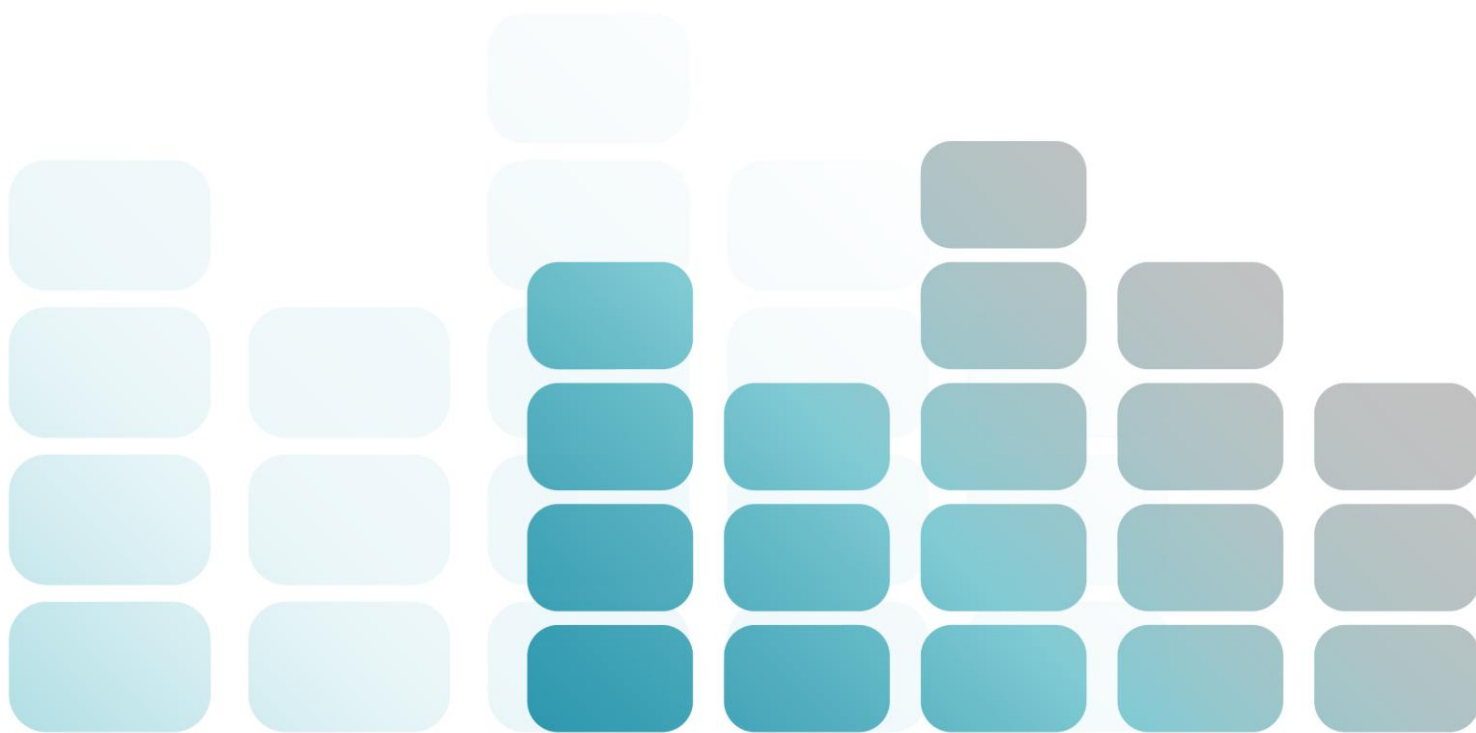


Shetland Islands Council

Annual Audit Plan 2025/26



Prepared for Shetland Islands Council
March 2026

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Introduction

Purpose of the Annual Audit Plan

1. The purpose of this Annual Audit Plan is to provide an overview of the planned scope and timing of the 2025/26 audit of Shetland Islands Council's annual accounts. It outlines the audit work planned to meet the audit requirements set out in [auditing standards](#) and the [Code of Audit Practice](#), including supplementary guidance.

