

Orkney Islands Council

2021/22 Annual Audit Report



 AUDIT SCOTLAND

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

November 2022

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Key messages

2021/22 annual accounts

- 1 Our audit opinions on the annual accounts of the council, its group and the section 106 charity administered by the council are unmodified.
- 2 The Covid-19 pandemic had a limited impact on audit evidence and the unaudited annual accounts were submitted in line with our agreed audit timetable.
- 3 Material adjustments were made to the accounts in relation to the revaluation of land and buildings and Covid-19 grants. The total adjustments were £77.2 million which were a combination of increases and decreases in income and expenditure and have resulted in an overall increase of £52.4 million to the surplus on the comprehensive income and expenditure statement and an increase of £52.4 million in net assets.

Financial management

- 4 The council's budget setting and financial management arrangements operated effectively during 2021/22.
- 5 The council reported a £3.4 million underspend against its 2021/22 general fund revenue budget.
- 6 The council reported slippage of 50 per cent against its 2021/22 Capital Plan. This level of slippage was partly due to delays linked to Covid-19 but is a cause for concern as it may lead to increased costs over the long term.
- 7 The conflict in Ukraine has significantly increased market volatility and returns on investments reduced significantly in the final quarter of 2021/22.

Financial sustainability

- 8 The council approved a balanced general fund budget of £92.6 million for 2022/23. This is based on contributions from reserves of £8.3 million.
- 9 The council's long term financial plan was set prior to Covid-19 and the cost of living crisis. The council is currently developing a strategic plan covering 2023-26 and this is an opportune time to revisit medium to long term financial planning to support the council's priorities while incorporating the impact of challenges from the external environment.

Governance and transparency

- 10** The council had appropriate and effective governance arrangements in place to support scrutiny of decision-making during 2021/22 and conducted its business in an open and transparent manner.
- 11** The council has made progress in appointing the revised Corporate Leadership Team but the council has not succeeded in recruiting to the post of Chief Executive on a permanent basis.

Best Value

- 12** The council has an appropriate and effective best value framework in place.
- 13** The council's performance measures are aligned to key priorities and outcomes. There are appropriate arrangements for collecting and reporting on indicators with regular reporting to the appropriate committee.
- 14** The council has made the necessary arrangements for collecting, recording, and publishing the statutory performance information.

Introduction

1. This report summarises the findings arising from the 2021/22 audit of Orkney Islands Council (the council) and its group.

2. The scope of the audit was set out in our 2021/22 Annual Audit Plan presented to the June 2022 meeting of the Monitoring and Audit Committee.

3. 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.

4. The main elements of our audit work in 2021/22 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 on the council's progress in implementing recommendations reported in our Best Value Assurance Report published in December 2017
- consideration of the four audit dimensions.

5. During 2021/22 the council continued to manage the operational and financial impact of the coronavirus pandemic and there remains significant challenges across a range of areas. We considered the risks related to the pandemic as part of our audit planning and did not consider there to be any significant audit risks for 2021/22.

Adding value through the audit

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

- identifying and providing insight on significant risks, and making clear and relevant recommendations

- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability
- sharing intelligence and good practice through our national reports ([Appendix 2](#)) and good practice guides.

Responsibilities and reporting

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

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

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

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

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

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

12. This report raises matters from our audit. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

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

Auditor Independence

14. Auditors appointed by the Accounts Commission 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.

15. We can also confirm that we have not undertaken any non-audit related services and therefore the 2021/22 audit fee of £200,730 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

16. 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.

Audit appointment from 2022/23

17. The Accounts Commission is responsible for the appointment of external auditors to local government bodies. External auditors are usually appointed for a five-year term either from Audit Scotland's Audit Services Group or a private firm of accountants. The current appointment round was due to end in 2020/21 but this was extended for a year so that 2021/22 is the last year of the current appointment round.

18. The procurement process for the new round of audit appointments was completed in May 2022. From financial year 2022/23 KPMG will be the appointed auditor for the council. We are working closely with the new auditors to ensure a well-managed transition.

19. A new [Code of Audit Practice](#) applies to public sector audits for financial years starting on or after 1 April 2022. It replaces the Code issued in May 2016. There are several significant changes introduced by the new Code, namely the integration of Best Value work into wider scope audit work and the audit of Best Value across the Integration Joint Boards.

Acknowledgements

20. We would like to thank Councillors, Monitoring and Audit Committee members, Executive Directors, and other staff, particularly those in finance for their co-operation and assistance over the last six years.

1. Audit of 2021/22 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 charity administered by the council are unmodified.

The Covid-19 pandemic had a limited impact on audit evidence and the unaudited annual accounts were submitted in line with our agreed audit timetable.

Material adjustments were made to the accounts in relation to the revaluation of land and buildings and Covid-19 grants. The total adjustments were £77.2 million which were a combination of increases and decreases in income and expenditure and have resulted in an overall increase of £52.4 million to the surplus on the comprehensive income and expenditure statement and an increase of £52.4 million in net assets.

Our audit opinions on the annual accounts are unmodified

21. The accounts for the council and its group for the year ended 31 March 2022 were approved by the Monitoring and Audit Committee on 17 November 2022. 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.

22. The Management Commentary is critical for aiding stakeholders understand the financial statements. We are pleased to report that the unaudited accounts provided a fair and balanced overview of the council's performance against objectives and the risks faced by the council in 2021/22.

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

23. As a result of the continuing impact of Covid-19 the submission deadlines for Local Government audited annual accounts and annual audit reports were revised to 30 November 2022.

24. The unaudited annual accounts were received on 30 June 2022 in line with our agreed audit timetable. The completeness and accuracy of accounting records and the extent of information and explanations that we required for our audit were not affected by the Covid-19 outbreak.

25. The working papers provided to support the accounts were of an acceptable standard although we noted that there was a higher incidence of presentational and disclosure issues in the accounts than in previous years.

26. We are aware that during 2021/22 there were departures of key members of the finance team. Recruitment for the vacant posts has continued throughout the audit and the council is making progress in building capacity. There is recognition that there are ongoing challenges in this area as outlined in [Exhibit 4](#).

Our audit opinions on the section 106 charity were unmodified

27. 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.

28. The Orkney General Charitable Trust is administered by the council and meets the registration criteria outlined in section 106.

29. Our duties as auditors of the charity administered by the council are to:

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

30. We have given an unmodified opinion on the financial statements of the Orkney General Charitable Trust and do not have any significant findings to report.

There were no objections raised to the annual accounts

31. The Local Authority Accounts (Scotland) Regulations 2014 require local government bodies to publish a public notice on their website that includes details of the period for inspecting and objecting to the accounts.

32. Regulation 9 requires a local authority to give public notice on its website by 17 June of the right to inspect its annual report and accounts. The date for inspection should be 14 days after the publication of the notice but cannot be later than 1 July and the inspection should last for 15 working days from the date specified in the notice.

33. As part of our audit, we identified that the inspection notice was not published until 27 June 2022 and therefore was outwith the timescales required by the regulations. It is important that timescales set out in the legislation are complied with to ensure members of the public have appropriate opportunity to inspect the accounts and raise any objections.

34. No objections were raised in relation to the 2021/22 annual report and accounts.

Recommendation 1

Procedures should be put in place to ensure the financial statements are advertised in accordance with The Local Authority Accounts (Scotland) Regulations 2014

Overall materiality is £3.0 million

35. We apply the concept of materiality in both planning and performing the audit. 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.

36. 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. 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.

37. We use materiality to evaluate the effect of identified misstatements and uncorrected misstatements on the audit and financial statements and when forming the opinion in the auditor's report.

38. Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

39. The revised materiality levels did not require a change in our audit approach as it did not change the assessment of material account areas.

Exhibit 1

Materiality values

Materiality level	Council	Group
Overall materiality	£3.0 million	£3.0 million
Performance materiality	£1.8 million	£1.8 million
Reporting threshold	£150 thousand	£150 thousand

Source: Audit Scotland

Significant findings from the audit of the annual accounts

40. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. The significant findings are summarised in [Exhibit 2](#).

