risk - the programme may not deliver planned changes and efficiencies.</p>	<p data-bbox="659 1424 1023 1637">The council should ensure the change programme sets out realistic plans and savings targets and that appropriate management arrangements in place to ensure delivery of the programme.</p>	<p data-bbox="1058 1357 1422 1603">Limited progress There has not been an update to committees in 2019/20 detailing the impact of the Change Programme or the level of savings which has been delivered.</p> <p data-bbox="1058 1619 1422 1921">Changes to the team responsible for the change programme were agreed in February 2020. We recommend that the council considers the purpose of the group and links to the development of long term savings options. See recommendation 5.</p>

Appendix 2

Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Include any audit risks arising from Covid-19

Audit risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
<p>1 Risk of management override of controls</p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>We have not identified any instances of management override from our testing.</p>
<p>2 Risk of fraud over income</p> <p>Orkney Islands Council receives a significant amount of income in addition to Scottish Government funding.</p> <p>The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>	<p>We gained appropriate assurance over the completeness and occurrence of income and we are satisfied that it is not fraudulently misstated in the annual accounts.</p>
<p>3 Risk of fraud over expenditure</p> <p>The Financial Reporting council's Practice Note 10 requires consideration of the risk of fraud over expenditure. The extent and nature of expenditure, for example, welfare benefits, social care payments and grants means that there is an inherent risk of fraud.</p>	<p>Review of work performed on the National Fraud Initiative matches.</p> <p>Assess the high-level key controls in areas of significant expenditure.</p> <p>Focused substantive testing of expenditure and housing benefit transactions.</p>	<p>We gained appropriate assurance over the completeness and occurrence of expenditure and we are satisfied that it is not fraudulently misstated in the annual accounts.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>4 Estimation and judgements</p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of non-current assets and provisions. This subjectivity represents an increased risk of misstatement in the financial statements</p>	<p>Review the appropriateness of the council's accounting policies in these areas.</p> <p>Completion of 'review of the work of an expert' in accordance with ISA500 for the professional valuer.</p> <p>Focused substantive testing of asset valuations and asset useful lives.</p> <p>Focused substantive testing of provisions.</p>	<p>We gained appropriate assurance over the competence, capability and objectivity of the valuer and the actuary.</p> <p>The assumptions used by the actuary were compared to benchmark information and we concluded that these were reasonable.</p> <p>There were no issues arising from our work on estimates and we have concluded there is sufficient assurance to support our audit opinions.</p>
<p>5 Value of Investments</p> <p>Several changes were made to the 2018/19 final accounts due to the council adopting the new standard IFRS 9 – Financial Instruments.</p> <p>Further work should be undertaken to ensure full compliance with the new standard and reduce the risk of a material error within the balance sheet.</p>	<p>Review implementation of IFRS 9.</p> <p>Substantive testing of investment values at year end to ensure fairly stated.</p> <p>Review of financial instruments' disclosures.</p>	<p>The valuations were agreed to valuation reports provided by the fund managers.</p> <p>We gained appropriate assurance over the competence, capability and objectivity of the fund managers.</p> <p>We have confirmed that the disclosures in the accounts were in line with the requirements of IFRS 9.</p>
<p>6 Harbour Authority ear-marked balance</p> <p>The council has earmarked a proportion of the Harbour Reserve to ensure it can meet the decommissioning costs of the Flotta Oil Terminal. The sum which has been earmarked is based on a report prepared by consultants in 1997, uprated for inflation.</p> <p>There is a risk that economic conditions and oil terminal operations have changed significantly since the consultants provided their initial estimate of costs, therefore the sum set aside may not be enough to meet the cost of any unexpected event.</p>	<p>Review and comment on the appropriateness of the council's updated valuation and accounting treatment.</p>	<p>In responding to this recommendation, the council determined that there had been an error in prior year accounts and that a liability had to be recognised. The council has now included a prior year adjustment of £29.866 million to create a provision for the contractual obligation to contribute towards the decommissioning of the Flotta Oil Terminal. The impact of this adjustment decreased the balance brought forward on the Strategic Reserve Fund from £247.84 million to £217.97 million. There was a charge through the Comprehensive Expenditure and Income statement of £0.70 million for the current year bringing the overall provision to £30.590 million at 31 March 2020.</p> <p>We are satisfied that the estimated provision is reasonable and accounted for in line with accounting standards and the CIPFA Code.</p>