Appointed auditor and independence

2. Rachel Browne, of Audit Scotland, has been appointed by the Accounts Commission as external auditor of Shetland Islands Council, hereafter referred to as 'the council', for the period from 2023/24 until 2026/27 (years two to five of the five-year audit appointment). The 2025/26 financial year is Rachel's third year of appointment and the fourth year of Audit Scotland's five-year audit appointment.

3. Rachel Browne and the audit team are independent of the council in accordance with relevant ethical requirements, including the Financial Reporting Council's Ethical Standard. This standard imposes stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has robust arrangements in place to ensure compliance with ethical standards. The arrangements are overseen by the Executive Director of Innovation and Quality, who serves as Audit Scotland's Ethics Partner.

4. The Ethical Standard requires auditors to communicate any relationships that may affect the independence and objectivity of the audit team. There are no such relationships pertaining to the audit of the council to communicate.

Audit scope and responsibilities

Scope of the audit

5. The audit is performed in accordance with the Code of Audit Practice, including supplementary guidance, International Standards on Auditing (UK), and relevant legislation. These set out the requirements for the scope of the audit which includes:

- an audit of the financial statements and an opinion on whether they give a true and fair view and are free from material misstatement
- an opinion on statutory other information published with the financial statements in the annual accounts, namely the Management Commentary and the Annual Governance Statement
- an opinion on the audited part of the Remuneration Report
- conclusions on the council's arrangements in relation to the wider scope areas: Financial Management, Financial Sustainability, Vision, Leadership, and Governance, and Use of Resources to Improve Outcomes
- reporting on the council's arrangements for securing Best Value
- providing assurance on the Housing Benefit Subsidy Claim and Non-Domestic Rates Return
- a review of the council's arrangements for preparing and publishing statutory performance information
- provision of an Annual Audit Report setting out significant matters identified from the audit of the annual accounts and the wider scope areas specified in the Code of Audit Practice.

Responsibilities

6. The Code of Audit Practice sets out the respective responsibilities of the council and the auditor. A summary of the key responsibilities is outlined below.

Auditor's responsibilities

7. The responsibilities of auditors in the public sector are established in the Local Government (Scotland) Act 1973. These include providing an independent opinion on the financial statements and other information

reported within the annual accounts, and concluding on the council's arrangements in place for the wider scope areas and to secure Best Value.

Shetland Islands Council's responsibilities

8. The council has primary responsibility for ensuring proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enables it to successfully deliver its objectives. The features of proper financial stewardship include:

- establishing arrangements to ensure the proper conduct of its affairs
- preparation of annual accounts, comprising financial statements that give a true and fair view and other information
- establishing arrangements for the prevention and detection of fraud, error and irregularities, and bribery and corruption
- implementing arrangements to ensure its financial position is soundly based
- making arrangements to secure Best Value
- establishing an internal audit function.

Communication of fraud or suspected fraud

9. In line with ISA (UK) 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements), in presenting this plan to the Audit Committee we seek confirmation from those charged with governance of any instances of actual, suspected or alleged fraud that should be brought to our attention. Should members of the committee or board have any such knowledge or concerns relating to the risk of fraud within Shetland Islands Council, we invite them to communicate this to the appointed auditor for consideration. Similar assurances will be sought as part of the audit completion process.

Audit of the annual accounts

Introduction

10. The audit of the annual accounts is driven by materiality and the risks of material misstatement in the financial statements, with greater attention being given to the significant risks of material misstatement. This chapter outlines materiality, the significant risks of material misstatement that have been identified, and the impact these have on the planned audit procedures.

Materiality

11. The concept of materiality is applied by auditors in planning and performing an audit, and in evaluating the effect of any uncorrected misstatements on the financial statements or other information reported in the annual accounts.

12. Broadly, the concept of materiality is to determine whether matters identified during the audit could reasonably be expected to influence the decisions of users of the financial statements. Auditors set a monetary threshold when determining materiality, although some issues may be considered material by their nature. Therefore, materiality is ultimately a matter of the auditor's professional judgement.