Exhibit 2

Significant findings from the audit of financial statements

Issue	Resolution
<p>1. Valuation of Non-Current Assets</p> <p>Orkney Islands Council carries out a rolling programme for its land and buildings, with all categories of assets revalued every five years. The use of a rolling revaluation programme is an accepted practice permitted by the Local Government Code. However, where this is adopted, it is important that management consider the likelihood of material movement on assets not valued in year.</p> <p>In view of the prevailing market and economic uncertainty we challenged the council's assertion that assets had not moved by a material amount in 2021/22. We drew on our experience across comparable bodies where there had been significant movements in the financial year.</p>	<p>The council engaged an external qualified valuer to conduct a desktop review of land and buildings. The valuer concluded that assets held at existing use value had not moved by a material amount. However, the council holds a number of specialised assets e.g. schools which are held at depreciated replacement cost. In recognition of increased construction costs there was deemed to be a material movement in value.</p> <p>As a result of the revaluation exercise the net book value of property assets increased by £52.4 million. The adjustments are set out at paragraph 44.</p>

Issue	Resolution
	<p>Although a five year rolling programme is permitted by the Local Government Code, significant movements in intervening years may suggest that revaluing each class of asset once every five years is not sufficient, particularly as inflationary pressures are having a significant impact on retender and rebuild prices.</p> <p>Recommendation 2</p> <p>(Refer Appendix 1, action plan)</p>
<p>2. Valuation of Investment Properties</p> <p>Investment properties are required by the LG Code to be carried at fair value and should be revalued at the end of each accounting period.</p> <p>In 2021/22 the council engaged its valuer to conduct a revaluation exercise for all investment properties but did not agree the properties which were required to be valued. This led to a number of investment properties being missed by the valuer.</p>	<p>The value of assets not subject to revaluation at the year-end was £0.9m, however one asset valued at £0.6m was only purchased in November 2021 at market value, and therefore any movement in the overall value of the investment properties is unlikely to be material.</p> <p>It is important that the council takes ownership of the valuation process and engages appropriately with the valuer. Although the valuer is deemed to be the expert it is critical that the council review the work of the valuer to ensure the completeness of the asset population and that reasonable assumptions inform the updated values.</p> <p>Recommendation 3</p> <p>(Refer Appendix 1, action plan)</p>
<p>3. Covid-19 Grants</p> <p>In 2021/22 the Scottish Government continued to disburse Covid-19 grant funding through the council.</p> <p>In line with the treatment in 2020/21 where the council is acting as an intermediary the grant funding should be accounted for as an agency arrangement.</p> <p>Where there is an agency arrangement the income and corresponding expenditure should not be recognised in the Comprehensive Income and Expenditure Statement.</p>	<p>The council had not identified the agency grants within the ledger and consequently an adjustment of £5.4 million was required to the financial statements.</p> <p>This did not have an impact on the net surplus position but did reduce both income and expenditure within the Comprehensive Income and Expenditure Statement.</p> <p>Although the council are unlikely to receive further Covid-19 grants, they may receive other funding to allocate on behalf of other bodies. Proper arrangements should be put in place to</p>

Issue	Resolution
	<p>identify agency arrangements and account for them appropriately.</p> <p>Recommendation 4</p> <p>(Refer Appendix 1, action plan)</p>
<p>4. Infrastructure Assets</p> <p>Across the UK, a technical accounting issue has been identified covering infrastructure assets, which we have considered as part of our audit this year.</p> <p>Infrastructure assets typically include highways, footpaths, bridges and culverts and are included at historical cost in the accounts (there is a net book value of £80.9 million at the council). A replaced component of an asset has to be derecognised and at some councils the records of additions were not detailed enough to comply with accounting code requirements. A failure to derecognise assets correctly would have resulted in double-counting and an overstatement of the gross book value, accumulated depreciation and potentially the net book value of the assets.</p> <p>The Scottish Government has approved a statutory override that is applicable to 31 March 2024. The statutory override is formed of two parts:</p> <ul style="list-style-type: none"> • a local authority is not required to report the gross cost and accumulated depreciation for infrastructure assets • the carrying amount to be derecognised in respect of a replaced part of an infrastructure asset is to be taken to be and accounted for as a nil amount. No subsequent adjustment shall be made to the carrying amount of the asset with respect to that part. <p>The council can choose to adopt either or both statutory overrides and this should be disclosed in the relevant note to the accounts.</p>	<p>The council considered the records available to support infrastructure additions and elected to apply both parts of the statutory override in its 2021/22 annual accounts. This treatment does not impact the overall financial position.</p> <p>As part of our audit, we reviewed the infrastructure assets disclosures and the related notes, including the relevant disclosure in the accounting policies.</p> <p>We are satisfied that these disclosures reflect the statutory override and adequately explain the approach adopted to readers of the accounts.</p>
<p>5. Calculation of employer's superannuation contributions</p> <p>The council payroll system calculates the employer superannuation contributions based on standard percentages and pensionable pay. In order to get assurance that the contributions are correctly reported in the financial statements we conducted sample testing of pension contributions. We found</p>	<p>We conducted additional audit procedures to gain assurance that the issues identified would not result in a material misstatement in the accounts.</p> <p>We are satisfied that the pension contributions are fairly stated in the accounts and recommend that the council take action to rectify the</p>

Issue	Resolution
<p>that for one sampled transaction the pensionable pay included the holiday pay in lieu in error.</p> <p>The council are aware that the payroll system is incorrectly calculating pensionable pay in some instances where there are temporary changes (e.g. statutory sick pay). The council are making manual adjustments where an error is identified.</p>	<p>systematic error in relation to employer pension contributions.</p> <p>Recommendation 5 (Refer Appendix 1, action plan)</p>

Source: Audit Scotland

41. We have obtained audit assurances over the identified significant risks of material misstatement to the financial statements. [Exhibit 3](#) sets out the significant risks of material misstatement to the financial statements we identified in our 2021/22 Annual Audit Plan. It summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 3

Significant risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p>1. Risk of material misstatement due to fraud caused by the management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<p>Assess the design and implementation of controls over journal entry processing.</p> <p>Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.</p> <p>Test journals at the year-end and post-closing entries and focus on significant risk areas.</p> <p>Consider the need to test journal entries and other adjustments during the period.</p> <p>Evaluate significant transactions outside the normal course of business.</p> <p>Assess the adequacy of controls in place for</p>	<p>We have not identified any indication of management override in the year leading to material misstatement or significant concern.</p> <p>We have reviewed the council's accounting records and obtained assurance that there were no transactions outside normal business processes.</p> <p>We have also reviewed management estimates and the journal entries posted in the period and around the year end. We did not identify any areas of bias in key judgements made by management.</p>

Audit risk	Assurance procedure	Results and conclusions
	<p>identifying and disclosing related party relationship and transactions in the financial statements.</p> <p>We will assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.</p> <p>Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year.</p> <p>Focussed testing of accounting accruals and prepayments.</p>	
<p>2. Estimation in the valuation of non-current assets.</p> <p>There is a significant degree of subjectivity in the valuation of land and buildings. Valuations are based on specialist and management assumptions and changes in these can result in material changes to valuations.</p> <p>All non-current assets are revalued on a five-year rolling basis. Values may also change year on year, and it is important that the council ensures the financial statements accurately reflect the value of the land and buildings.</p>	<p>Review the information provided to the external valuer to assess for completeness.</p> <p>Review the minute of the discussions between valuers and the council.</p> <p>Review detailed working papers to support asset reviews and impairments.</p> <p>Evaluate the competence, capabilities, and objectivity of the professional valuer.</p> <p>Obtain an understanding of the management's involvement in the valuation process to assess if appropriate oversight has occurred.</p> <p>Critically assess the approach the council has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach.</p>	<p>In line with ISA 500 we have reviewed the competence, capability, and objectivity of the valuer.</p> <p>As highlighted in Exhibit 2 we identified an issue in relation to property assets not valued in year which resulted in a material adjustment (paragraph 44.).</p> <p>We are satisfied that the nature and scope of the valuer's work on land and buildings is appropriate.</p> <p>We are content the revised value of assets in the financial statements is reasonable.</p>

