

Orkney Islands Council

2020/21 Annual Audit Report



 AUDIT SCOTLAND

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

November 2021

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Key messages

2020/21 annual accounts

- 1 Our audit opinions on the annual accounts of the council, its group and the section 106 charities administered by the council are unmodified.
- 2 The continuing impact of Covid-19 led to delays in the auditing timetable for 2020/21 annual accounts. The audited annual accounts have been certified in line with revised government timescales.

Financial management

- 3 Financial management is effective with a budget process focussed on the council's priorities.
- 4 The council delivered services within budget in 2020/21 and utilised uncommitted general fund reserves for accelerated payment of loan debt and contributions to the repairs and renewals fund.
- 5 The council continues to have significant levels of slippage against capital programmes and planned work to address the issue has been delayed due to Covid-19.
- 6 The council has maintained significant useable reserves with the Strategic Reserve Fund increasing by £40.2 million in year resulting in a year-end balance of £239.5 million.
- 7 Systems of internal control operated effectively in 2020/21. There were a small number of areas where controls could be strengthened.

Financial sustainability

- 8 The council approved a balanced general fund budget of £91.2 million for 2021/22. This is based on contributions from reserves of £7.5 million and assumes efficiency savings of £0.6 million.
- 9 The council plans to use reserves to support services over the medium term to long term in line with its approved strategy.
- 10 The council is facing significant workforce issues which increases the risk that service delivery will not be maintained at required levels.

Governance and transparency

- 11** The governance arrangements introduced in response to the pandemic are appropriate and operated effectively.
- 12** The council is developing a revised structure for the senior management team. This is likely to be fully implemented by 31 March 2022.

Best Value

- 13** The council reported in 2020/21 that all actions agreed as part of the Best Value Assurance Report published in 2017 have been completed. There are emerging issues in relation to workforce strategy, management of capital projects and long term financial planning which need to be addressed.
- 14** The council reported performance in line with the 2018 SPI Direction. Progress in delivering corporate priorities continues to be monitored and appropriate action taken as necessary.
- 15** The council has made progress in addressing the issues highlighted in the Care Inspectorate report on children's services.

Introduction

1. This report summarises the findings arising from the 2020/21 audit of Orkney Islands Council (the council) and its group.

2. The scope of the audit was set out in our 2020/21 Annual Audit Plan presented to the April 2021 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](#) namely, financial management, financial sustainability, governance and transparency and value for money.

3. The main elements of our audit work in 2020/21 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 relating to the use of resources
- consideration of the four audit dimensions

4. The global coronavirus pandemic has had a considerable impact on Orkney Islands Council during 2020/21. This has had significant implications for the services it delivers and the suspension of non-essential projects and activities, such as capital construction. Risks related to the pandemic were included in our Annual Audit Plan.

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 3](#)) and good practice guides

- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability

Responsibilities and reporting

6. 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.

7. 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.

8. 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.

9. 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.

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

11. 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.

12. 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

13. 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 2020/21 audit fee of £196,350 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

14. 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.

1. Audit of 2020/21 annual accounts

The principal means of accounting for the stewardship of resources and performance

Main judgements

Our audit opinions on the annual accounts of the council, its group and the section 106 charities administered by the council are unmodified.

The continuing impact of Covid-19 led to delays in the auditing timetable for 2020/21 annual accounts. The audited annual accounts have been certified in line with revised government timescales.

Our audit opinions on the annual accounts are unmodified

15. The accounts for the council and its group for the year ended 31 March 2021 were approved by the Monitoring and Audit Committee on 11 November 2021. 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

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

16. As a result of the continuing impact of Covid19 the submission deadlines for Local Government audited annual accounts and annual audit reports were revised to 30 November 2021.

17. The unaudited annual accounts were received on 29 June 2021 in line with our agreed audit timetable. Remote working meant that audit tasks took longer than usual as the audit team were unable to access staff, records, and systems as readily as when we could be on site. In addition, there were additional accounting issues associated with Covid-19 funding which resulted in adjustments to the unaudited annual accounts and additional work for the finance team.

18. Throughout the audit process there has been ongoing discussion with the finance team around issues arising and audit timescales. The working papers provided with the unaudited accounts were satisfactory and finance staff provided good support to the audit team during the audit.

19. Although later than first planned, the annual accounts were signed off in line with the revised timetable permitted to reflect the impact of Covid-19.

Our audit opinions on Section 106 charities were unmodified

20. 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.

21. We received the Orkney General Charitable Trust accounts in line with the agreed timetable and after completing our audit we reported in the independent auditor's report that:

- the financial statements properly present the section 106 charities' financial position and are properly prepared in accordance with charities legislation
- the trustees' annual report is consistent with the financial statements and prepared in accordance with proper accounting practices
- there were no matters on which we are required to report by exception.

22. Our audit opinions on the Section 106 charity is unmodified.

There were no objections raised to the annual accounts

23. The Local Authority Accounts (Scotland) Regulations 2014 require local government bodies to publish a public notice on its website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period. As part of our audit we confirmed that the inspection notice complied with the regulations.

24. The regulations also require a local authority to give the right of interested persons to object to its accounts, as provided by section 101 (11) (rights of interested persons to inspect and copy documents and to object to the accounts) of the 1974 Act. No objections were raised to the 2020/21 Annual Accounts.

Overall materiality remained unchanged on receipt of the draft accounts

25. We apply the concept of materiality in both planning and performing the audit and in evaluating the effect of identified misstatement on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report. We identify a benchmark on which to base

overall materiality, such as gross expenditure, and apply what we judge to be the most appropriate percentage level for calculating materiality values.

26. The determination of materiality is based on professional judgement and is informed by our understanding of the entity and what users are likely to be most concerned about in the annual accounts. In assessing performance materiality, we have considered factors such as our findings from previous audits, any changes in business processes and the entity's control environment including fraud risks.

27. Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit. This was reviewed on receipt of the unaudited annual accounts and is summarised in [Exhibit 1](#). Our planning materiality was unchanged and there was no impact on our audit approach.

Exhibit 1

Materiality values

Materiality level	Council	Group
Overall materiality	£1.66 million	£1.72 million
Performance materiality	£0.83 million	£0.86 million
Reporting threshold	£50 thousand	£50 thousand

Source: Audit Scotland

Conclusions on audit work to address risks of material misstatement

28. Our assessment of risks of material misstatement in the annual report and accounts and any wider audit dimension risks identified in our Annual Audit Plan are included at [Appendix 2](#). 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. [Appendix 2](#) also identifies the work we undertook to address these risks and our conclusions from this work.

Significant findings from the audit of the annual accounts

29. 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 council's accounting practices. We have included significant findings to report on the qualitative aspects covering accounting policies, accounting estimates and financial statements disclosures.

30. The significant findings are summarised in [Exhibit 2](#). Where a finding has resulted in a recommendation to management, a cross reference to the action plan in [Appendix 1](#) has been included.

Exhibit 2

Significant findings from the audit of the financial statements

Issue	Resolution
<p>1. Covid-19 grant funding</p> <p>The Council received additional funding in 2020/21 relating to Covid-19 grants payable to businesses and individuals.</p> <p>The nature of the funding required the council to consider if it should be classified as agency, those where the council is acting as an intermediary, or principal, those where the council is acting on its on behalf.</p> <p>Where the council is acting as an agent, the income and expenditure should not be recognised in the Comprehensive Income and Expenditure Statement.</p>	<p>The council identified it was acting as an agent for grants totalling £11.8 million and an adjustment to remove this from income and expenditure was processed.</p> <p>There was a debtor and matching creditor of £0.3 million. This related to the £500 bonus for social care workers announced by the Scottish Government. This was accrued prior to the guidance on Covid-19 grants being issued in May 2021. The guidance noted that the social care payment should be regarded as agency and consequently this required adjustment in the accounts.</p> <p>We are satisfied that the Covid-19 funds have been appropriately accounted for in the revised accounts</p>
<p>2. Payroll reconciliations</p> <p>Employee expenses in the accounts are driven by the costs from the payroll system. The payroll costs are input into the general ledger by way of a monthly journal.</p> <p>As part of our review of the payroll controls system we found that there were differences between the payroll costs on the general ledger and the payroll system. The council does not carry out regular reconciliations between the systems and therefore there was not a clear explanation for the reconciling items.</p>	<p>Our year end testing procedures found that some of the differences were as a result of manual journals posted to the payroll accounting codes and we could reconcile the costs on the ledger to the underlying payroll records. We are therefore satisfied that the staff costs recorded in the ledger are appropriate and complete.</p> <p>We would recommend that the council conducts a reconciliation between the payroll system and the general ledger on a regular basis.</p> <p>Recommendation 1</p>
<p>3. Stock valuation</p> <p>The level of stock held by the council was above our levels of materiality for the first time in 2020/21.</p> <p>Stock counts are undertaken at various sites and are attended by internal audit who reperform the counts on a sample basis. We considered the work of internal audit in year to provide assurance on the stock value held at the year end.</p> <p>When considering the work of internal audit, we found that they had not considered</p>	<p>We placed reliance on the work of internal audit when considering the stock count information in 2020/21. Due to the issues with internal audit work on quarries and pricing we conducted analytical procedures and sample testing of pricing information. This testing provided appropriate audit assurance over the stock figures in the accounts.</p> <p>We would recommend the council puts in place appropriate procedures to provide them with assurance that the stock held at the year</p>