13. The materiality levels determined for the audit of the council are outlined in [Exhibit 1](#).

Exhibit 1

2025/26 Materiality levels for Shetland Islands Council

Materiality	Amount
Materiality – based on an assessment of the needs of users of the financial statements and the nature of the council operations, the benchmark used to determine materiality is gross expenditure based on the audited 2024/25 financial statements. Materiality has been set at 2% of the benchmark.	£5.7 million

Materiality	Amount
Performance materiality – this acts as a trigger point. If the aggregate of misstatements identified during the audit exceeds performance materiality, this could indicate that further audit procedures are required. Using professional judgement, performance materiality has been set at 60% of planning materiality.	£3.4 million
Reporting threshold – all misstatements greater than the reporting threshold will be reported.	£285,000

Source: Audit Scotland

Significant risks of material misstatement to the financial statements

14. The risk assessment process draws on the audit team’s cumulative knowledge of the council, including the nature of its operations and its significant transaction streams, the system of internal control, governance arrangements and processes, and developments that could impact on its financial reporting.

15. As part of the risk assessment process, we engage with the Local Area Network (LAN) of scrutiny bodies. The LAN supports scrutiny bodies to share information on performance and scrutiny risks to inform risk assessment discussions and identify any opportunities for coordinated scrutiny. We have a planned meeting with LAN members in April 2026 (including Education Scotland, the Care Inspectorate and the Scottish Housing Regulator). Any additional risks arising from this meeting or plans for shared scrutiny activity will be reported to the council and those charged with governance as appropriate.

16. Based on the risk assessment process, significant risks of material misstatement to the financial statements have been identified and these are summarised in [Exhibit 2, page 8](#). These are the risks which have the greatest impact on the planned audit approach, and the planned audit procedures in response to the risks are outlined in [Exhibit 2](#).

17. The risk assessment process is an iterative and dynamic process. The assessment of risks set out in this Annual Audit Plan and [Exhibit 2](#) may change as more information and evidence is obtained over the course of the audit. Where such changes occur, these will be reported to the council and those charged with governance, where relevant.

Exhibit 2**Significant risks of material misstatement to the financial statements**

Risk of material misstatement	Planned audit response
<p data-bbox="113 430 730 510">Fraud caused by management override of controls</p> <p data-bbox="113 519 730 712">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 data-bbox="737 430 1481 488">The audit team will:</p> <ul data-bbox="737 497 1481 1290" style="list-style-type: none"><li data-bbox="737 497 1481 577">• evaluate the design and implementation of controls over journal entry processing<li data-bbox="737 586 1481 734">• make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries<li data-bbox="737 743 1481 900">• test journal entries, focusing on those that are assessed as higher risk, such as those affecting revenue and expenditure recognition around the year-end<li data-bbox="737 909 1481 981">• evaluate significant transactions outside the normal course of business<li data-bbox="737 990 1481 1137">• assess the adequacy of controls in place for identifying and disclosing related party relationships and transactions in the financial statements<li data-bbox="737 1146 1481 1290">• assess changes to the methods and underlying assumptions used to prepare accounting estimates and assess these for evidence of management bias.

Risk of material misstatement	Planned audit response
<p>Valuation of property, plant and equipment</p> <p>The council held £527.6 million of property, plant, and equipment (PPE) at 31 March 2025, of which £265.5 million was land and building assets (excluding council dwellings).</p> <p>The council is required to value land and building assets at existing use value where an active market exists for these assets. Where there is no active market, these assets are valued on a depreciated cost replacement (DRC) basis. As a result, there is a significant degree of subjectivity in these valuations which are based on specialist assumptions, and changes in the assumptions can result in material changes to valuations.</p> <p>From 2025/26, CIPFA/LASAAC's revised Code introduces HM Treasury's reforms, moving local authorities to quinquennial (5-yearly) valuations with annual indexation applied in intervening years. The first year of implementation brings an increased risk of material misstatement due to the change in accounting treatment and the new judgements required, particularly when selecting appropriate indices to apply.</p>	<p>For assets subject to revaluation in year, the audit team will:</p> <ul style="list-style-type: none"> • Evaluate the design and implementation of controls over the valuation process. • Review the information provided to the valuer and assess this for completeness and accuracy. • Evaluate the competence, capabilities, and objectivity of the valuer. • Obtain an understanding of management's involvement in the valuation process to assess if appropriate oversight has occurred. • Review the appropriateness of the key data and assumptions used in the 2025/26 valuation process, and challenge these where required. <p>For assets where indexation is applied in year, the audit team will:</p> <ul style="list-style-type: none"> • Review the indices applied by management to assets not subject to valuation in 2025/26 and assess if these are reasonable and have been correctly applied. • Review the information provided to the valuer and assess this for completeness and accuracy. • Evaluate the competence, capabilities, and objectivity of the valuer. • Review the appropriateness of the key data and assumptions used in the 2025/26 indexation process, and challenge these where required.