Audit risk	Assurance procedure	Results and conclusions
	<p>Challenge management's assessment of why it considers that the land and buildings not revalued in 2021-22 are not materially misstated. We will critically assess the appropriateness of any assumptions.</p> <p>Test the reconciliation between the financial ledger and the property asset register.</p> <p>Critically assess the adequacy of the council disclosures regarding the assumptions in relation to the valuation of land and buildings.</p>	
<p>3. Estimation in the valuation of Level 3 investments</p> <p>The council has a significant portfolio of level 3 investments, for example unquoted equities, where valuations involve the application of a variety of estimates in determining appropriate valuations. This subjectivity gives rise to a significant risk of misstatement in the financial statements.</p>	<p>Evaluate the competence, capabilities, and objectivity of the fund manager.</p> <p>Confirmation of year-end values to valuation reports and other supporting documentation.</p> <p>Review the relevant investment manager service auditor reports for qualifications.</p> <p>Review arrangements at the council to assess the reasonableness of values provided by the fund manager.</p> <p>Review the accounts to ensure there is adequate disclosure on the sources of uncertainty and the key estimates and judgements associated with level 3 assets.</p>	<p>We gained appropriate assurance over the competency, capability and objectivity of fund managers.</p> <p>Each year, the council receives internal control reports on its investment managers, and the custodian. These are high-level reports under International Standard on Assurance Engagements (ISAE3402), to provide assurance to user organisations and their auditors on the controls at a service organisation that are likely to impact or be a part of the user organisation's system of internal control over financial reporting.</p> <p>The valuations were agreed to valuation reports provided by the fund managers at the year-end.</p>

Other areas of audit focus

42. We identified in our 2021/22 Annual Audit Plan areas where we considered there to be other risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we did not consider these to represent significant risks.

43. We kept these areas under review throughout our audit based on the findings of the audit procedures performed. The results of our audit procedures and conclusions are set out in [Exhibit 4](#).

Exhibit 4

Other areas of audit focus

Audit risk	Results and conclusions
<p>Estimation in the valuation of the IAS19 pension liability</p> <p>The actuarial valuation depends on a range of financial and demographic estimations about the future. The subjectivity around these estimates gives rise to a risk of material misstatement in the financial statements.</p>	<p>We are satisfied that the pension liability is correctly recognised on the balance sheet at 31 March 2022 and has been accounted for and disclosed correctly in line with International Accounting Standard (IAS) 19 Retirement benefits.</p> <p>We use an auditor's expert to inform our review of the assumptions used in calculating this estimate and management's judgements. We concluded the assumptions are appropriate and within a range which we consider to be acceptable.</p> <p>We are also satisfied the controls in place over the provision of information to the actuary are appropriate.</p>
<p>Valuation of level 1 and level 2 assets</p> <p>Investments held by the council are subject to market price fluctuations and a degree of estimation. The council holds material level 1 and level 2 investments (where the valuation is based on quoted market price or where the fair value is determined using valuation techniques based on market prices). Due to the material amounts and, in particular, the degree of subjectivity and complexity in the valuation of level 2 assets, this gives rise to a risk of material misstatement in the financial statements.</p>	<p>Our work on fund managers outlined in Exhibit 3 provided assurance over all classes of investments in levels 1, 2 and 3.</p> <p>We agreed the value of level 1 and 2 investments to fund manager reports. In order to validate the figures in the fund manager reports we agreed the closing bid price of the shares to external sources.</p>
<p>Finance team capacity</p> <p>There has been significant change within the finance team in 2021/22. With</p>	<p>The finance team worked to deliver good quality accounts in line with the agreed audit timelines. We are aware that there were significant pressures on the finance team in year which we feel has</p>

Audit risk	Results and conclusions
<p>this level of change there is an increased risk of error in the financial statements both in the figures reported and the disclosures.</p>	<p>contributed to the level of adjustments required in the year.</p> <p>It is important that the finance team has sufficient capacity to drive the accounting process and ensure there is a proactive approach to dealing with technical accounting issues.</p> <p>There has been successful recruitment to a number of posts in year, however there is a reliance on existing members of the finance team to provide training and knowledge. This is therefore an on-going risk for the 2022/23 accounts process.</p>
<p>Covid 19 funding</p> <p>The Scottish Government has provided a significant amount of additional funding for Covid-19 support schemes. The council is required to assess the nature of the transactions that are taking place to establish the appropriate accounting treatment. Where the council is acting as an intermediary for the Scottish Government the transactions should be recorded as agency in the accounts. Due to the volume and high value of grants this increases the risk of material misstatement.</p>	<p>We conducted testing of those grants in year identified as being in relation to Covid-19. The main findings from this work are summarised in Exhibit 2 with significant adjustments made to the unaudited financial statements.</p>

Identified misstatements of £77.2 million were adjusted in the annual audited accounts

- 44.** Total misstatements identified were £77.2 million and related to the revaluation of assets and the reclassification of Covid-19 grants from principal to agency as outline in [Exhibit 2](#).
- 45.** Adjustments made in the audited accounts increased the total comprehensive income and expenditure surplus by £52.4 million and increased net assets in the balance sheet by £52.4 million.
- 46.** We are satisfied the adjustments have been appropriately processed in the revised financial statements and we have concluded that the misstatements arose from issues that have been isolated and identified in their entirety and do not indicate further systematic error.
- 47.** We identified some disclosure and presentational amendments during our audit which have been reflected in the final set of accounts.
- 48.** The nature of the errors did not impact on our planned audit approach and no additional audit procedures were conducted.

49. 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. Management have adjusted all identified misstatements above our reporting threshold and there are no unadjusted errors to report.

Reasonable progress was made on prior year recommendations

50. The council has fully implemented four of our prior year recommendations and is processing the remaining five recommendations. For actions not complete, 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

The council's budget setting and financial management arrangements operated effectively during 2021/22.

The council reported a £3.4 million underspend against its 2021/22 general fund revenue budget.

The council reported slippage of 50 per cent against its 2021/22 Capital Plan. This level of slippage was partly due to delays linked to Covid-19 but is a cause for concern as it may lead to increased costs over the long term.

The conflict in Ukraine has significantly increased market volatility and returns on investments reduced significantly in the final quarter of 2021/22.

We have obtained audit assurances over the wider audit dimension risk relating to Financial Management identified in our 2021/22 Annual Audit Plan

51. [Exhibit 5](#) sets out the audit dimension risk relating to Financial Management we identified in our 2021/22 audit plan. It summarises the audit procedures we performed during the year to obtain assurances over this risk and the conclusions from the work completed.

Exhibit 5

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

Audit risk	Assurance procedure	Results and conclusions
<p>Financial management-capital slippage</p> <p>The council has a history of slippage in its capital programme.</p>	<p>Review the capital investment strategy in place at the council.</p> <p>Consider the council's approach to capital monitoring.</p>	<p>We considered the action taken in 2021/22 to develop the arrangements for monitoring capital expenditure.</p> <p>Capital expenditure in 2021/22 was £13.9 million</p>

Audit risk	Assurance procedure	Results and conclusions
<p>The original approved limit for capital expenditure during 2021/22 was £28.7 million and an underspend of £5.2 million is expected at 31 March 2022.</p> <p>There is a risk that slippage in capital projects will result in increased costs for the council and delays in delivering key services.</p>	<p>Review actions taken by the council to reduce slippage.</p>	<p>and our detailed findings on the council's approach for managing capital slippage is set out in paragraph 69. below.</p>

The council operated within budget in 2021/22

52. The council approved its 2021/22 budget in April 2021. The budget was set at £91.2 million and relied on £0.6 million efficiency savings and £7.5 million from the Strategic Reserve Fund. Throughout the year additional budgeted expenditure of £6.3 million was approved by the council which was partially met by additional income of £5.2 million.

53. The most significant elements of the increased budget were redeterminations from the Scottish Government for ring fenced projects and approved funding from earmarked reserves to support businesses during Covid-19.

54. The council reported a surplus of £3.4 million against the revised general fund services budget.

55. 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 overspend on non-general fund areas was £2.7 million.

56. The more significant under and overspends are summarised in [Exhibit 6](#).

Exhibit 6

Summary of significant under/overspends against budget

Area	£m	Reason for variance
Underspends		
General Fund- Other Services	£3.08	The budget included loan charges based on borrowing for planned capital projects. Due to slippage of capital projects the level of borrowing did not increase as planned and there was an

Area	£m	Reason for variance
underspend against planned finance charges.		
Overspends		
Harbour Authority Account- Strategic Reserve Fund	£2.85	The majority of the overspend is a result of poor investment performance in the fourth quarter of the financial year (paragraph 86. The income from investments was lower than budgeted which resulted in an overspend.