Issue	Resolution
<p>significant movements in stock when directing their testing and consequently quarries stock which had doubled in value in 2020/21 had not been subject to physical verification by internal audit. In addition, internal audit do not test the pricing of stock to purchase invoices and there is a risk that the value of stock is incorrect.</p>	<p>end is appropriately valued for the financial statements.</p> <p>Recommendation 2</p>
<p>4. Registers of interest</p> <p>The council conduct an annual refresh of the registers of interests in September. This never took place in September 2020 and in some cases the registers of interest held date back to September 2019.</p> <p>There is a risk that the information used to identify related parties for the accounts is out of date and disclosures in the accounts are incomplete.</p>	<p>The council procedures state that any changes to interests should be reported to the council straight away and officers should not wait for the annual exercise.</p> <p>In order to provide assurance of completeness in year we have reviewed Companies House to identify any potential undisclosed related parties. This testing did not identify any gaps in the registers of interests, but we did note that some of the information was obsolete.</p> <p>We are satisfied we have sufficient assurance that related party disclosures are complete. We recommend that the council aligns register of interests requests with the year end and they ensure up to date information is passed to the finance team as part of the accounts preparation process.</p> <p>Recommendation 3</p>

Source: Audit Scotland

Identified misstatements of £13.4 million were adjusted in the annual accounts

31. Total misstatements identified in the council accounts were £12.2 million. The adjustments did not however impact on the total comprehensive income and expenditure surplus which was reported in year.

32. There was a further adjustment of £1.2 million to the group accounts to recognise the council's share of the IJB reserves and this brings the total adjustments made in 2020/21 to £13.4 million.

33. The largest element of the council adjustment related to the reclassification of Covid-19 grants from principal to agency and income and expenditure decreased by £12.1 million in the revised accounts.

34. The council also processed a £0.1 million adjustment in relation to the council's share of Personal Protective Equipment. NHS NSS was centrally responsible for ordering appropriate PPE and community testing kits and issuing them to councils through the NHS Board for use within their local area. This was done at no additional cost to the council. This arrangement was reviewed centrally, and it was concluded that the provision of PPE and testing kits should be treated as non-monetary grants and as such the expenditure should be included in the council's accounts.

35. 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.

36. We identified some disclosure and presentational amendments during our audit which have been reflected in the final set of accounts. The adjustments included disclosures relating to financial instruments, inventories and our audit fee.

37. 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 and materiality. There were no unadjusted misstatements above our reporting threshold identified from our audit

Financial and performance reporting in the Management Commentary has improved in 2020/21

38. Management Commentaries included in the annual accounts should provide information on a body, its main objectives and the principal risks faced. It should provide a fair, balanced, and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

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

40. In 2019/20 we highlighted that there was scope to improve the management commentary included in the annual accounts. The council reviewed the narrative elements of the annual accounts to improve clarity and assist users in their understanding of the financial statements.

41. We are satisfied that the action taken by the council has enhanced the quality of its management commentary and that the council meets the reporting requirements of Local Government Finance Circular 10/2020.

The deadline for whole of government accounts has been extended

42. The whole of government accounts (WGA) are the consolidated financial statements for all branches of government in the UK. The council is required to

provide information in a WGA return and external auditors are required to review and provide assurance on the WGA return.

43. HM Treasury have informed local government bodies in Scotland that the WGA data collection tool will not be available until December 2021 at the earliest and therefore the submission deadline will be extended in to 2022. In accordance with the WGA guidance, we will complete the required assurance statement and submit it to the National Audit Office once the WGA return is completed by the council.

Limited progress was made on prior year recommendations

44. The council has made limited progress in implementing our prior year audit recommendations. We recognise that the council has prioritised its response to Covid-19 and this has resulted in some actions being delayed and we are satisfied that work on these areas has now restarted. For actions not yet implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).

2. Financial management

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

Main judgements

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

The council delivered services within budget in 2020/21 and utilised uncommitted general fund reserves for accelerated payment of loan debt and contributions to the repairs and renewals fund.

The council continues to have significant levels of slippage against capital programmes and planned work to address the issue has been delayed due to Covid-19.

The council has maintained significant useable reserves with the Strategic Reserve Fund increasing by £40.2 million in year resulting in a year-end balance of £239.5 million.

Systems of internal control operated effectively in 2020/21. There were a small number of areas where controls could be strengthened.

The council reported a break even position against the general fund budget

45. The council approved its updated 2020/21 budget in June 2020. The budget was set at £86.5 million with a funding gap of £9.8 million. The achievement of the budget was based on a 3 per cent increase in council tax levels and relied on efficiency savings of £1.0 million split across services. The council planned to draw £6.3 million from the Strategic Reserve Fund.

46. The council reported a break even position against the revised general fund services budget. In 2020/21 the council made the decision to utilise an element of the uncommitted general fund reserve for planned expenditure including the accelerated repayment of loan debt and a contribution to the repairs and renewals fund for roads.

47. The council conducts a range of 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 underspend on non-general fund areas was £39.1 million. This underspend was primarily attributable to the unrealised gains recognised on Strategic Reserve Fund investments at 31 March 2021.

48. The more significant under and overspends are summarised in [Exhibit 3](#).

Exhibit 3

Summary of significant under/overspends against budget

Area	£m	Reason for variance
Underspends		
Harbour authority- Scapa Flow Oil Port	£1.96	Income was higher than anticipated in year due to an extra tanker at the Flotta Oil Terminal, additional ship to ship operations and overall reduced costs due to Covid-19.
Harbour authority- Strategic Reserve Fund	£40.19	The majority of the underspend relates to unrealised gains on the SRF investment portfolio combined with a lower than anticipated draw on the reserve.
Overspends		
Harbour authority- Miscellaneous piers	£2.93	Income has fallen due to cancelled cruise liner visits and a reduction in passenger numbers due to Covid-19.

Source: Orkney Islands Council Revenue Outturn Reports

Housing revenue account operated within budget

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

50. The housing revenue account delivered a small underspend against budget in year and reserves increased to £0.6 million (£0.5 million at 31 March 2020).

51. The housing revenue account reported total underspends of £0.1 million in 2020/21 with the majority of this relating to reduced repairs and maintenance costs. The reduction was due to the Covid-19 lockdown which impacted the council's ability to deliver repairs and maintenance.

Budget processes were appropriate

52. 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.

53. We reviewed the council's budget monitoring arrangements. From our review of budget monitoring reports, review of committee papers and attendance at committees we confirmed that senior management and those charged with governance receive regular, timely and up to date financial information on the council's financial position.

54. The budget monitoring reports presented to service committees clearly show the cost pressures facing the service and the content and format of the reports allow members to perform their scrutiny role.

The Covid-19 pandemic had a significant impact on the 2020/21 budget

55. The impact on public finances of the Covid-19 pandemic has been unprecedented, which has necessitated both the Scottish and UK governments providing substantial additional funding for public services as well as support for individuals, businesses and the economy. It is likely that further financial measures will be needed and that the effects will be felt well into the future.

56. During 2020/21 the council received around £13.1 million of additional Scottish Government funding towards the additional service costs associated with the Covid-19 pandemic. These schemes covered a range of areas including money for welfare and hardship funds, free school meals and community food funding, vulnerable children and young people, community mental health, and additional teachers and support staff.