Risk of material misstatement	Planned audit response
<p>Valuation of council dwellings</p> <p>Shetland Islands Council held £74.3 million of council dwellings at 31 March 2025.</p> <p>The valuations of council dwellings are significant estimates. Valuations are based on a beacon approach and specialist assumptions including discount factors, changes in which can result in material changes to valuations.</p> <p>Council dwellings were last revalued at 31 March 2024. Values may change year on year, and it is important that the council ensures the financial statements accurately reflect the value of dwellings.</p>	<p>The audit team will:</p> <ul style="list-style-type: none"> • Review management’s assessment that the value in the balance sheet of assets not subject to a formal valuation process in 2025/26 is not materially different to current value at the year-end, and challenge as required. • Review information provided to the valuer to inform the overall assessment, and assess this for completeness and accuracy. • Evaluate the competence, capabilities, and objectivity of the valuer. • Review the appropriateness of the key data and assumptions used in the assessment, and challenge where required.

Source: Audit Scotland

Key audit matters

18. The Code of Audit Practice requires public sector auditors to communicate key audit matters. Key audit matters are those matters, that in the auditor’s professional judgement, are of most significance to the audit of the financial statements and require most attention when performing the audit.

19. In determining key audit matters, auditors consider:

- areas of higher or significant risk of material misstatement
- areas where significant judgement is required, including accounting estimates that are subject to a high degree of estimation uncertainty
- significant events or transactions that occurred during the year.

20. The matters determined to be key audit matters will be communicated in the Annual Audit Report. [Exhibit 2](#) outlines the significant risks of material misstatement to the financial statements that have been identified.

21. In addition to the risks in [Exhibit 2](#), the valuation of pension assets and liabilities and the valuation of long-term investments have been identified as accounting estimates that are subject to a high degree of estimation uncertainty. Focused audit work will be undertaken to:

- assess the scope, independence and competence of management experts engaged to provide these estimates

- establish management arrangements for ensuring the reasonableness of the professional estimates and the accuracy of the information provided to the council by the expert.

22. The results of this work will be reported in our Annual Audit Report.

Wider scope audit

Introduction

23. Reflecting the fact that public money is involved, the Code of Audit Practice requires that public audit is planned and undertaken from a wider perspective than in the private sector. The wider scope audit set out by the Code of Audit Practice broadens the audit of the annual accounts to include consideration of additional aspects or risks in four wider scope areas, which are summarised below:

- **Financial Management** – this means having sound budgetary processes. Factors that can impact on the council being able to secure sound financial management include the strength of the financial management culture, accountability, and arrangements to prevent and detect fraud, error and other irregularities, bribery and corruption.
- **Financial Sustainability** – this means looking forward over the medium and longer term in planning the services to be delivered and how they will be delivered effectively. This is assessed by considering the council's medium to longer-term planning for service delivery.
- **Vision, Leadership and Governance** – this means having a clear vision and strategy, with set priorities within the vision and strategy. This is assessed by considering the clarity of plans in place to deliver the vision and strategy and the effectiveness of the governance arrangements to support delivery.
- **Use of Resources to Improve Outcomes** – this means using resources to meet stated outcomes and improvement objectives through effective planning and working with partners and communities. This is assessed by considering the council's arrangements for ensuring resources are deployed to improve strategic outcomes, meet the needs of service users, and deliver continuous improvement.

24. A conclusion on the effectiveness and appropriateness of arrangements the council has in place for each of the wider scope areas will be reported in the Annual Audit Report.

Significant wider scope risks

25. The risk assessment process has identified significant risks in the wider scope areas as outlined in [Exhibit 3](#), and this includes the planned audit procedures in response to the risks.

Exhibit 3

Significant wider scope risk

Description of risk	Planned audit response
<p>Unsustainable use of resources to balance the budget</p> <p>The council continues to use reserves to balance its annual budget. The agreed budget for 2026/27 includes an “unsustainable” draw on reserves of £26.1 million to achieve balance.</p>	<p>The audit team will:</p> <ul style="list-style-type: none"> • review medium to long term financial planning • review trends and projections for movements in reserves, including the estimated future funding gap • assess the sustainability of using reserves to balance the budget.