Source: Orkney Islands Council 2021/22 Annual Accounts and outturn reports

Housing revenue account operated within budget

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

58. The council reported a £0.03 million underspend against the annual housing revenue account budget for 2021/22. This was attributable to lower than anticipated expenditure on property costs, mainly repairs and maintenance and higher than anticipated levels of rent.

59. At the year end the balance on the housing revenue account was £0.7 million with £0.5 million earmarked in a property maintenance fund.

The Covid-19 pandemic had a significant impact on the 2021/22 budget

60. 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 the effects will be felt well into the future.

61. The council budget approved in April 2021 included additional non-recurring funding of £1.8 million for Covid-19 which was added to the contingency funding to allow flexibility in light of the ongoing pandemic.

62. In year there were additional re-determinations of £3.5 million from the Scottish Government relating to Covid-19 and planned contributions of £3.0 million from earmarked reserves to support businesses.

63. In 2020/21 the council created two earmarked reserves, the Covid Redeterminations Fund and the Business Support Fund, to support on-going interventions and recovery from the pandemic. During 2021/22 the council utilised £0.3 million of the Covid-19 reserves.

64. The balance of the Covid-19 reserves at the year-end was £4.7 million. In December 2021 the council approved one-off funding of £8.2 million towards a series of projects aimed at promoting recovery from the pandemic.

65. The council continued to administer a number of grant schemes on behalf of the Scottish Government. The council made grant payments of £5.4 million in 2021/22 including £3.8 million of Strategic Framework Business Funds for transition and business restarts.

Budget processes were appropriate

66. We reviewed the council's budget setting and monitoring arrangements in 2021/22 and observed that senior management and those charged with governance receive regular and accurate financial information.

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

68. We have concluded that the council has appropriate budget monitoring arrangements in place.

The council reported slippage of 50 per cent against its 2021/22 Capital Plan

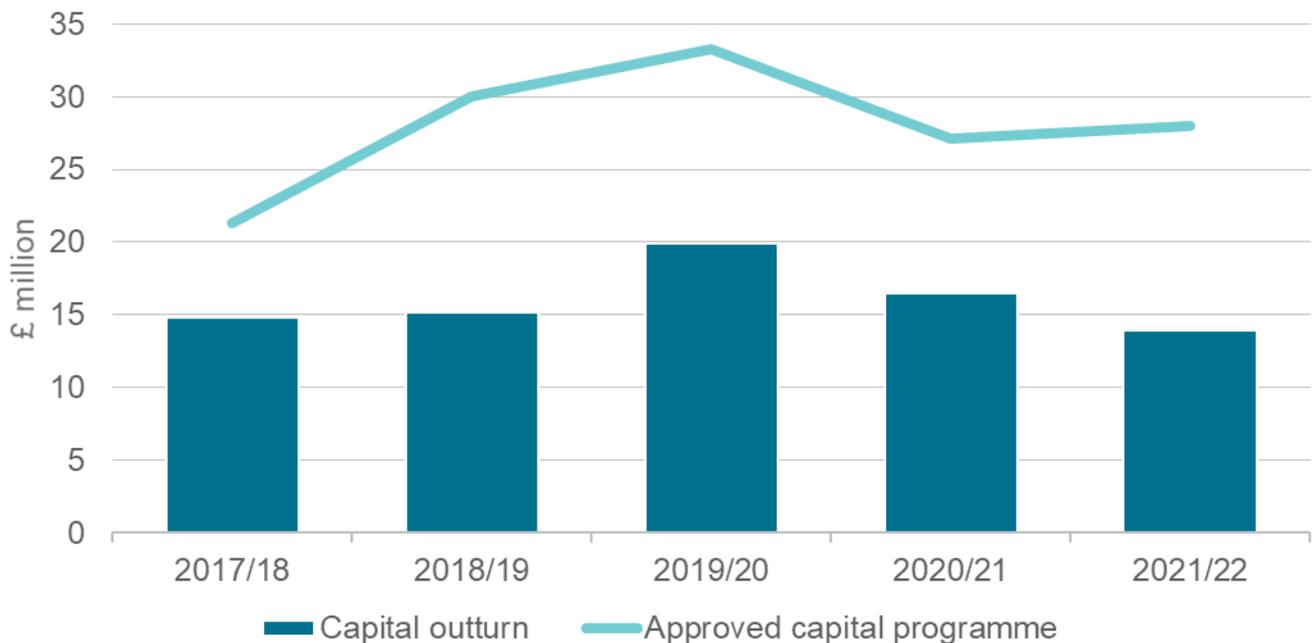
69. The council approved a capital programme of £28.7 million for 2021/22 which incorporated £8.6 million of slippage from 2020/21.

70. The final outturn reported for the year showed that capital works costing £13.9 million were completed during 2021/22. This represented slippage against the original plan of 50 per cent. The main areas of project slippage were in relation to the design and build of council dwellings, the purchase of a replacement tug for the Scapa Flow Oil Port and the extension to the St Andrew's school.

71. We recognise that over 2020/21 and 2021/22 there were issues arising from Covid-19, however, slippage against the capital budget is a long standing issue at the council as shown in [Exhibit 7](#). Across the past five years the average slippage has been between 40 and 50 per cent of the original budget.

Exhibit 7

Capital slippage against original budget in the last five years



Source: Orkney Islands Council capital outturn reports

72. The lower than anticipated capital expenditure means that borrowing levels have remained stable at £35 million over recent years. In addition in 2021/22 the council held cash balances of £22.7 million which they earned a small amount of interest on.

73. Inflationary pressures mean construction costs are increasing at a rate higher than earned interest and therefore the delay in capital projects is likely to have a significant adverse impact on the council's financial position.

74. The council has taken action in recent years as a result of previous audit reports including internal audit work on major capital projects and our Best Value Assurance Report. Despite the action taken the overall level of slippage continues to be a cause for concern, particularly with rising construction costs.

Recommendation 17

The council should consider whether actions taken are having the desired outcome and whether the capital budget of £34.4 million for 2022/23 is realistic and deliverable.

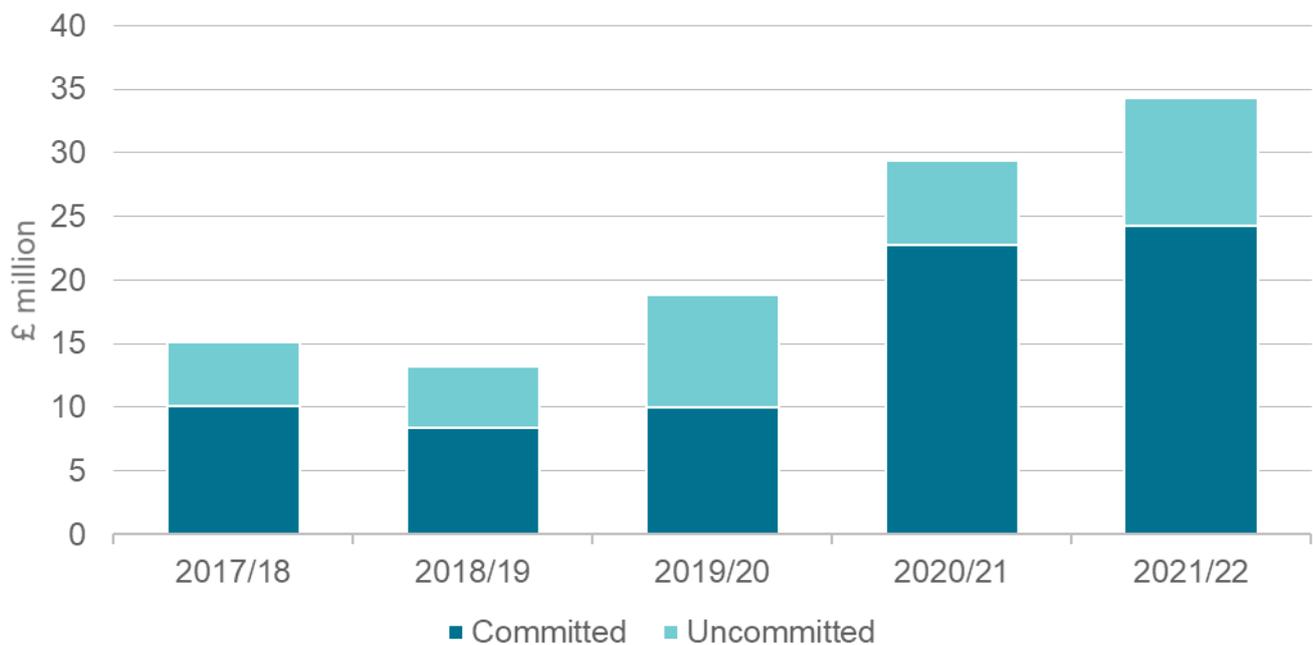
There has been a significant increase in the General Fund reserve

75. One of the key measures of the financial health of a body is the level of reserves held. The general fund reserve is a significant useable reserve and is used to support delivery of services.