57. The council was also required to administer around £11.8 million of agency income for 12 separate Covid-19 support schemes. The vast majority of this income was for the business support grant scheme with payments totalling around £8.3 million made by 31 March 2021. The other support schemes where the council acted as an agent included payments to childcare providers, taxi drivers grants and retail and hospitality top-up support.

58. While the provision of additional Scottish Government financial support was essential to alleviate the impact of the pandemic, we noted that managing the volume and complexity of the various Covid-19 support schemes placed additional pressure on finance staff during the year.

Capital expenditure reduced in 2020/21 as the council paused its capital investment projects

59. The council approved a capital programme of £27.1 million for 2020/21 in September 2020 which incorporated £5.7 million of slippage from 2019/20.

60. Total capital expenditure in 2020/21 was £16.5 million of which £6.5 million related to general services and £10.0 million related to non-general fund areas including the housing revenue account (£2.4 million) and Scapa Flow Oil Port (£6.5 million).

61. The year-end position represents slippage against the original plan of 39 percent (2019/20 had slippage of 40 per cent against a budget of £33.3 million).

62. We have reported that capital slippage is a significant issue for the council for a number of years. In 2019/20 internal audit conducted a review of major capital projects and capital programme slippage and made recommendations to improve the performance of the council. Work has commenced in addressing the recommendations of internal audit including programme oversight and development of a project management approach however work to improve monitoring and reporting procedures remains to be addressed.

Recommendation 10

The council should ensure appropriate action is taken to minimise capital slippage in line with internal audit recommendations.

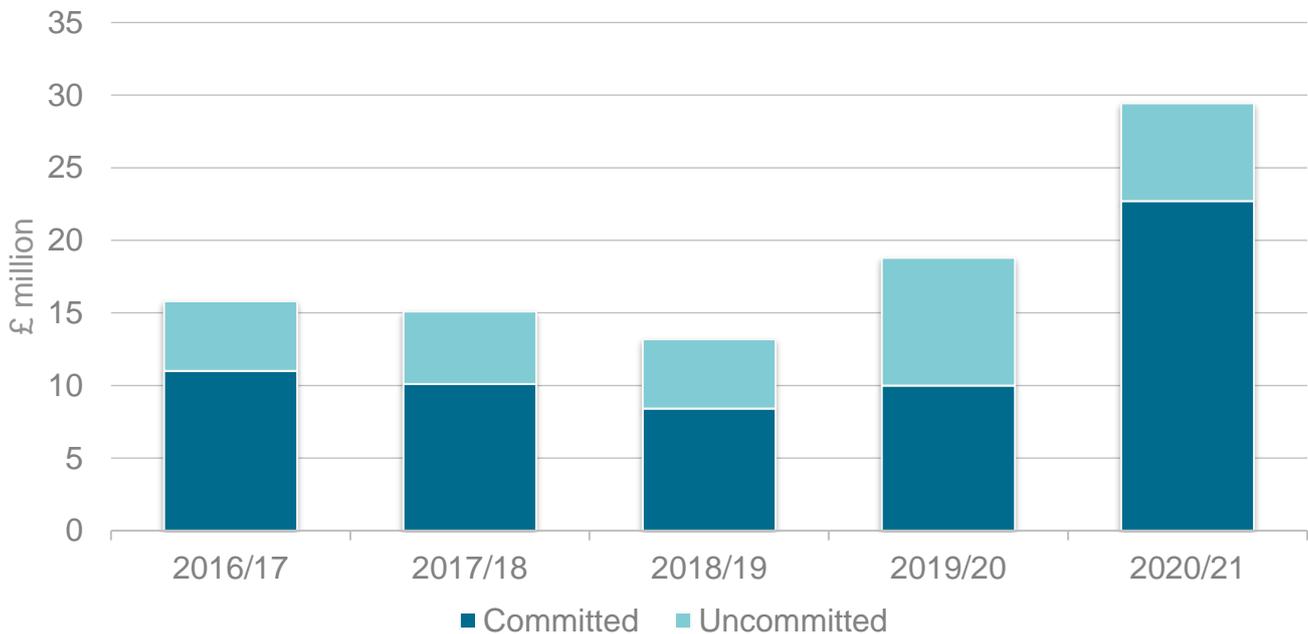
The General Fund reserve has increased, and the proportion of earmarked reserves has also increased

63. All councils maintain a general fund reserve and an element of the general fund balance is generally held for specific purposes with a small proportion remaining uncommitted. The uncommitted balance is used to provide against unforeseen circumstances and mitigate the financial impact of these. [Exhibit 4](#) provides an analysis of the general fund over the last five years split between committed and uncommitted reserves.

64. The council approved a revised reserves strategy in February 2020 which was to reduce the uncommitted balance on the general fund. The approved strategy was to leave the uncommitted reserves at 4 per cent of the council's net budgeted expenditure and allow the council to make additional early repayments on capital debt.

Exhibit 4

Analysis of general fund balance



Source: Orkney Islands Council Annual Accounts 2016/17 to 2020/21

65. Following the emergence of the Covid-19 pandemic the council decided to maintain a higher level of uncommitted reserves in 2019/20 and 2020/21 to allow the council to respond to increased demands on services quickly. In 2019/20 advanced debt repayments were postponed and the uncommitted element of the general fund balance was significantly higher than the policy baseline.

66. The level of uncommitted reserves held by the council decreased from £8.8 million in 2019/20 to £6.7 million in 2020/21.

67. The council has utilised funds in line with the approved policy, however, it remains higher than the level set out in the reserves strategy in recognition of the ongoing uncertainty relating to Covid-19.

There has been a significant movement in the level of other usable reserves

68. One of the key measures of the financial health of a body is the level of usable reserves held. The council is in a very fortunate position of having significant usable reserves in addition to the general fund.

69. The level of usable reserves held by the council increased from £229.6 million in 2019/20 to £282.9 million in 2020/21. The increase is mainly attributable to the harbour fund which increased by £40.2 million in 2020/21 bringing the balance at 31 March 2021 to £239.5 million. The upward movement is a result of unrealised gains on investments.

70. The harbours fund accounts for 85 per cent of overall reserves and the majority of this fund is held in the Strategic Reserve Fund. The purpose of the Strategic Reserve Fund is to provide for the benefit of Orkney and its inhabitants.

71. 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.

72. The council allocated £6.3 million from the Strategic Reserve Fund to the general fund in 2020/21. 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 and the year-end balance was £215.9 million which is £2.7 million above the floor level of £212.6 million.

Treasury management

73. The council has a significant portfolio of managed funds through the Strategic Reserve Fund. The total value of investments at 31 March 2021 was £258.5 million, an increase of £47.9 million from the prior year.

74. 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.

75. 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'.

76. 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.

77. At 31 March 2021 the Strategic Reserve Fund reported a return on investments of 23% against a benchmark of 15%. Over three years the Funds performed marginally above the benchmark of 6.3%, reporting a return on investments of 6.4%.

Borrowing levels have remained static

78. At 31 March 2021, total borrowing stood at £35.5 million, split between long term (£35.1 million) and short term (£0.4 million) which is broadly in line with the 2019/20 levels of borrowing.

79. 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.

Financial systems of internal control are operating effectively

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

81. Although there were no significant weaknesses identified from our review of controls, we identified two areas for improvement:

- In 2020/21 due to Covid-19 and resourcing issues there was no internal review of Council Tax and Non-Domestic Rates discounts and exemptions. In addition, monthly checks of changes to Council Tax and Non-Domestic Rate payers accounts were not undertaken. This impacted our audit approach, and we conducted a higher level of sample testing on both areas. We obtained appropriate assurance that in year the discounts and exemptions were appropriate.
- In 2020/21, for the first time, we used our data analytics system to interrogate the ledger operated by the council. We note that the council makes use of the Integra Finance System to provide book-keeping services for over a dozen entities including the council and its group. Annual reconciliations and accounting are recorded on a large and complex spreadsheet which carries an onerous requirement for manual input from finance system reports. The finance system, if configured correctly, should be able to create reports that are suitable for direct input into the financial statements which could create significant efficiencies in the financial statements preparation and lower the risk of error.

Recommendation 4 and 5

We recommend the council reinstates controls suspended due to Covid-19 as soon as possible.

The council should also consider whether improvements could be made to the structure of the ledger to increase the efficiency of the preparation of the accounts.

