



**Item: 1**

**Monitoring and Audit Committee: 4 June 2026.**

**External Audit Annual Plan.**

**Report by Director of Enterprise and Resources.**

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## **1. Overview**

- 1.1. This report presents the External Audit Plan for 2025/26, for members' information.
- 1.2. The Accounts Commission appointed KPMG as external auditor of the Council for the five-year period 2023 to 2028.
- 1.3. The auditor's responsibilities as independent appointed auditor is established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, including supplementary guidance, and are guided by the auditing profession's ethical guidance.
- 1.4. The Annual Audit Plan, attached at Appendix 1, contains an overview of the planned scope and timing of the audit. The plan identifies the audit work required to provide an opinion on the financial statements and related matters and to meet the wider scope requirements of public sector audit including the approach to Best Value.
- 1.5. The wider scope of public audit contributes to conclusions on the appropriateness, effectiveness and impact of corporate governance, financial management and financial sustainability, value for money and best value arrangements.

## **2. Recommendations**

- 2.1. It is recommended that members of the Committee:
  - i. Note the external audit plan for 2025/26, prepared by KPMG, attached as Appendix 1 to this report.

## **3. Audit Plan 2025/26**

- 3.1. The indicative audit materiality is outlined on page 4 of the Audit Plan 2025/26, attached as Appendix 1 to this report, and is set at £5.3m. The significant audit risks identified by the auditors are listed in the table on page 5 and detailed on pages 6 to 9. The group accounts scope is shown on page 10.

- 3.2. The overall Financial Statements cycle, including reporting arrangements, is represented by the diagram on page 11. The deadline for completion of the Audit and reporting to the Accounts Commission is 30 September 2026.
- 3.3. Pages 12 to 20 of the attached Audit Plan details the Wider Scope to be undertaken by the auditors in respect of Best Value regarding the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources. Included within the Wider-Scope, the auditors are required to report on a Best Value related theme prescribed by the Accounts Commission. For the 2025/26 audit, the theme is "asset management".
- 3.4. The auditor's mandatory communication in respect of their responsibilities and independence is included on page 23. This includes the expression of an opinion on the financial statements. The opinion shall cover whether the financial statements have been properly prepared in accordance with the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014, the Local Government in Scotland Act 2003 and the 2025 to 2026 Code of Practice on Local Authority Accounting in the United Kingdom.

**For Further Information please contact:**

Gareth Waterson, Director of Enterprise and Resources, extension 2521, Email [Gareth.Waterson@orkney.gov.uk](mailto:Gareth.Waterson@orkney.gov.uk).

**Implications of Report**

1. **Financial** Audit Scotland's fee proposal for the 2025/26 audit is £253,350. This is an increase of £10,540 or 4.3% from the 2024/25 audit fee. The expected fee is calculated by Audit Scotland and billed to each entity within its remit.
2. **Legal** Arranging for the provision of external audit and review helps the Council meet its statutory obligations to secure best value.
3. **Corporate Governance** In terms of the Scheme of Administration, review of External Audit's annual audit plan is a referred function of the Monitoring and Audit Committee.
4. **Human Resources** N/A.
5. **Equalities** An Equality Impact Assessment is not required.
6. **Island Communities Impact** An Island Communities Impact Assessment is not required.
7. **Links to Council Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Council Plan strategic priorities:
  - Growing our economy.

Strengthening our communities.

Developing our Infrastructure.

Transforming our Council.

**8. Links to Local Outcomes Improvement Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Local Outcomes Improvement Plan priorities:

Cost of Living.

Sustainable Development.

Local Equality.

Improving Population Health.

**9. Environmental and Climate Risk** N/A.

**10. Risk** N/A.

**11. Procurement** N/A.

**12. Health and Safety** N/A.

**13. Property and Assets** N/A.

**14. Information Technology** N/A.

**15. Cost of Living** N/A.

#### **List of Background Papers**

None

#### **Appendix**

Appendix 1: KPMG – Indicative External Audit Plan for the year ended 31 March 2025.



# External Audit Plan for the year ended 31 March 2026

**Orkney Islands Council**

**DRAFT**

**12 May 2026**

## Key contacts

Your key contacts in connection with this report are:

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### About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's Code of Audit Practice ("the Code").

This report is intended for the benefit of Orkney Islands Council ("the Council") and is made available to Audit Scotland and the Controller of Audit (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report and it will not be quoted or referred to, in whole or in part, without our prior written consent. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scoping and purpose section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

# Introduction

## To the Monitoring and Audit Committee of Orkney Islands Council

We are pleased to have the opportunity to meet with you on 4 June 2026 to discuss our anticipated approach to the audit of the financial statements of Orkney Islands Council, as at and for the year ending 31 March 2026.