76. The general fund reserve now stands at £34.3 million and includes committed balances of £24.2 million for specific future commitments such as the Renewable energy, Redevelopment and Regeneration Fund (£9.9 million).

77. [Exhibit 8](#) provides an analysis of the general fund over the last five years and shows the significant increase in reserves over the last two years due to surpluses and Covid-19 funding.

Exhibit 8 Analysis of general fund balance



Source: Orkney Islands Council Annual Accounts

78. The council's agreed reserves strategy aimed to maintain the uncommitted balance on the general fund at 3 per cent of the council's net budgeted expenditure. This would allow the council to make savings through early repayments of capital debt.

79. In response to the pandemic the council elected to maintain uncommitted reserves higher than the 3 per cent target to allow the council to respond to increased demands on services quickly. The level of uncommitted reserves held by the council increased from £6.7 million in 2020/21 to £10 million in 2021/22.

80. Although the uncertainty around Covid-19 has mostly abated the financial effect is likely to extend across several years and budgets will also be impacted by inflationary pressures associated with the cost of living crisis. It is likely that the additional funds held as uncommitted reserves will be required in future years.

Other useable reserves have remained stable despite market fluctuations

81. The council is in a very fortunate position of having significant useable reserves in addition to the general fund. The level of useable reserves held by the council increased by 1 per cent from £282.9 million in 2020/21 to £285.6 million in 2021/22.

82. The Harbour Reserve accounts for 84 per cent of useable 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. The fund is used for specific projects, council initiatives and supporting economic development across the council area.

83. The Strategic Reserve Fund reserve consists of investments managed by fund managers and a provision for future commitments in relation to decommissioning costs. Although investments increased in year (paragraph 86.), due to contributions to the general fund the balance on the Strategic Reserve Fund fell marginally in 2021/22 to £215.3 million from £215.9 million in 2020/21.

84. The council has an established policy on disbursements from the Strategic Reserve Fund which aims to ensure that the value of the fund does not fall in real terms against a minimum floor balance set at £215.6 million at 1 April 2021.

85. The council made net contributions of £7.5 million from the Strategic Reserve Fund to the general fund in 2021/22. The allocation was based on the forecast performance of investments and was set at a level aimed at maintaining the floor balance. Due to market performance issues outlined below the balance on the Strategic Reserve Fund at the year-end was £0.3 million lower than the minimum floor balance.

The performance of the council investments was significantly impacted by Covid-19 and other world events

86. The council faced a challenging year in 2021/22 but still reported an increase in the value of investments of £12.1 million held in the Strategic Reserve Fund. The total value of investments at 31 March 2022 was £270.9 million.

87. 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 has historically been relatively low in order to give priority to security of its investments. However, the council recognise there has been an increasing draw on the Strategic Reserve Fund and the investment strategy is being reviewed to move towards a focus on income generation.

88. 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.

89. 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.

90. The council appoints five external fund managers and investment performance is monitored by the Investments Sub-Committee. At 31 March 2022 the council reported a return on investments of 2.4 per cent against a benchmark of 9.1 per cent. Over three years investments performed 1.7 per cent behind the benchmark of 7.3 per cent reporting a return on investments of 5.5 percent.

91. Financial markets have been exceptionally volatile in recent years due to the ongoing Covid-19 pandemic and more recently as a result of the conflict in Ukraine. Returns against most asset classes reduced significantly in the final quarter of 2021/22 and the council reported a -3.5 per cent return on assets between 1 January and 31 March 2022.

92. The council has 40 per cent of funds invested in equities which were impacted adversely by the market volatility in 2021/22 and contributed to the investment performance being behind benchmark.

Financial systems of internal control operated effectively

93. 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 the council has sound systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

94. Our 2021/22 work covered a high level review of key financial systems including payroll, general ledger, accounts payable, accounts receivable, council tax, non-domestic rates and housing rents.

95. Our review of the systems identified only minor changes in the systems and in accordance with ISA 330 we took reliance from audit evidence obtained in the prior year. We conducted appropriate controls testing of any changes identified from our high level review.

96. Our review of the payroll function identified that there is no process for regularly validating the employee listings. This increases the risk of fictitious employees being included within the payroll. We understand there are other controls around new starts and monitoring changes which lower this risk, and we did not identify any issues from our substantive testing.

Recommendation 6

The council should implement a procedure to validate employees on a periodic basis to mitigate the risk of ghost employees on the payroll system.

97. We concluded that controls put in place by management were satisfactory and operating effectively with only minor points for improvement. The audit recommendations raised in 2020/21 have been followed up in [Appendix 1](#).

Internal audit

98. 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).

99. The overall conclusion of internal audit is that the council has a framework of controls in place that provides reasonable assurance regarding the organisation's governance framework and management of key risks. We are satisfied that internal audit findings are appropriately reported within the governance statement.

100. Over the course of our audit appointment we have noted that the council's internal audit reports include clear and focussed recommendations for improvement that are accepted by management.

101. Internal audit track progress on agreed actions throughout the year end and report progress to the Corporate Leadership Team. Transparency and scrutiny could be improved through reporting progress to the Monitoring and Audit Committee members in addition to the executive directors.

Recommendation 7

Internal audit should provide updates to those charged with governance on the progress the council has made in implementing agreed audit actions.

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

102. 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.

103. The risk profile of public bodies during 2021/22 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.

104. 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.

105. The National Fraud Initiative (NFI) is a counter-fraud exercise across the UK public sector which aims to prevent and detect fraud. It uses computerised techniques to compare information about individuals held by different public bodies and on different financial systems to identify matches that might suggest fraud or irregularity.

106. The council had resource issues over 2020/21 and 2021/22 which meant that there were delays in submitting the NFI data sets and investigating matches. The council prioritised the matches which were high risk which accounted for 25 per cent of total matches.

107. The NFI investigation did not identify any frauds, errors or other such observations. The results have not been presented to the Monitoring and Audit Committee.

Recommendation 8

The council should ensure the NFI process is completed on a timely basis and reported to those charged with governance to ensure that they get value from the exercise.

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 £92.6 million for 2022/23. This is based on contributions from reserves of £8.3 million.

The council's long term financial plan was set prior to Covid-19 and the cost of living crisis. The council is currently developing a strategic plan covering 2023-26 and this is an opportune time to revisit medium to long term financial planning to support the council's priorities while incorporating the impact of challenges from the external environment.

We have obtained audit assurances over the wider audit dimension risks relating to Financial Sustainability identified in our 2021/22 Annual Audit Plan

108. [Exhibit 9](#) sets out the audit dimension risks relating to Financial Sustainability which we identified in our 2021/22 annual audit plan. It summarises the audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 9

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

Audit risk	Assurance procedure	Results and conclusions
<p>Financial sustainability</p> <p>Councils continue to face significant financial pressures on funding and increasing demand on services.</p> <p>The council developed a long-term financial strategy identifying a cumulative funding gap of £65.7 million. However, there are currently no options developed to allow the council to close the gap</p>	<p>Review and comment on the appropriateness of process implemented to generate the council's option appraisals.</p> <p>Review and comment on the operation and delivery outcomes of the Improvement Support Team.</p> <p>We will review emerging long-term financial strategies to see how a balanced budget is to be achieved.</p>	<p>We considered the council's approach to developing savings plans to bridge the funding gap.</p> <p>Our detailed findings on the council's framework for achieving financial sustainability over the long term is set out below.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>and it does not take into account the impact of Covid.</p> <p>There is a risk that the council is reliant on reserves to deliver services over the longer term.</p>		

The council approved a general fund budget of £92.6 million for 2022/23

109. The draft general fund revenue budget for 2022/23 of £83.9 million was approved by the council in February 2022. This includes a specific grant allocation of £12.8 million for provision of ferry services.