82. We concluded that with the exceptions above controls put in place by management are satisfactory and are operating effectively.

Internal audit

83. 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).

84. 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. In 2020/21 we used the work of internal audit to inform our review of stock and statutory performance indicators.

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

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

86. The risk profile of public bodies during 2020/21 has been significantly affected by the Covid-19 pandemic. This is likely to have increased the risk of fraud and error as control environments and internal controls have had to change to allow for services to operate effectively and respond to issues in a timely manner. We have reviewed the arrangements put in place by the council to address any heightened risks and concluded that there are appropriate arrangements for the prevention and detection of fraud, error and irregularities.

87. In addition, we have reviewed the arrangements in place to maintain standards of conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

Arrangements are in place for investigating and reporting data matches identified by the National Fraud Initiative

88. The National Fraud Initiative (NFI) is a counter-fraud exercise across the UK public sector which aims to prevent and detect fraud. Audit Scotland coordinate NFI in Scotland. Computerised techniques are used to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.

89. The current NFI exercise runs over 2020/21 and 2021/22 and participating bodies began to receive matches for investigation in January 2021. These matches are categorised by risk and all recommended matches, plus any further matches based on findings, should be investigated.

90. The council has processed 225 out of 1,283 matched (18 per cent) and to date 8 errors in relation to duplicate suppliers held on the council system have been identified. No frauds have been identified as a result of the errors.

91. The council recognised that NFI is an important tool in allowing investigative resource to be targeted at high risk areas and historically has prioritised matches which are identified as higher risk.

92. We will continue to monitor progress on the NFI exercise in 2021/22. The council expects all high risk matches will be investigated and reported to the Monitoring and Audit Committee in line with required timescales.

3. Financial sustainability

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

Main judgements

The council approved a balanced general fund budget of £91.2 million for 2021/22. This is based on contributions from reserves of £7.5 million and assumes efficiency savings of £0.6 million.

The council plans to use reserves to support services over the medium term to long term in line with its approved strategy.

The council is facing significant workforce issues which increases the risk that service delivery will not be maintained at required levels.

The council approved a general fund budget of £91.2 million for 2021/22

93. In April 2021 the council approved an updated budget of £91.2 million for the general fund. A draft budget was approved in February 2021 and the updated budget included additional non-recurring funding for Covid of £1.8 million which has been added to contingency funding to allow flexibility in light of the ongoing pandemic.

94. In order to balance the budget in 2021/22 the council have built in £0.6 million of efficiency savings and a transfer of £7.5 million from the Strategic Reserve Fund.

95. The financial impact of the pandemic on the council is likely to extend across several years and could include a reduction in income from business rates and council tax non-payments as well as a reduction in fees and charges from, for example, leisure, public transport and parking. Bodies may also face increased costs such as higher staff costs to cover the delivery of services.

96. The approved budget did not include the use of the new financial flexibilities available to mitigate, or defer, the financial impact of Covid-19. These flexibilities have been the subject of ongoing discussions between COSLA and the Scottish Government over the last year and permit:

- capital receipts being used to finance Covid-19 revenue expenditure

- flexibility to amend the accounting treatment of debt included in service concession contracts (for example, public private partnership) contracts, thereby reducing charges to services, and
- a Loans Fund repayment holiday to defer loans fund repayments due to be repaid in 2021/22.

97. The Council has been able to rely on a contribution from reserves so has not planned to make use of the new financial flexibilities in the 2021/22 general fund budget.

98. In 2019/20 and 2020/21 the council had made the decision to build up the balance of uncommitted balances on the general fund to allow the council to respond quickly to additional demands on services due to Covid-19. The council had earmarked £2.1 million of the General Fund balance at 31 March 2021 for Covid-19 related costs pressures.

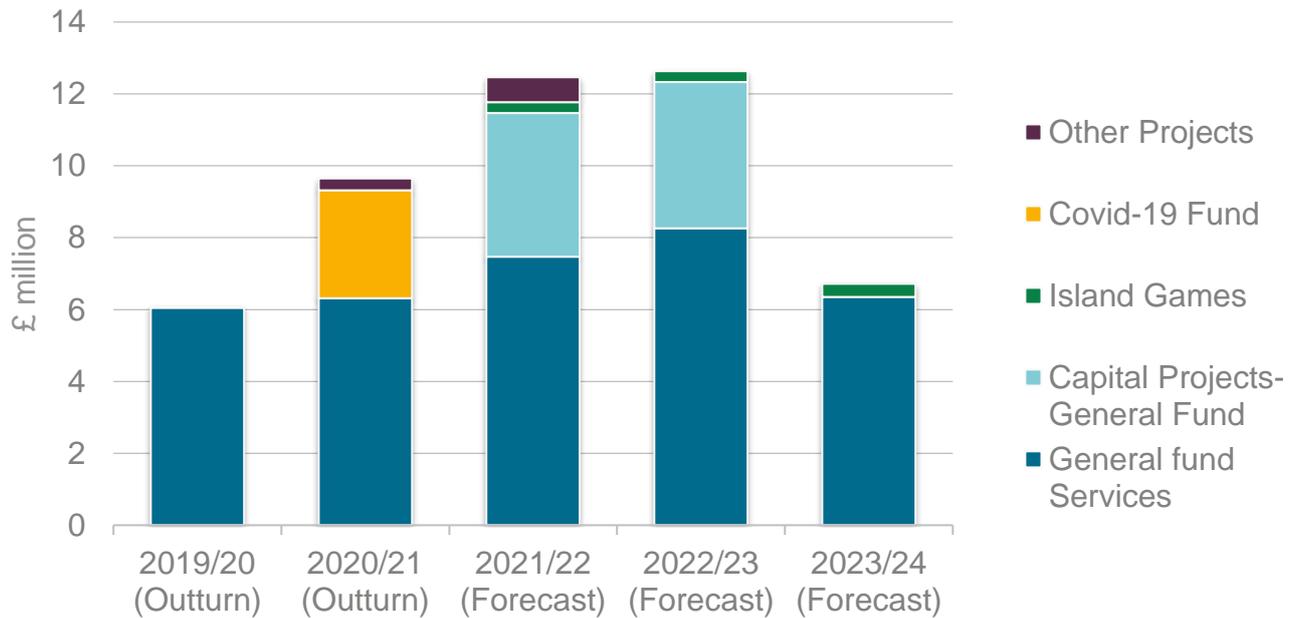
Use of reserves to support council services is planned over the medium to long term

99. The Strategic Reserve Fund has been applied to supplement General Fund Services as part of the strategy for delivering services within the budget constraints without requiring significant cuts. The Strategic Reserve Fund has also been used to finance capital projects.

100. Over the past 10 years, up to and including 2020/21, the Strategic Reserve Fund has been used to fund the provision of council services and contribute to various capital projects and other initiatives to the value of £75.1m.

101. The council publishes an annual budget review of the Strategic Reserve Fund which incorporates a long term forecast. [Exhibit 5](#) shows that over the 5 year period from 2019/20- 2022/23 the planned disbursements from the Strategic Reserve Fund have increased significantly although they are planned to fall in 2023/24.

Exhibit 5 Distributions from the Strategic Reserve Fund



Source: Orkney Islands Council Strategic Reserve Fund Budget Review and Investment Outturns

102. The council has planned disbursements with regard to the investment performance to ensure that in each year over the three years to 2023/24 the balance on reserves is above the floor level by at least 2 per cent. Over this three year period the projected balance on reserves is to increase from £228.7 million to £231.7 million.

103. In light of the current financial climate the importance of sustaining a sufficient reserve position is pivotal to the financial framework of the council. 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 best practice, particularly given the levels of volatility that continue to impact on investment returns.

104. The council has developed a rolling long term plan for the strategic reserve fund which is linked to the overall council budgets and should be considered when developing long term savings options (see recommendation 11).

Medium and longer term financial plans are in place but will have to be updated to reflect the impact of the pandemic

105. In February 2019 the Policy and Resources Committee approved 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.

106. 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.

107. The long term financial strategy was prepared prior to the Covid-19 pandemic and there is ongoing uncertainty around the longer term financial impact of the Covid-19 pandemic including future funding levels, the impact on income from piers and harbours and the increased costs of delivering services.