We provide this report to you in advance of the meeting to allow you time to consider the key matters and formulate your questions.

### The engagement team

Michael Wilkie is the engagement leader on the audit. Michael will lead the engagement and is responsible for the audit opinion. Taimoor Alam will be the senior manager responsible for the audit and will be responsible for overseeing the delivery of our audit. Other key members of the engagement team include Michelle Ho (In-charge auditor).

Yours sincerely,  
Michael Wilkie  
12 May 2026

### How we deliver audit quality

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. We consider risks to the quality of our audit in our engagement risk assessment and planning discussions.

We define 'audit quality' as being the outcome when audits are:

- **Executed consistently**, in line with the requirements and intent of **applicable professional standards** within a strong **system of quality controls**; and
- All of our related activities are undertaken in an environment of the utmost level of **objectivity, independence, ethics and integrity**.

We are committed to providing you with a high-quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Michael Wilkie ([Michael.Wilkie@kpmg.co.uk](mailto:Michael.Wilkie@kpmg.co.uk)), the engagement lead to the Council, who will try to resolve your complaint. If you are dissatisfied with the response, please contact the national lead partner for all of KPMG's work under our contract with Audit Scotland, Tim Cutler ([tim.culter@kpmg.co.uk](mailto:tim.culter@kpmg.co.uk)).

### Restrictions on distribution

This report is intended solely for the information of those charged with governance of Orkney Islands Council and the report is provided on the basis that it should not be distributed to other parties; that it will not be quoted or referred to, in whole or in part, without our prior written consent; and that we accept no responsibility to any third party in relation to it.

# Materiality (Group and Council)

Total group expenditure\*  
£247m

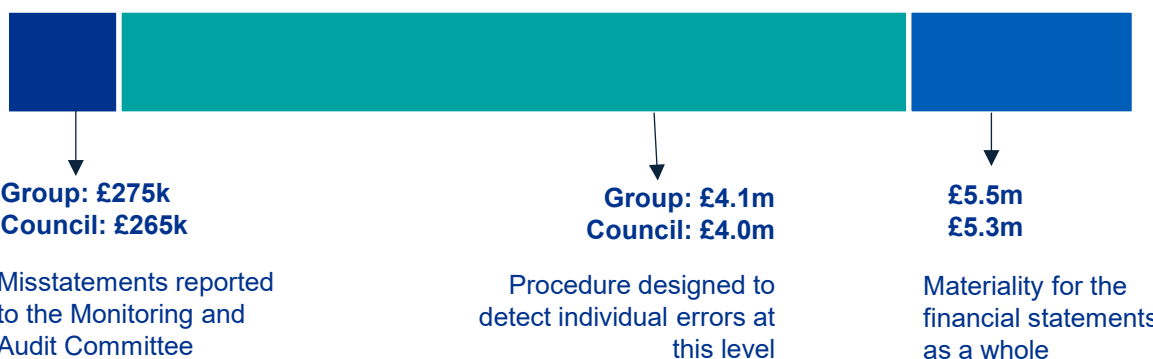
Total council expenditure\*  
£240m

\*Based on 2024-25 financial statements.



Group materiality  
£5.5m, 2.2% of total expenditure  
(PY £5.5m, 2.2% of total expenditure)

Council materiality  
£5.3m, 2.2% of expenditure  
(PY £5.3m, 2.2% of total expenditure)



## Our materiality levels

We determine materiality for the consolidated financial statements at a level which could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. We expect to use a benchmark of total expenditure for cost of services (before asset impairments and defined benefit pension charges) which we consider to be appropriate as it reflects the scale of the Authority's services and we consider this most clearly reflects the interests of users of the Authority's accounts. To respond to aggregation risk from individually immaterial misstatements, we design our procedures to detect misstatements at a lower level of performance materiality. We also adjust this level further downwards for items that may be of specific interest to users for qualitative reasons, such as information in the remuneration report.

## Reporting to the audit and risk committee

Under ISA 260, we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

In the context of the Council and its Group, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £265k and £275k respectively.

If management has corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Monitoring and Audit Committee to assist it in fulfilling its governance responsibilities.

# Audit risks and our audit approach

**Our risk assessment draws upon our knowledge of the industry and the wider economic environment in which Orkney Islands Council operates.**

We also use our regular meetings with senior management to update our understanding.