110. Additional funding from the Scottish Government was confirmed and a finalised budget of £92.6 million was presented to the Policy and Resources Committee in June 2022.

111. The budget was based on an increase of 3 per cent in council tax and a contribution of £8.3 million from the Strategic Reserve Fund.

112. In recognition of the difficulties over 2020/21 and 2021/22 as a result of the pandemic and the pressure that services have been under, no efficiencies were built into the 2022/23 budget.

113. The current economic climate remains uncertain. The continuing impact of Covid-19 combined with inflationary pressures and the cost of living crisis will present significant challenges to the council's ability to deliver quality services within available resources.

The council approved a 2.6 per cent increase in rent levels for 2022/23 to fund the annual HRA budget of £4.2 million

114. In February 2022 the council approved a 2.6 per cent increase in the average weekly rent levels for tenants for 2022/23. The rent level set reflected the income required to fund the annual HRA budget of £4.2 million.

115. The approved budget included an allowance for public sector pay increases of 1 per cent for 2022/23. However, it is now anticipated that the actual pay settlement for the year may be significantly higher than this level. As the 2022/23 rent levels are set and cannot be revisited, these additional costs will need to be funded from savings and underspends within the approved annual budget.

The council should develop a medium to long term financial plan in tandem with the updated strategic plan

116. Following the election in May 2022 the council is working towards a strategy covering 2023-26. This will reflect the vision for the council covering this period and its priorities.

117. The council strategic plan 2018-2023 was supported by a medium term financial plan covering the period to 2021/22. The medium term financial plan was superseded by a long term financial plan covering the period from 2018/19 to 2029/30. The long term financial plan identified a potential cumulative funding gap of between £23.6 million and £145.6 million.

118. We have previously reported that the long term financial strategy does not include detailed savings plans demonstrating how the council will bridge the funding gap.

119. In addition the long term financial plan was prepared prior to the Covid-19 pandemic, the cost of living crisis and the revised council strategy. It is important that the council reviews the long term strategy to take account of the changes in the economic climate and to reflect the strategic priorities looking forward. We raised an action around long term financial planning in 2020/21 and this is included as an outstanding action in [Appendix 1](#).

Transformational plans have been paused

120. The council is aware that current levels of budgeted expenditure are not sustainable over the long term. The continued use of reserves to support current spend is not best practice and represents a risk that over time the level of reserves will diminish in real terms. This risk increased in 2022/23 with increased volatility in the markets and general inflation.

121. To minimise reliance on reserves the council recognises the need to identify savings, however, in recent years little progress has been made in generating savings. As outlined at paragraph 119. we recommended the council review the approach to long term savings plans and this is outstanding at the time of concluding our audit.

4. Governance and transparency

The effectiveness of scrutiny and oversight and transparent reporting of information

Main Judgements

The council had appropriate and effective governance arrangements in place to support scrutiny of decision-making during 2021/22 and conducted its business in an open and transparent manner.

The council has made progress in appointing the revised Corporate Leadership Team but the council has not succeeded in recruiting to the post of Chief Executive on a permanent basis.

We have obtained audit assurances over the wider audit dimension risks relating to Governance and Transparency identified in our 2021/22 Annual Audit Plan

122. [Exhibit 10](#) sets out the audit dimension risks relating to Governance and Transparency we identified in our 2021/22 audit plan. It summarises the audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 10

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

Audit risk	Assurance procedure	Results and conclusions
<p>Senior management restructuring</p> <p>Interim senior management team arrangements were introduced in the summer of 2021.</p> <p>A review of the council operating model and leadership commenced in 2021/22 with the first phase</p>	<p>We will review the governance processes for approval of the revised operating model.</p> <p>We will consider the impact of any changes on the interactions between the Executive Team and those charged with governance.</p>	<p>In 2021/22 the council approved phase 1 and 2 of the Corporate Management Structure as described at paragraph 147. below.</p> <p>The restructuring proposals are supported by detailed plans which clearly outline the financial implications.</p> <p>The plans were presented to the Policy and Resources Committee in November</p>

Audit risk	Assurance procedure	Results and conclusions
<p>considering the Corporate Management Structure</p> <p>Changes of this nature bring risks over the governance and transparency of decision making processes and stability of operations.</p>		<p>2021 and April 2022 for approval.</p> <p>We are satisfied that there was appropriate scrutiny and challenge of the revised corporate management structure.</p>

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

123. In common with all other public bodies in Scotland the council moved to revised governance arrangements at the beginning of the UK lockdown. The council and committees met virtually throughout the financial year but have moved to in person meetings in 2022/23.

124. In June 2022 the council reviewed governance arrangements following the easing of Covid-19 restrictions. The council has upgraded the technology in the council chamber to allow more effective blended meetings, however, members recognise the value of in person meetings.

125. In order to support effective communication, debate and decision making the council elected to hold all meetings in person and implement clear guidance on the limited circumstances in which remote attendance is appropriate.

126. We are satisfied that the council maintained its schedule of business throughout 2021/22.

127. We have reviewed the committee minutes and papers throughout the year. The papers are available to the public via the Orkney Islands Council website and are sufficiently detailed to allow for effective decision making and scrutiny of performance.

128. We attended the Monitoring and Audit Committee throughout 2021/22 and we observed and concluded that members are engaged during the meetings and provide effective scrutiny and challenge.

The new council approved the same decision-making structure as had been used for the previous administration

129. The Local Government (Scotland) Act 1973 allows councils to delegate decision-making to committees or sub-committees. There is no requirement for councils to adopt a particular decision-making and scrutiny structure; it is a matter for each council to decide what is most appropriate for its circumstances and context.

130. At its first meeting on 16 May 2022, the new council noted the Scheme of Appointment of Members of Committees which had been approved by the

previous administration in December 2021 and did not make any changes. The structure consists of two service area committees: a Policy and Resources Committee, Planning Committee, Monitoring and Audit Committee, Licensing Committee and the Integration Joint Board.

131. The Policy and Resources Committee is attended by all members and is supported by seven sub-committees. Appointments to all sub-committees were approved on 19 May 2022.

The council has a training programme to support new and returning councillors

132. Nine new councillors were elected to the council at the local government elections in May 2022. To support these new members, and continuing members, the council provided an induction programme which included sessions outlining members' key roles and responsibilities as councillors, and training on the ethical standards regime.

133. Tailored training was also provided to members based on their specific responsibilities, this included bespoke training for councillors sitting on the Pension Fund Sub-Committee and the Investments Sub-Committee.

134. We are satisfied that the council has made arrangements to provide new members with the knowledge and understanding required to provide effective challenge and scrutiny.

Performance reporting was of a good standard

135. 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.

136. We highlighted in 2019/20 that improvements were required to the management commentary to improve clarity. We reported that some progress had been made in 2020/21 and we are pleased that further improvements have been made in 2021/22.

137. The Management Commentary in the unaudited accounts submitted to audit provided information on the council, its main objectives and the principal risks faced during 2021/22. It is fair, balanced and an understandable analysis of the council's performance for the year. It adequately explains to stakeholders, in plain English, the performance of the council and group and is consistent with the performance shown in the financial statements.

Integration scheme review

138. The Public Bodies (Joint Working) (Scotland) Act 2014 required a review of the integration schemes by March 2021. The council, NHS Orkney and Orkney Integration Joint Board (the IJB) conducted an interim review which

identified no high priority actions for 2020/21, however, it was agreed that a more detailed review would take place in 2021/22.

139. As a result of audit recommendations in 2019/20 the revised scheme was updated to ensure there was a shared understanding between partners that it is undesirable to cut subsequent years' funding allocations by the current year additional funding as this would compound any funding gaps identified by the IJB.

140. The revised scheme was submitted to the Scottish Government for comments and feedback before being approved by the council and partner bodies in winter 2021. The finalised Integration Scheme was approved by Scottish Ministers in May 2022.

The council has made improvements to procurement processes

141. 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.

142. 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.

143. 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.

144. The council considered the actions to be urgent and we have confirmed with internal audit that all were addressed within the first quarter of 2021/22.

145. We considered that there was a risk that this was not an isolated incident and there were other instances where procurement guidance had not been followed.

146. We tested a sample of transactions above the procurement threshold of £10 thousand and did not find any instances where the procurement was not compliant with guidance. There was one sampled item where there was no evidence of appropriate tendering, or a contract held. This was a historic arrangement; however, it is important that key documentation for service arrangements is maintained.