108. In 2019/ 20 we reported that although the long term financial strategy helps the council identify the funding gaps the strategy does not include detailed savings plans showing how the council will bridge the funding gap. Due to Covid-19 work to identify savings options was delayed and is planned to take place along side the development of the 2022/23 budget.

Recommendation 11

The council should update the long term financial strategy to reflect the impact of Covid-19 on the council finances as part of this exercise detailed savings options should be identified showing how the council can bridge the financial gap without an over reliance on reserves.

Transformational plans have been paused

109. In 2014 the council established a small team to deliver its Change Programme as a result of a forecast reduction in funding.

110. The Change Programme was intended to drive an evaluation of key business processes and review options for modernising and delivering frontline services more efficiently.

111. The Change Programme has proved difficult to manage and there has been a delay in delivering the intended outcomes. The Change Programme focused on generating savings of £3.8 million over 7 key priority areas. The financial position in the 2021/22 budget shows outstanding savings of £2.0 million against the target.

112. In February 2020 the council approved the creation of an Improvement Support Team, whose purpose is to support services in the delivery of projects, improvements, and initiatives. The team's activities fall into three areas:

- Project support
- Activities support

- Building capability.

113. The Improvement Support Team supports several Change Programme projects, however, it does not have ownership of the projects and simply supports the relevant service in its delivery.

114. A number of Change Programme priorities were approved as part of the Improvement Support Team programme of work in February 2020 including purchasing and procurement and IT, however, many were paused to allow the team to support critical improvements required as a result of the Care Inspectorate report on children's services.

115. Support from the Improvement Support Team focused on:

- Orkney Partnership Children's Services Improvement Plan
- Electronic Document and Records Management System
- Ground's maintenance
- Customer services platform

116. Prior to Covid-19 the Senior Management Team had identified thirteen potential change programme projects which were crucial to the next stage of delivering improved services more efficiently. The council should ensure they review the project initiation documents and reassess priorities given the changes which have taken place due to Covid-19.

Recommendation 15

The council should ensure the change programme sets out realistic plans and savings targets which are aligned to its priorities.

Finance staff faced additional pressures over the last 12 months due to the work involved in administering the Covid-19 support schemes and Islands Deal Project activity

117. Additional pressure been placed on finance staff due to the administrative burden presented by the Covid-19 support schemes and the increased planning activity linked to the Islands Deal projects.

118. Looking forward to 2021/22 there have been a number of changes in key finance staff at the council due to a combination of promotions and departures. Pressure on the team is likely to continue as Covid-19 grants continue to be administered by the council and the Islands Deal progresses. This is likely to have a greater impact in 2021/22 due to the changes within the finance team.

119. The council has also recognised there is a wider issue with the workforce across all services in relation to the recruitment and retention of staff. The

council has recognised that there is a significant risk to the delivery of services due to inadequate staffing levels in place.

Recommendation 6

Management should review the current service structure and staffing to ensure that it will continue to provide sufficient capacity to undertake key functions going forward. This should include ensuring that all new staff have adequate support and training to undertake their roles effectively.

4. Governance and transparency

The effectiveness of scrutiny and oversight and transparent reporting of information

Main Judgements

The governance arrangements introduced in response to the pandemic are appropriate and operated effectively.

The council is developing a revised structure for the senior management team. This is likely to be fully implemented by 31 March 2022.

Governance arrangements operating throughout the Covid-19 pandemic have been appropriate and operated effectively

120. Elected members and management of the council are responsible for establishing arrangements to ensure that its business is conducted in accordance with the law and proper standards, that public money is safeguarded and for monitoring the adequacy and effectiveness of these arrangements. The governance and accountability arrangements we consider include:

- council and committee structure
- 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 committees
- reporting of performance and whether this is fair, balanced and understandable.

121. The impact of the Covid-19 pandemic from March 2020 impacted on a number of aspects of the governance arrangements during the year. The changes included the alteration of the Standing Orders to allow for remote attendance and speedier decision making and the suspension of all committees other than the general council from March 2020 until the end of the summer recess in August 2020.

122. Meetings continue to take place remotely but there is a move for some smaller committees to meet physically within 2021/22.

123. 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.

The Islands Growth Deal

124. In March 2021, the Heads of Terms for the Islands Growth Deal was signed by Comhairle nan Eilean Siar, Orkney Islands Council and Shetlands Islands Council. The agreement commits both Scottish and UK Governments to working collaboratively with the councils to deliver a number of key projects designed to support growth and support thriving sustainable communities.

125. The Islands Growth Deal will receive £50 million of funding from each of the Scottish and UK Governments and an anticipated £235 million from project partners.

126. The Growth Deal process requires a three stage approach (Exhibit 6) to developing business cases in line with the requirements of the HM Treasury Green Book Standard.

Exhibit 6 Growth Deal Business Case



Source: Orkney Islands Council Islands Growth Deal updates to Policy and Resources Committee

127. While the council can play an active role in the development of the projects and support advancement of the business cases it does not have the ability to approve any individual project.

128. A requirement of the funding process is that there is an appropriate governance structure which will manage full implementation of the Growth Deal and approve the Outline Business Cases prior to submission to the Government

129. In September 2021 the Policy and Resources Committee approved a Joint Committee Governance Arrangement which established a joint committee with Comhairle nan Eilean Siar and Shetlands Islands Council. There will be equal representation from each council and the chair and vice chair will rotate annually between the different authorities.

Changes in senior management

130. Over recent years the council has had significant turnover within the senior management team and in July 2021 a review of the management structure of the council commenced.

131. Following recent departures within the senior management team there was a resource gap and therefore along with the overall review interim measures were put in place. From July 2021 the Chief Executive is supported by four executive directors:

- Orkney Health and Care
- Education, Leisure, Housing, Human Resources and Improvement
- Regulatory, Marine Services, Transportation and Finance
- Environment, Property and IT

132. Two of the above positions are on an interim basis and employees of the council have been appointed temporarily. The internal promotions to these positions has created resource gaps at lower levels which further compounds the resourcing issues which the council is facing.

133. As the positions are on an interim basis it limits the ability for the council to backfill roles at the lower levels and it also limits the ability of the new executive directors to create change and drive improvement. It is therefore crucial that a permanent solution is implemented swiftly. Current plans are in place for the restructuring and appointment of individuals to be complete by March 2022.

134. In addition, the Chief Executive is also appointed on an interim basis and in 2020/21 a recruitment campaign failed to identify a suitable candidate for the role. It is anticipated the interim Chief Executive will remain in role until after the local government elections in 2022 to provide stability for the council.

135. The issues are ongoing and will continue to be monitored as part of our audit work in 2021/22.

Procurement

136. In 2020/21 the council procured 80,000 tonnes of stone along with haulage and ship discharge. The council's contract standing orders, financial regulations and sustainable procurement guidelines were not followed when making this purchase.

137. Internal audit conducted a review of the order of the quarry stone and concluded that there were fundamental weaknesses in the framework of governance, risk management and control such that it is inadequate and ineffective or is likely to fail.

138. Key findings included that council policy was not followed and the procurement team had not been consulted appropriately. There were five high

priority actions agreed at a special meeting of the Monitoring and Audit Committee in March 2021.

139. We considered that there was a risk that other items were not subject to open tendering in line with procurement regulations and we plan to conduct further sample testing in this area. We will bring a separate report to the Monitoring and Audit Committee in 2021/22.

5. Best Value

Using resources effectively and continually improving services.

Main judgements

The council reported in 2020/21 that all actions agreed as part of the Best Value Assurance Report published in 2017 have been completed. There are emerging issues in relation to workforce strategy, management of capital projects and long term financial planning which need to be addressed.

The council reported performance in line with the 2018 SPI Direction. Progress in delivering corporate priorities continues to be monitored and appropriate action taken as necessary.

The council has made progress in addressing the issues highlighted in the Care Inspectorate report on children's services.

The council is making good progress in securing Best Value

140. 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 will be considered by the Accounts Commission at least once in this period. The BVAR report for the council was published in December 2017.

141. The recommendations of the BVAR included the development of key strategies, linking outcomes to council plans and improving the approach to community engagement.

142. The council reported on progress against the Council Delivery Plan to the Policy and Resources Committee in June 2021 which included the actions taken in response to our BVAR. It was noted at this time that all actions had been completed.