Source: Audit Scotland

Best Value audit

Introduction

26. Under the Code of Audit Practice, the audit of Best Value in councils is fully integrated within the annual audit. As part of the annual audit, auditors are required to take a risk-based approach to assessing and reporting on whether the council has made proper arrangements for securing Best Value, including follow up of findings previously reported in relation to Best Value.

27. The Accounts Commission also reports nationally on thematic aspects of councils' approaches to, and performance in, meeting their Best Value duties. As part of the annual audit, thematic reviews, as directed by the Accounts Commission, are conducted on the council. The thematic review for 2025/26 is on the subject of asset management and involves considering how the council is managing its assets to ensure high quality services whilst also responding to the challenges around financial sustainability and climate change. Conclusions and judgements on the thematic review will be reported in a separate Management Report and summarised in the Annual Audit Report, where required.

28. At least once over the five-year appointment, the Controller of Audit will report to the Accounts Commission on the council's performance in meeting its Best Value duties. The third year of this programme runs from October 2025 to August 2026. A Controller of Audit report on Shetland Islands Council was presented to the Accounts Commission in February 2026. We will follow up on the council's progress in addressing the Accounts Commission's findings as part of our audit work.

29. Auditors have a statutory duty to satisfy themselves that councils have made proper arrangements for preparing and publishing statutory performance information in accordance with the [Statutory Performance Information Direction 2024](#) (the Direction) issued by the Accounts Commission. The outcome of this will be reported in the Annual Audit Report, which will include:

- a conclusion on the council's arrangements for preparing and publishing the statutory performance information
- any instances where the arrangements or reporting are not in accordance with the Direction
- areas where the arrangements require to be improved.

30. In addition, the Accounts Commission requires auditors to include a summary of Local Government Benchmarking Framework (LGBF) indicators that the council has reported in the Annual Audit Report.

31. There is an expectation that equalities will be advanced through the audit process. We will carry out a high-level review of the fairness and equalities arrangements in place at the council, assess these arrangements, and report our conclusions in our 2025/26 Annual Audit Report.

Significant Best Value risks

32. No significant Best Value risks were identified from the risk assessment process. Audit work on the wider scope areas will help support conclusions around Best Value.

Reporting arrangements, timetable and audit fee

Audit outputs

33. The outputs from the 2025/26 audit include:

- this Annual Audit Plan
- an Independent Auditor's Report to the council and the Accounts Commission setting out opinions on the annual accounts
- an Annual Audit Report to the council and the Accounts Commission setting out significant matters identified from the audit of the annual accounts, conclusions from the wider scope and Best Value audit, recommendations, where required, and any good practice identified.

34. The matters to be reported in the outputs will be discussed with the council for factual accuracy before they are issued. All outputs from the audit will be published on [Audit Scotland's website](#), apart from the Independent Auditor's Report, which is included in the audited annual accounts.

35. Target dates for the audit outputs are set by the Accounts Commission. In setting the target dates for the audit outputs, consideration is given to the statutory date for approving the annual accounts, which is 30 September 2026 for local government bodies.

36. The audit team will be unable to achieve the target date of 30 September 2026 for issuing the Independent Auditor's Report and Annual Audit Report. This is due to prioritising the quality of our audit work over meeting target dates, as required by the Accounts Commission, and consistent with messaging from the Financial Reporting Council which has made clear that audit quality takes precedence. The audit team is working towards completion of the audit by for consideration at Audit Committee on 10 November 2026 and are working towards delivering the audit by target dates over the course of the five-year audit appointment.

Audit timetable

37. Achieving the timetable for production of the annual accounts, supported by complete and accurate working papers, is critical to delivery of the audit to agreed target dates. [Exhibit 4](#) includes a timetable for the

audit, which has been agreed with management. Agreed target dates will be kept under review as the audit progresses, and any changes required, and their potential impact, will be discussed with the council and reported to those charged with governance, where required.