Recommendation 6

The council should ensure contracts are held for all active services.

The council has taken action to create resource and leadership capacity but there are ongoing challenges

147. The council conducted a review of the senior management team in 2021/22 as a result of significant turnover within the executive team. There was recognition that the existing operating model had been in place for 10 years and was no longer fit for purpose. Through the review the council aimed to address capacity challenges and create strong foundations to ensure the council can deliver its ambitions and meet the needs of the community.

148. Phase 1 focused on the Corporate Leadership Team which created four corporate director roles in addition to the Chief Officer at the Integration Joint Board. The Corporate Leadership Team are supported by Heads of Service and Service Managers and their responsibilities have been realigned to the new directorates.

149. Phase 2 focused on creating additional capacity in key areas below service manager level. The proposal focused on building capacity across services in the council and had a particular emphasis on creating opportunities for young people.

150. The Corporate Management Structure is part of the council strategic priorities outlined in the Our People, Our Plan programme and is monitored by the Policy and Resources Committee.

151. The Interim Chief Executive has now been in post for over 2 years. A second recruitment exercise did not identify any suitable candidates. The council agreed that the interim arrangements can continue in 2022/23 and that further consideration of market conditions will be used to inform a revised recruitment campaign.

152. We acknowledge that attracting suitable candidates for leadership roles is particularly challenging and we are satisfied the council are taking actions which have been approved by elected members.

5. Best Value

Using resources effectively and continually improving services.

Main judgements

The council has an appropriate and effective best value framework in place.

The council's performance measures are aligned to key priorities and outcomes. There are appropriate arrangements for collecting and reporting on indicators with regular reporting to the appropriate committee.

The council has made the necessary arrangements for collecting, recording, and publishing the statutory performance information.

The council continues to demonstrate commitment to Best Value

153. 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.

154. The council's assessment of Best Value is informed by progress against the Council Delivery Plan. The actions arising from our BVAR were incorporated into the 2018-2023 Council Delivery Plan and progress is monitored on a biannual basis by the Policy and Resources Committee.

155. In June 2021 the council concluded that all agreed BVAR actions had been completed.

156. Our work across 2020/21 and 2021/22 identified that issues raised in our BVAR were still applicable to the council (e.g. capital slippage, long term financial planning). We recognise that since the issue of our BVAR there has been a number of global and national events which has impacted the delivery of council services and may have limited the impact of planned actions. Our work in considering the Best Value Action Plan suggests that the council has further work to do to achieve the desired outcomes.

Recommendation 7

The council should review the BVAR action plan to establish whether the issues highlighted were resolved by the actions taken.

157. The Controller of Audit will consider the results of this follow-up work and report to the Accounts Commission on the extent of improvements made.

Performance management arrangements provide a sound base for improvement

158. We reviewed the performance information submitted to the Policy and Resources Committee and service committees to assess whether performance measures are aligned to the council's key priorities and outcomes.

159. The council prepares performance reports on a six monthly basis for committees which detail progress against the Council Delivery Plan.

160. The council continues to make progress against the priorities from the delivery plan but progress has slowed due to the pandemic. There is a higher incidence of indicators graded red or amber (i.e. at risk of target deadlines not being met) compared to pre-pandemic levels.

161. Where the council has identified a risk that target deadlines will not be met the report includes an action plan outlining the actions being taken by the council to ensure the achievement of the objective in a timely basis.

162. We are satisfied that the performance management arrangements remained operational in 2021/22 despite the impact of Covid-19 and resourcing issues at the council.

The requirements of the Statutory Performance Information (SPI) Direction are being met

163. 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.

164. 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

165. Orkney Islands Council continues to participate in the Local Government Benchmarking Framework and publish this data along with other performance information, including an annual performance report on its website.

166. The council has a Strategic Planning and Performance Framework which covers council performance against community plans, service plans and the corporate plan. The council Delivery Plan monitoring includes the assessment of progress in achieving Best Value as outlined in paragraphs 153. to 157.

167. The arrangements in place to report on the council's performance are effective in meeting the requirements set out in the SPI direction issued by the Accounts Commission.

Further progress has been made in addressing issues in children's services

168. Over the past two financial years the council has been working to implement recommendations arising from a Care Inspectorate report on a Joint Inspection of Services for Children and Young People in need of Care and Protection in Orkney.

169. There were 27 actions arising from the report over four themes: governance, assurance and data; policy, systems, process and procedure; getting it right for every for every child; and corporate parenting.

170. The council has been monitoring progress in implementing actions across both 2020/21 and 2021/22. The Care Inspectorate and partners have also conducted two follow-up reviews focusing on progress made in addressing the findings.

171. The most recent review findings were presented to the council in June 2022 and it was highlighted that the council and partners had continued to make changes designed to improve practice and encourage consistency.

172. The Care Inspectorate found there had been developments to support engagement of children and young people in decisions about their lives, however, they reported there was no mechanism for routinely collecting information about the children's satisfaction with the outcomes.

173. The council continues to recognise challenges with its management information systems and recruitment and retention of social workers. There is an ongoing risk that these issues could impact the council's ability to demonstrate continuous improvement in this service area and the council is taking actions to mitigate these risks.

National performance audit reports

174. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2021/22, Audit Scotland published a number of reports which may be of interest to the body. These are outlined in [Appendix 2](#).