143. In 2020/21 we conducted focussed work on the council's arrangements for demonstrating Best Value in Effective Use of Resources. We found that although the council had completed the specific actions from the BVAR in relation to the workforce strategy, management of capital projects and the long term financial strategy, there were emerging issues in these areas which means there is further work required. Our findings are reported in the financial management and financial sustainability sections of the report and appropriate recommendations have been raised in [Appendix 1](#).

Arrangements in place for following the public pound should be strengthened

144. 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.

145. 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.

146. 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.

147. In 2019/20 we concluded that the council has appropriate arrangements for ensuring compliance with the Code of Guidance on funding external bodies, but we noted that monitoring of Orkney Ferries could be improved by reviewing financial performance on an annual basis.

148. In 2020/21 there were no performance reports for either the Pickaquoy Centre Trust or Orkney Ferries. These bodies have been significantly impacted by a loss of income due to Covid-19 and it is critical that the council is aware of the pressures facing the bodies and providing scrutiny over how resources are used in this challenging time.

Recommendation 13

Following the public pound arrangements for bodies within the Orkney group should include an annual review of the financial position and general performance.

Statutory performance indicators (SPIs) are being met

149. The Accounts Commission has a statutory responsibility to define the performance information that councils must publish. In turn, councils have their own responsibility, under their Best Value duty, to report performance to the public. 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.

150. 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.

151. We have evaluated council's arrangements for fulfilling the above requirements and concluded that the council has appropriate arrangements for meeting these requirements in particular:

- The council has a Strategic Planning and Performance Framework which covers council performance against community plans, service plans and the corporate plan.
- The council published an annual performance report on its website
- The performance section of the council's website provides lots of information which is updated with sufficient regularity.

The council continues to progress with corporate priorities but this has slowed due to Covid-19

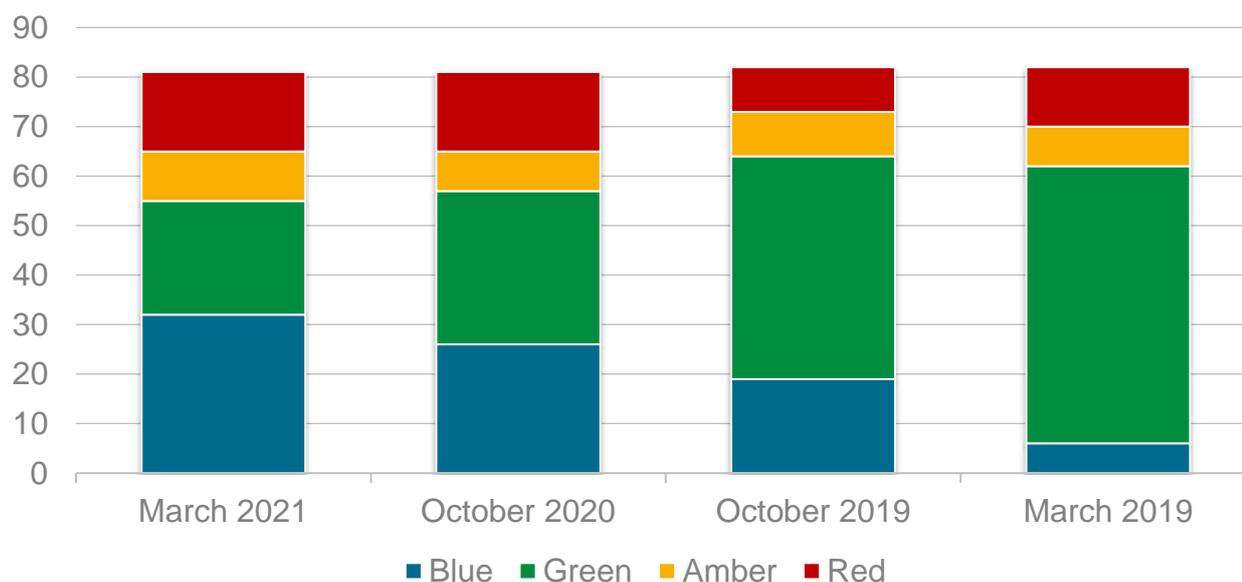
152. The pandemic is expected to have had a substantial impact on performance measures, particularly for services which have been temporarily suspended, are operating at a reduced level or have had to adapt to new ways of working. The council have continued to monitor key performance targets throughout the year with performance being regularly reported to relevant service committees. These reports monitor progress against the council's key priorities.

153. [Exhibit 7](#) shows that the council continues to make progress against priorities from the corporate plan but there is a higher level of priorities where there is a risk that target dates will not be met in 2020/21.

154. The pandemic and resource challenges being faced by the council has impacted the ability to deliver priorities. Action plans are in place and there is continued monitoring at both a corporate level and through service committees.

Exhibit 7

Performance trend analysis



Source: Orkney Islands Council performance reports to Policy and Resources Committee

155. 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.

156. The 2019/20 report on the national benchmarking framework shows that the council are performing above the national average in 57 per cent of the indicators which is in line with the performance reported in 2018/19. Areas where the council has reported low performance compared to the national average is:

- Cost per primary and secondary school pupils
- Rent arrears as a percentage of rent due
- Percentage of the highest 5 per cent paid employees and women and the gender pay gap.

Progress is being made in addressing issues in children's services

157. 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.

158. An action plan was developed to address the improvement areas outlined in the Care Inspectorate report. There were 27 actions covering four themes:

- Governance, assurance and data
- Policy, systems, process and procedure
- Getting it right for every child
- Corporate parenting.

159. Between April and June 2021, a team of inspectors from the Care Inspectorate, Healthcare Improvement Scotland, Her Majesty's Inspectorate of Constabulary for Scotland and Education Scotland carried out a review of the progress made in addressing the findings.

160. The review focused on the response to the initial concerns in relation to the children in need of protection and the way leaders were overseeing arrangements to protect children and young people.

161. The review found that there was encouraging progress in responding to areas of improvement and key processes in responding to children in need of protection had been improved. The report also highlighted that all partners need to maintain momentum to sustain the improvements and they should be able to evidence that recent changes are improving outcomes for children and families.

National performance audit reports

162. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2020/21, Audit Scotland published a number of reports were issued which may be of interest to the body. These are outlined in [Appendix 3](#). National reports are reviewed by officers and taken for elected members' consideration where appropriate.

Appendix 1

Action plan 2020/21

2020/21 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. Payroll reconciliations</p> <p>Payroll costs are input into the general ledger by way of an automated monthly journal. The council does not carry out reconciliations between the systems.</p> <p>Risk – there is a risk that the general ledger does not accurately reflect the transactions in the payroll system</p>	<p>The council should conduct a reconciliation between the payroll system and the ledger on a regular basis.</p> <p>Paragraph 30.</p>	<p>A monthly reconciliation between the Payroll System and General Ledger is part of existing Payroll procedures. Completion of the reconciliations had slipped but has now been brought up to date.</p> <p>Payroll and Pensions Manager</p>
<p>2. Stock valuations</p> <p>Stock counts are undertaken at various sites and are attended by internal audit who reperform the counts on a sample basis. The testing does not include any consideration of movements or validation of pricing information.</p> <p>Risk – there is a risk that the stock valuation reported in the financial statements is not appropriate.</p>	<p>The council should ensure there are appropriate procedures in place to validate the value of stock held at the year end</p> <p>Paragraph 30.</p>	<p>A valuation exercise on a sample basis will be included in stock checking procedures for the 2021/22 year end.</p> <p>Chief Internal Auditor</p> <p>March 2022</p>
<p>3. Registers of interest</p> <p>The council conduct an annual refresh of the registers of interests in September. This never took place in September 2020 and in some cases the registers</p>	<p>The council should align register of interests requests with the year end and they ensure up to date information is passed to the finance team as part of the accounts preparation process.</p>	<p>Annual Declarations of Interest will be sought as at 31 March 2022 for the 2021/22 year end. Declarations have now been brought up to date.</p> <p>Head of HR and Performance</p> <p>March 2022</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>of interest held date back to September 2019.</p> <p>Risk – there is a risk that the information used to identify related parties for the accounts is out of date and disclosures in the accounts are incomplete.</p>	<p>Paragraph 30.</p>	
<p>4. Controls over NDR and Council Tax</p> <p>In 2020/21 due to Covid-19 and resourcing issues there was no internal review of Council Tax and Non-Domestic Rates discounts and exemptions.</p> <p>Risk – there is a risk that inappropriate reliefs and discounts are awarded.</p>	<p>The council should reinstate controls suspended due to Covid-19 as soon as possible.</p> <p>Paragraph 81.</p>	<p>The recommendation relates largely to work that was not carried out due to staffing constraints arising from long term sickness and difficulty with recruitment to vacancies. Efforts are being made to fill vacancies which will enable internal review procedures to be undertaken.</p> <p>Revenues and Benefits Manager</p> <p>April 2022</p>
<p>5. Accounts are supported by complex schedules</p> <p>Annual reconciliations and accounting are recorded on a large and complex spreadsheet which carries an onerous requirement for manual input from finance system reports. The finance system if configured correctly, should be able to create reports that are suitable for direct input into the financial statements.</p> <p>Risk – there is a risk that the current process is inefficient and could result in manual error.</p>	<p>The council should also consider whether improvements could be made to the structure of the ledger to increase the efficiency of the preparation of the accounts.</p> <p>Paragraph 81.</p>	<p>A review of the ledger structure to explore whether there are opportunities to increase the efficiency of the preparation of the accounts will be considered when the detailed Audit findings have been considered. Due to the current pressures on staffing this is likely to be a piece of work with an extended timescale.</p> <p>Head of Finance</p> <p>December 2023</p>
<p>6. Workforce capacity</p> <p>The council has recognised there is an issue with the workforce across all services</p>	<p>The council should review the current service structure and staffing to ensure that it will continue to provide sufficient capacity to undertake key</p>	<p>A review of the current service structure and staffing has been commenced by the Interim Chief Executive. This review will reflect input from</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>in relation to the recruitment and retention of staff. There are particular issues within the finance team following recent departures and promotions.</p> <p>Risk – there is a risk that the council will be unable to deliver required services with the current level of resource.</p>	<p>functions going forward. This should include ensuring that all new staff have adequate support and training to undertake their roles effectively.</p> <p>Paragraph 135.</p>	<p>all service areas including Finance as there are pressure points in many services.</p> <p>Interim Chief Executive June 2022</p>

Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>7. 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>Complete</p> <p>We are satisfied there is appropriate communication between the finance department and the legal department.</p>
<p>8. 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</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>Complete</p> <p>We are satisfied that the provision is reviewed on an annual basis to ensure the level is appropriate.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>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>9. 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. 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>Complete</p> <p>We are satisfied that the action taken by the council has enhanced the quality of its management commentary and that the council meets the reporting requirements of Local Government Finance Circular 10/2020.</p>
<p>10. 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</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>Outstanding</p> <p>The council should ensure appropriate action is taken to minimise capital slippage in line with internal audit recommendations.</p> <p>Updated action</p> <p>Action continues on this recommendation and it</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>that are dependent on capital projects being completed on time.</p>		<p>remains a priority of the Capital Programme team. Workforce capacity remains a very high risk, as does recovery from the impact of the Covid19 Pandemic, and current issue around cost and availability of materials.</p> <p>Interim Executive Director, Environment, Property and IT</p> <p>June 2022</p>
<p>11. Longer term savings options</p> <p>The council improved its 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 timing 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</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>Outstanding</p> <p>The council should update the long term financial strategy to reflect the impact of Covid-19 on the council finances as part of this exercise detailed savings options should be identified showing how the council can bridge the financial gap without an over reliance on reserves.</p> <p>Updated action</p> <p>The medium- and long-term financial strategy documents will be updated as part of the budget setting process for 2022/23.</p> <p>Senior Management Team</p> <p>February 2022</p>
<p>12. 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</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>Outstanding</p> <p>We have merged this recommendation with recommendation 11 as the use of reserves should be considered as part of the savings options development.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>benefit the people of Orkney. Risk –the reserve balances may not support strategic aims.</p>		
<p>13. 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>Outstanding</p> <p>Following the public pound arrangements for bodies within the Orkney group should include an annual review of the financial position and general performance.</p> <p>Updated action</p> <p>The Financial performance of Orkney Ferries in 2020/21 will be considered by the Development and Infrastructure Committee on 9 November 2021.</p>
<p>14. Expenses</p> <p>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>Risk –Expenses claimed may not comply with agreed procedures.</p>	<p>All claims should include detailed receipts to support items of expenditure</p>	<p>Outstanding</p> <p>Due to the impact of Covid the level of officers' expense claims has fallen drastically and therefore we have not conducted detailed testing in year.</p>
<p>15. Change programme</p> <p>The Change Programme is intended to drive an evaluation of key business processes, including a review</p>	<p>The council should ensure the change programme sets out realistic plans and savings targets and that appropriate management arrangements in place to</p>	<p>Outstanding</p> <p>The council should ensure the change programme sets out realistic plans and</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>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>Risk -the programme may not deliver planned changes and efficiencies.</p>	<p>ensure delivery of the programme.</p>	<p>savings targets which are aligned to its priorities.</p> <p>Updated action:</p> <p>A report to the Policy and Resources Committee of 18 February 2020 included a recommendation that the Change Team be renamed the Improvement Support Team, with the purpose to support services in the delivery of projects, improvements, and initiatives; be they incremental or transformational in nature.</p> <p>The report also recommended that the Change Team priorities should include: -</p> <ul style="list-style-type: none"> • Purchasing and Procurement • Modernising IT <ul style="list-style-type: none"> – Customer Service Platform. – HR System Development. – Integra System Development. • Ground Maintenance. • Electronic Document and Records Management System. • Strategic Data Warehouse. • Internal communications review. • Controls for Household Waste Recycling Centres. • Roads, Waste and Environmental Services efficiencies.

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](#).

Audit risk	Assurance procedure	Results and conclusions
<p>1. Risk of management override of controls</p> <p>International Auditing Standards require that audits are planned to consider the risk of material misstatement in the financial statements caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of fraud due to the management override of controls.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates and judgements.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business</p> <p>Evaluate systems for timely notification of significant transactions from all functions to Finance.</p>	<p>Results: Audit testing of journal entries, accruals and prepayments was completed. We also reviewed accounting estimates and transactions for appropriateness. We did not identify any incidents of management override of controls.</p> <p>Conclusion: Satisfactory.</p>
<p>2. Risk of fraud in the recognition of income</p> <p>As set out in ISA (UK)240, there is a presumed risk of fraud in the recognition of income. There is a risk that income may be misstated resulting in a material misstatement in the financial statements.</p> <p>The council receives a significant amount of income from a variety of sources including grants, council tax, housing rents and fees(including harbour dues and college fees)and charges.</p>	<p>Consider the design of the system of control and conclude on whether key controls are operating effectively.</p> <p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>	<p>Results: We gained appropriate assurance over the completeness and occurrence of income and we are satisfied that the likelihood of material misstatement through fraud in the annual accounts is low.</p> <p>Conclusion: Satisfactory.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>Our work will focus on the completeness and occurrence of fees and charges and service specific grant income. We consider the risk to be most prevalent in these areas due to increased incentive and opportunity for fraudulent recognition.</p>		
<p>3. Risk of fraud over expenditure</p> <p>As most public-sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. During the year significant additional grants, relating to Covid-19 support, have been disbursed by the council. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</p> <p>We consider this risk to be the most prevalent where there is incentive and opportunity for fraudulent manipulation. We therefore focus on the completeness of non-pay expenditure.</p>	<p>Consider the design of the system of control and conclude on whether key controls are operating effectively.</p> <p>Review of work performed on the National Fraud Initiative matches.</p> <p>Focused substantive testing of non-pay expenditure and housing benefit transactions.</p>	<p>Results: We gained appropriate assurance over the completeness and occurrence of expenditure and we are satisfied that the likelihood of material misstatement through fraud in the annual accounts is low.</p> <p>Our specific testing of Covid-19 grants resulted in a material adjustment to the accounts. We are satisfied that the matter has been resolved appropriately.</p> <p>Conclusion: Satisfactory.</p>
<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(including vessels), provisions and pension liabilities. This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Ensuring a good understanding of the business through review of board and committee minutes</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 and the actuary.</p>	<p>Results: 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>We considered the work of the valuer in applying the beacon principal approach to valuing council houses and concluded the assumptions were</p>