Audit risk	Assurance procedure	Results and conclusions
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
<p>7 Financial management</p> <p>The council has not developed a long-term financial plan for its Strategic Reserve Fund. Longer term financial planning would improve the likelihood of achieving the strategic aims of that fund.</p>	<p>Monitor progress with preparing long term financial plan providing comment in our annual audit report 2019/20</p>	<p>The council has completed a review of the Strategic Reserve Fund strategy but there is not a long term financial plan for the Strategic Reserve Fund.</p> <p>Appendix 1, action plan point 6</p>
<p>8 Financial management</p> <p>The council has a history of slippage in its capital programme due to unrealistic timescales and budgets. The original approved limit for capital expenditure during 2019/20 was £33.3 million, however, capital expenditure to date is £8.8 million. The projected underspend for the year is £7.2 million.</p> <p>There is a risk that ineffective direction and control of the capital investment programme may lead to rescheduling of projects which impact of service delivery intentions.</p>	<p>Monitor capital slippage and assess any actions taken to reduce slippage providing comment in our annual audit report 2019/20</p>	<p>The original approved limit for capital expenditure during 2019/20 was £33 million. Capital slippage in 2019/20 amounted to £18 million due to weaknesses in forward planning arrangements.</p> <p>Appendix 1, action plan point 4</p>
<p>9 Value for money</p> <p>The council's Change Programme aims to deliver significant savings of £3.8 million between 2017/18 and 2021/22. To date £1.5 million baseline savings have been approved. However, £2.3 million savings have yet to be identified.</p> <p>There is a risk that the planned savings will not be achieved by 2021/22.</p>	<p>Monitor progress with identifying and achieving savings, providing comment in our annual audit report 2019/20.</p>	<p>The savings from the change programme have not been reported in 2019/20.</p> <p>The council received a paper outlining changes to the team running the Change Programme in February 2020 but the impact of the team is not clear from reports to council committees.</p> <p>Appendix 1, action point 10</p>

Appendix 3

Summary of uncorrected misstatements

We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting threshold of £17 thousand and request they be corrected.

The table below summarises uncorrected misstatements that were identified during our audit testing and have not been corrected by management. Cumulatively these errors are below our performance materiality level as explained in [Exhibit 2](#). We are satisfied that these errors do not have a material impact on the financial statements.

#	Account areas	Comprehensive income and expenditure statement		Balance sheet	
		Dr £000	Cr £000	Dr £000	Cr £000
1	Property, Plant and Equipment			72	
	Depreciation		(72)		
2	Property, Plant and Equipment			50	
	Revaluation Reserve				(50)
Net impact		0	(72)	122	(50)

Notes:

Entry 1 relates to depreciation charged on an asset classified as vehicles, plant and equipment and subsequently moved to assets under construction

Entry 2 relates to a revaluation of a council House which was not reflected in the Fixed Asset Register or the unaudited annual accounts

Appendix 4

Summary of national performance reports 2019/20

		 2019/20 Reports	
		Apr	
Social security: Implementing the devolved powers		May	
Scotland's colleges 2019		Jun	 Enabling digital government
		Jul	
NHS workforce planning - part 2		Aug	
Finances of Scottish universities		Sept	
NHS in Scotland 2019		Oct	
		Nov	
Local government in Scotland: Financial overview 2018/19		Dec	
Scotland's City Region and Growth Deals		Jan	 Privately financed infrastructure investment: The Non-Profit Distributing (NPD) and hub models
		Feb	
		Mar	 Early learning and childcare: follow-up

Reports of relevant interest:

[Local Government in Scotland: Financial Overview 2018/19](#) –December 2019.

[Equal pay in councils - Impact report](#) – June 2020

[Local government in Scotland Overview 2020](#) - June 2020

Orkney Islands Council

2019/20 Annual Audit Report

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