Appendix 1. Action plan 2021/22

2021/22 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. Advertising the Financial Statements</p> <p>The financial statements were not advertised in accordance with the Local Authority Accounts (Scotland) Regulations 2014.</p> <p>Risk – there is a risk that the public does not have the ability to inspect and object to the accounts in a timely fashion.</p>	<p>Procedures should be put in place to ensure the financial statements are advertised in accordance with The Local Authority Accounts (Scotland) Regulations 2014</p> <p>Paragraph 33.</p>	<p>Actions have been put in place to ensure the deadline for publication of the inspection notices is not missed in future years.</p> <p>Service Manager - Accounting</p> <p>31 March 2023</p>
<p>2. Frequency of revaluations</p> <p>Our review identified that as a result of the council's policy to revalue assets every five years there is a risk that the valuation of major asset classes may have materially changed since their last full valuation.</p> <p>In 2021/22 a significant audit adjustment was required (paragraph 44.) to reflect the current value of assets at 31 March 2022.</p> <p>Risk – There is a risk that the carrying value of land and buildings is materially different to the current value.</p>	<p>The council should conduct an annual assessment of whether the carrying value differs significantly from the current value of land and buildings.</p> <p>Paragraph 40.</p>	<p>An impairment review will be carried out each financial year end to ensure the carrying value of assets has not been materially affected during the current times of large market volatility.</p> <p>Service Manager – Corporate Finance</p> <p>31 March 2023</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>3. Valuation of investment properties</p> <p>In 2021/22 the council engaged their valuer to conduct a revaluation exercise for all investment properties but did not agree the properties which were required to be valued. This led to a number of investment properties being missed by the valuer.</p> <p>Risk – there is a risk that property assets are materially misstated due to miscommunication with the valuer or inadequate review of the valuer’s work.</p>	<p>The council should clearly set out the scope of the work required by the valuer clearly outlining the assets which should be included in the year end valuation exercise. In addition the council should review the work of the valuer for appropriateness. This should cover the completeness of the assets subject to valuation and the reasonableness of assumptions used.</p> <p>Paragraph 40.</p>	<p>Financial year end 2021/22 was affected by staff changes and staff shortages in both OIC and with the valuation team.</p> <p>OIC will ensure a proper meeting takes place in advance of each financial year-end going forward to discuss the revaluation exercise that will take place.</p> <p>Service Manager – Corporate Finance</p> <p>31 March 2023</p>
<p>4. Accounting for agency grants</p> <p>In both 2020/21 and 2021/22 the council had accounted for Covid-19 grants where they were acting as an agent incorrectly, resulting in a material adjustment to the accounts.</p> <p>Risk – there is a risk that income and expenditure are overstated due to inappropriate accounting treatment.</p>	<p>The council should put arrangements in place to identify agency arrangements and account for them appropriately.</p> <p>Paragraph 40.</p>	<p>The disclosure of agency grants was considered to be a voluntary, however, the materiality of grants paid out under this arrangement had not been taken into account.</p> <p>Procedures will be put in place to review the materiality value of grants considered to be agency in nature going forward.</p> <p>Service Manager – Accounting</p> <p>31 March 2023</p>
<p>5. Calculation of employer superannuation contributions</p> <p>We identified one instance where the payroll system used an incorrect figure for pensionable pay when calculating the employer superannuation contribution. We are aware this is systematic issue and manual</p>	<p>The council should take action to rectify the systematic error and ensure that pension contributions are based on the appropriate pensionable pay.</p> <p>Paragraph 40.</p>	<p>The background system requires a fix. The fix has been tested, and it works, so what remains is an appropriate time to update the live system. This would have to coincide with system upgrades and operational testing on new releases.</p> <p>Service Manager – Payroll & Pensions</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>adjustments are being made by the council.</p> <p>Risk – there is a risk that the employer contributions made to the pension fund are incorrect.</p>		31 December 2022
<p>6. Validation of employees</p> <p>The council does not conduct regular validation exercises for employees held on the payroll system.</p> <p>Risk – this increases the risk that ghost employees are held on the payroll system through fraud or error.</p>	<p>The council should implement a procedure to validate employees on a periodic basis to mitigate the risk of ghost employees on the payroll system.</p> <p>Paragraph 96.</p>	<p>Permanent and temporary staff are regularly reviewed as part of the budget setting process.</p> <p>For 2023/24 budget setting the payroll/HR system will be the starting point for staff budget calculation. As part of the preparation a review of all posts within the system has been carried out.</p> <p>All budget holders, with staff in the establishment will be asked to validate their staff as part of the budget setting process.</p> <p>A new process is also being rolled out to ensure that all temporary staff are end-dated to ensure no employees are paid in error, or through fraud.</p> <p>Service Manager – Payroll & Pensions</p> <p>31 March 2023</p>
<p>7. Monitoring progress against internal audit recommendations</p> <p>Internal audit track progress on agreed actions throughout the year and report progress to the Corporate Leadership Team. There is no reporting to those charged with governance.</p> <p>Risk – there is a risk that elected members are not</p>	<p>Internal audit should provide updates to those charged with governance on the progress the council has made in implementing agreed audit actions.</p> <p>Paragraph 101.</p>	<p>A progress report detailing any issues in implementing actions and any actions which have not been implemented by the agreed date will be presented to the Monitoring and Audit Committee every six months. The first report which will show the position at year end will be presented to Committee in June 2023.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>aware of any issues in implementing actions and cannot apply appropriate challenge and scrutiny.</p>		<p>Chief Internal Auditor 30 June 2023</p>
<p>8. National Fraud Initiative</p> <p>Due to resource issues in 2020/21 and 2021/22 the NFI data sets were submitted late and only 25 per cent of matches were investigated. In addition the results were not reported to the Monitoring and Audit Committee.</p> <p>Risk – there is a risk that fraud or error is not detected.</p>	<p>The council should ensure the NFI process is completed on a timely basis and reported to those charged with governance to ensure that they get value from the exercise.</p> <p>Paragraph 107.</p>	<p>The Council will complete the NFI process on a timely basis and the results of the matching exercise will be reported to the Monitoring and Audit Committee.</p> <p>Chief Internal Auditor 30 June 2024</p>
<p>9. Records management for contracts</p> <p>We conducted sample testing of 37 contracts over the £10 thousand procurement threshold and identified one instance where the contract could not be located.</p> <p>Risk – there is a risk that inadequate evidence is held in the event of a legal dispute.</p>	<p>The council should ensure contracts are held for all active services.</p> <p>Paragraph 146.</p>	<p>The Council will ensure that contracts are retained in accordance with the periods set out in the Council's Records Retention Policy by all Service Managers with responsibility for holding contracts.</p> <p>Service Manager (Procurement), Service Manager (Property and Capital Projects) and Service Manager (Engineering)</p> <p>30 November 2022</p>
<p>10. Outcomes from BVAR actions</p> <p>The council has reported that all actions agreed as a result of the BVAR have been completed. Our work in recent years has found that some issues reported in the BVAR are ongoing.</p> <p>Risk – there is a risk that the council cannot demonstrate continuous improvement.</p>	<p>The council should review the BVAR action plan to establish whether the issues highlighted were resolved by the actions taken.</p> <p>Paragraph 156.</p>	<p>The Corporate Leadership Team will review the BVAR action plan to establish whether the issues highlighted were resolved by the actions taken. Areas of further improvement that have already been identified are being progressed through Our People Our Plan.</p> <p>Head of Improvement and Performance 31 March 2023</p>

Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>11. 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>Complete</p> <p>We are satisfied that payroll reconciliations took place in 2021/22.</p>
<p>12. 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>Complete</p> <p>We are satisfied that there was appropriate stock validation procedures in place at 31 March 2022.</p>
<p>13. 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>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>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>Complete</p> <p>We are satisfied the council has made appropriate improvements to the process for the annual update of registers of interest.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>14. 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>In progress</p> <p>A schedule is now in place for carrying out reviews of discounts and reliefs in the current financial year and future years.</p>
<p>15. 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>In progress</p> <p>A review of cost centre structures, subjective codes is underway.</p> <p>We are also looking to review the process of calculation of apportioned costs.</p> <p>The finance system is also moving to a new platform (Centros).</p> <p>Further reviews of processes, procedures and schedules will be carried out over time.</p> <p>31 March 2024 year-end accounts would be the earliest financial year to put new schedules in place.</p>
<p>16. Workforce capacity</p> <p>The council has recognised there is an issue with the workforce across all services 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>The council 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.</p>	<p>In progress</p> <p>We have reported in paragraph 147. that the council has progressed the review of the workforce structure and work is ongoing to create additional capacity.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>17. Capital slippage</p> <p>The original approved limit for capital expenditure during 2019/20 was £33 million. Capital slippage in 2019/20 amounted to £18 million due to weaknesses in forward planning arrangements.</p> <p>Risk –capital slippage might impact on strategic priorities that are dependent on capital projects being completed on time.</p>	<p>The council should minimise slippage and re-profiling of capital projects through the use of historic experience to inform capital programmes and create realistic timelines for incurring capital spend.</p>	<p>In progress</p> <p>The capital programme is regularly reviewed and monitored. Capital slippage is likely to be an issue until the programme catches up as we only have limited resources to deliver against the programme.</p> <p>Changes in the programming of the capital projects will help remove slippage going forward.</p>
<p>18. 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 savings options.</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>On-going</p> <p>The MTFs and LTFP are being looked at very closely given the funding gap previously identified, and the economic and political pressures impacting costs and funding in the short term.</p> <p>The Change programme requires reinvention to meet the challenges going forward.</p> <p>The Improvement Support Team now focus on the delivery of projects, improvements, and initiatives; be they incremental or transformational, which deliver efficiencies which may or may not deliver financial savings</p>
<p>19. 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>Following the public pound arrangements for Orkney Ferries should include an annual review of the financial position.</p>	<p>Complete</p> <p>We are satisfied that there is an annual review of the performance of subsidiaries through the appropriate service committees.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>Risk—there is a risk the council is not aware of any significant financial issues at its subsidiary bodies.</p>		
<p>20. Change programme</p> <p>The Change Programme is intended to drive an evaluation of key business processes, including a review of options for modernising and delivering frontline services more efficiently. The Change Programme, which has been in place since 2011, has proved difficult to manage and there has been a delay in delivering the intended outcomes.</p> <p>Risk -the programme may not deliver planned changes and efficiencies.</p>	<p>The council should ensure the change programme sets out realistic plans and savings targets and that appropriate management arrangements in place to ensure delivery of the programme.</p>	<p>The Council is re-focussing support for outstanding Change Programme projects which were included within a renewed corporate Improvement Programme agenda.</p>

Appendix 2. Summary of 2021/22 national performance reports and briefing papers

May

[Local government in Scotland Overview 2021](#)

June

[Covid 19: Personal protective equipment](#)

July

[Community justice: Sustainable alternatives to custody](#)

September

[Covid 19: Vaccination programme](#)

January

[Planning for skills](#)

[Social care briefing](#)

February

[NHS in Scotland 2021](#)

March

[Local government in Scotland: Financial Overview 20/21](#)

[Drug and alcohol: An update](#)

[Scotland's economy: Supporting businesses through the Covid 19 pandemic](#)

Orkney Islands Council

2021/22 Annual Audit Report

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