Audit risk	Assurance procedure	Results and conclusions
	<p>Focused substantive testing of asset valuations and asset useful lives.</p> <p>Use of an auditor's expert to assess the competence of the actuary and evaluate the results of their work.</p> <p>Liaison with Monitoring Officer to determine completeness of contingent liabilities and provisions.</p>	<p>reasonable and the approach was in line with guidance.</p> <p>We reviewed estimates and judgments in other areas including impairments and asset life assumptions and did not identify any issues.</p> <p>Conclusion: Satisfactory.</p>
<p>5. Provision for decommissioning costs</p> <p>The council have a significant provision for recognising its legal obligation to contribute a set amount to the decommissioning costs of the Flotta Oil Terminal.</p> <p>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>Economic conditions and oil terminal operations can change significantly, and management must remain alert to any changes in the risk profile associated with decommissioning obligations.</p>	<p>Review on the appropriateness of the annual assessment undertaken and accounting treatment.</p> <p>Focused substantive testing of provisions.</p> <p>Evaluate systems for timely notification of potential liabilities from all functions to Finance</p>	<p>Results: We gained appropriate assurance that the estimated provision is reasonable and accounted for in line with accounting standards and the CIPFA Code.</p> <p>Conclusion: Satisfactory.</p>
<p>6. 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>We identified the need for improvements to be made to the management commentary in the 2019/20 accounts. There is</p>	<p>Review and comment on the appropriateness of the council's updated management commentary.</p>	<p>Results: We reviewed the management commentary, and we are satisfied that the action taken by the council has enhanced the quality of its management commentary and that the council meets the reporting requirements of Local Government Finance Circular 10/2020.</p> <p>Conclusion: Satisfactory.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>an ongoing risk that the performance of the council and its group is not transparent in the 2020/21 annual accounts.</p>		
<p>7. Valuation of investments</p> <p>The council held investments of £217.86 million as part of its Strategic Reserve Fund at 31 March 2020. There is a significant degree of subjectivity in the classification of investments, particularly those which are defined as level 3 by IFRS 13 and are based on significant unobservable inputs. At 31 March 2020 the council investment portfolio included £28.98 million of financial assets which were defined as level 3. Investments of this nature are complex, difficult to value and include a significant degree of judgement from the investment manager.</p>	<p>Completion of 'review of the work of an expert' in accordance with ISA 500, for significant unquoted investments.</p> <p>Confirmation of valuations to valuation reports and/ or other supporting documentation.</p>	<p>Results: 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>Conclusion: Satisfactory.</p>
<p>8. Orkney College account</p> <p>The council provides further and higher education provision through the Orkney College. The trading activities from these activities is reflected within the council's Comprehensive Income and Expenditure Statement.</p> <p>The council rely on the University of Highlands and Islands (UHI) to provide supporting documentation for the annual accounts in respect of the college. In March 2021 there was a cyber-attack on UHI which may impact its ability to produce the back-up required for the council annual accounts.</p>	<p>We will continue to liaise with the council regarding implications for the year end timetable.</p> <p>We will monitor the situation and establish whether there is an impact on our assessed risks and audit approach.</p>	<p>Results: The college accounts were prepared in line with original timescales. We tested college transactions as part of our work on the council and did not have any issues accessing information.</p> <p>Conclusion: Satisfactory.</p>

Risks identified from the auditor's wider responsibility under the Code of Audit Practice

Audit risk	Assurance procedure	Results and conclusions
<p>9. Longer term savings options</p> <p>For a number of years the council has identified a funding gap, the most recent long term financial strategy showing a cumulative funding gap of £65.7 million, based on realistic assumptions. However, there are currently no options developed to allow the council to close the gap.</p> <p>In April 2016 the council approved a change programme which would generate £3.8 million in efficiency savings between 2017/18 and 2020/21 following an evaluation of business processes. The Improvement Support Team was refreshed in February 2020 but with new challenges in 2020, there has been no update on progress in meeting the savings targets. It is not clear how the change programme will lead to the generation of the savings required over the long term.</p> <p>There is a risk that the council does not take a long term view when creating savings plans.</p>	<p>Review and comment on the appropriateness of process implemented to generate the council's option appraisals.</p> <p>We will review the operation and scrutiny of the revised change programme.</p> <p>We will review emerging long term financial strategies to see how a balanced budget is to be achieved.</p>	<p>Results: Due to the impact of Covid-19 and competing priorities the council has not completed its review of savings options and the change programme remained paused at the year end.</p> <p>Conclusion: The council should consider the long term savings options and the future of the change programme in 2021/22.</p> <p>Appendix 1 recommendations 11 and 15</p>
<p>10. Changes in senior management</p> <p>The council has an interim Chief Executive in place and has implemented interim arrangements to cover a vacancy within the senior management team. The council are taking steps to</p>	<p>We will monitor progress with the recruitment process and consider the governance processes around the appointment.</p> <p>We will consider whether the induction and handover processes are appropriate.</p>	<p>Results: The council failed to appoint a permanent Chief Executive in 2020/21. There are ongoing issues in developing the right structure for the senior management team but action is being taken to build capacity.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>recruit key members of staff, however, there is a risk that the council is unable to attract candidates of the right calibre.</p>	<p>We will consider the impact of interim arrangements on governance processes.</p>	<p>Conclusion: We will continue to monitor progress in developing the senior management team in 2021/22.</p>
<p>11. 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 2020/21 was £26.4 million, however, capital expenditure to date is £8.3 million. The projected underspend for the year is £4.6 million, however, this may increase due to Covid-19 restrictions.</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 and comment on capital slippage and assess any actions taken to reduce slippage.</p>	<p>Results: The council approved a capital programme of £27.1 million for 2020/21 and total capital expenditure in 2020/21 was £16.5 million. There is still significant slippage against capital budgets.</p> <p>Conclusion: The council should ensure appropriate action is taken to minimise capital slippage.</p> <p>Appendix 1 recommendation 10</p>
<p>12. Financial sustainability of group bodies</p> <p>The council group has a number of subsidiaries, associates and joint ventures including the Pickaquoy Centre Trust and Orkney Ferries Limited. These bodies have been significantly impacted by a loss of income due to Covid-19.</p> <p>There is a risk that the bodies become increasingly reliant on funding from the council to support its ongoing operation.</p>	<p>We will consider the financial statements of all group bodies as part of our work on the group financial statements.</p> <p>We will seek assurances over the going concern of group bodies from component auditors.</p> <p>We will consider any accounting implications of any additional support provided by the council to its group bodies.</p>	<p>Results: In 2020/21 there were no performance reports for either the Pickaquoy Centre Trust or Orkney Ferries.</p> <p>Conclusion: Following the public pound arrangements for bodies within the Orkney group should include an annual review of the financial position and general performance.</p> <p>Appendix 1 recommendation 13</p>
<p>13. Compliance with regulations</p>	<p>We will consider the outcome of the internal audit findings</p>	<p>Results: We are satisfied the council are taking action in line with the internal audit recommendations and that</p>

Audit risk	Assurance procedure	Results and conclusions
<p>The council recently procured 80,000 tonnes of stone along with haulage and ship discharge. The council's contract standing orders, financial regulations and sustainable procurement guidelines were not followed when making this purchase. In addition the council is in breach of EU public procurement regulations.</p> <p>The purchasing activity was not carried out via open tendering and therefore is not in line with the principals of openness and transparency. The use of open tendering, as outlined in the council's contract standing orders and EU regulations, is designed to ensure the council obtains value for money. There is a risk that the council cannot demonstrate that this contract delivers the best value in relation to overall cost combined with quality.</p>	<p>and monitor management actions.</p> <p>We will consider the content of the governance statement and ensure disclosures appropriately reflect the internal audit findings.</p> <p>We will consider contract award processes at the council to ensure this was an isolated incident.</p>	<p>appropriate disclosures were made within the governance statement.</p> <p>We plan to conduct further sample testing in this area. We will bring a separate report to the Monitoring and Audit Committee in 2021/22.</p> <p>Conclusion: outstanding.</p>

Appendix 3

Summary of national performance reports 2020/21

April

[Affordable housing](#)

June

[Highlands and Islands Enterprise: Management of Cairngorm mountain and funicular railway](#)

[Local government in Scotland Overview 2020](#)

July

[The National Fraud Initiative in Scotland 2018/19](#)

January

[Digital progress in local government](#)

[Local government in Scotland: Financial overview 2019/20](#)

February

[NHS in Scotland 2020](#)

March

[Improving outcomes for young people through school education](#)

Orkney Islands Council

2020/21 Annual Audit Report

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