Exhibit 4

2025/26 audit timetable

Audit activity	The council target date	Audit team target date	Audit Committee/ Council date
Issue of Annual Audit Plan	N/A	27 March 2026	14 April 2026
Annual Accounts:			
• Consideration of unaudited annual accounts by those charged with governance	30 June 2026	N/A	30 June 2026
• Submission of unaudited annual accounts and all working papers to audit team	30 June 2026	N/A	N/A
• Latest date for audit clearance meeting	16 October 2026	16 October 2026	N/A
• Issue of draft Letter of Representation, proposed Independent Auditor's Report, and proposed Annual Audit Report	N/A	27 October 2026	10 November 2026
• Agreement of audited and unsigned annual accounts	27 October 2026	N/A	10 November 2026
• Approval by those charged with governance and signing of audited annual accounts	10 November 2026 – Audit Committee 9 December 2026 - Council	N/A	10 November 2026 – Audit Committee 9 December 2026 - Council
• Signing of Independent Auditor's Report and issue of Annual Audit Report	N/A	9 December 2026	N/A
Issue of Best Value Management Report	N/A	27 October 2026	10 November 2026

Audit activity	The council target date	Audit team target date	Audit Committee/ Council date
Certification of Non-Domestic Rates Return	N/A	30 November 2026	N/A
Certification of Housing Benefit Subsidy Claim	N/A	30 November 2026	N/A

Source: Audit Scotland

Audit fee

38. The council's audit fee is determined in line with Audit Scotland's fee setting arrangements. The proposed audit fee for the 2025/26 audit is £285,690 (2024/25 - £276,245). This includes a £1,000 fee element for the additional procedures required to audit complex and hard to value investments held by the council.

39. In setting the audit fee, it is assumed that the council has effective governance arrangements in place and the complete annual accounts will be provided for audit in line with the agreed timetable. The audit fee assumes there will be no significant changes to the planned scope of the audit. Where the audit cannot proceed as planned, for example, due to incomplete or inadequate working papers, the audit fee may need to be increased.

Other matters

Internal audit

40. The council is responsible for establishing an internal audit function as part of an effective system of internal control. As part of the audit, the audit team will obtain an understanding of internal audit, including its nature, responsibilities, and activities.

41. While internal audit and external audit have differing roles and responsibilities, external auditors may seek to rely on the work of internal audit where it is considered appropriate. A review of internal audit's 2025/26 audit plan was carried out to identify if there were any areas where the audit team could rely on its work. The audit team concluded it will not rely on internal audit's work. However, the audit team will review internal audit's reports and assess if there is any impact on the audit.

Audit quality

42. Audit Scotland is committed to the consistent delivery of high-quality audit. Audit quality requires ongoing attention and improvement to keep pace with external and internal changes. Details of the arrangements in place for the delivery of high-quality audits is available from the [Audit Scotland website](#).

43. The International Standards on Quality Management (ISQM) applicable to Audit Scotland for 2025/26 audits are:

- ISQM (UK) 1, which deals with an audit organisation's responsibilities to design, implement, and operate a system of quality management (SoQM) for audits. Audit Scotland's SoQM consists of a variety of components, such as governance arrangements and culture to support audit quality, compliance with ethical requirements, ensuring Audit Scotland is dedicated to high-quality audit through engagement performance and resourcing arrangements, and ensuring there are robust quality monitoring arrangements in place. Audit Scotland carries out an annual evaluation of its SoQM and has concluded it complies with this standard.
- ISQM (UK) 2, which sets out arrangements for conducting engagement quality reviews, which are performed by senior management not involved in an audit, to review significant judgements and conclusions reached by the audit team, and the appropriateness of proposed audit opinions on high-risk audits.

44. To monitor quality at an individual audit level, Audit Scotland carries out internal quality reviews on a sample of audits. Additionally, the Institute of Chartered Accountants of England and Wales (ICAEW) carries out independent quality reviews on a sample of audits.

45. Actions to address deficiencies identified by internal and external quality reviews are included in a rolling Quality Improvement Action Plan, which is used to support continuous improvement. Progress with implementing planned actions is monitored on a regular basis by Audit Scotland's Quality and Ethics Committee.

46. Audit Scotland may periodically seek the views of the council on the quality of audit services provided. The audit team would also welcome feedback at any time.

Shetland Islands Council

Annual Audit Plan 2025/26



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