## Relevant factors affecting our risk assessment

### Significant risks

- 1 Valuation of land and building and Investment Properties  
(revaluation required by the Code and a new requirement for indexation required in respect of 2025/26 for the first time)
- 2 Retirement benefit obligations  
(assumptions and methodology)
- 3 Fraud risk from management override of controls  
(presumed risk per ISA 240)
- 4 Fraud risk from income recognition\* and expenditure  
(presumed risk per ISA 240)

\* We expect to rebut fraud risk from income recognition (see page 9).

### Wider Scope and Best Value

We are required to provide commentary on the arrangements in place in relation to wider scope and best value and report on this via our Auditor's Annual Report. This will be published on the Council's website and will include a commentary on our view of the appropriateness of the Council's arrangements against each of the four dimensions of wider scope and best value.

We have outlined the approach and results of risk assessment procedures on pages 13 to 20.

# Audit risks and our audit approach

## 1. Valuation of land and buildings, and Investment Properties

### Significant audit risk

#### **Risk: The carrying amount of revalued assets differs materially from the fair value**

The value of the Council's Other Land and Buildings at 31 March 2025 was £359.6m, and Investment Property was £23m.

The Code of Practice on Local Authority Accounting in the UK 2025/26 ('the Code') has introduced changes to asset revaluation. The Code requires revaluations for each class of PPE are undertaken using one of the following:

- A quinquennial revaluation, supplemented by annual indexation in intervening years.
- A rolling programme of revaluations over a five-year cycle, with annual indexation applied to assets during the intervening four years.

There is a risk that the carrying value of assets not revalued in year differs materially from the year end current value as the indexation applied is not appropriate.

A further risk is presented for those assets that are revalued in year as valuations are inherently judgmental and there is a risk of error that the assumptions are not appropriate or correctly applied.

### Planned response

We will perform the following procedures designed to specifically address the significant risk associated with the assets revalued in year:

- We will critically assess the independence, objectivity and expertise of the valuers used in developing the valuation of the Council's properties at 31 March 2026;
- We will inspect the instructions issued to the valuers for the valuation of land and buildings to verify they are appropriate to produce a valuation consistent with the requirements of the Code;
- We will compare the accuracy of the data provided to the valuers for the development of the valuation to underlying information;
- We will evaluate the design and implementation of controls in place for management to review the valuation and the appropriateness of assumptions used;
- We will challenge the appropriateness of the valuation of land and buildings; including any material movements from the previous revaluations. We will challenge key assumptions within the valuation as part of our judgement;
- We will agree the calculations performed of the movements in value of land and buildings and verify that these have been accurately accounted for in line with the requirements of the Code;
- We will utilise our own valuation specialists to review the valuation report prepared by the Council's valuers to confirm the appropriateness of the methodology utilised;
- Disclosures: We will consider the adequacy of the disclosures concerning the key judgements and degree of estimation involved in arriving at the valuation; and
- In respect of the new accounting requirement applicable in 2025/26 we will challenge the appropriateness of the indices used and agree the indexations applied.

# Audit risks and our audit approach

## 2. Risk of retirement benefit obligations

### Significant audit risk

#### **Risk: An inappropriate amount is estimated and recorded for the defined benefit obligation**

The valuation of the Local Government Pension Scheme (Orkney Pension Fund) relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation.

There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions should be derived on a consistent basis year to year, or updated to reflect any changes.

There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.

Pension Funds in surplus pose an additional risk to Councils, as the entity will need to assess the level of surplus that it can recognise. This will need to be assessed each year, and the conclusion can change from one year to the next based on facts and circumstances for each participation.

*We do not consider there to be a significant level of estimation uncertainty over the valuation of the LGPS assets in year end valuation on the basis that this calculation is completed using an appropriate roll forward method. As a result procedures performed over this element of the valuation are not detailed in our audit plan.*

### Planned Response

#### *Control design:*

- Testing the design and operating effectiveness of controls over the provision of membership information to the actuary who uses it, together with management's review of assumptions, to calculate the pension obligation.

#### *Benchmarking assumptions:*

- Challenging, with the support of our own actuarial specialists, the key assumptions applied, being: the discount rate; inflation rate; and mortality/life expectancy against externally derived data.
- Challenging the rate of increase in pensionable salaries assumption, by comparing it to other evidence such as business and transformation plans and our understanding of Government and staff expectations.

#### *Assessing transparency:*

- Considering the adequacy of the disclosures in respect of the sensitivity of the liabilities to these assumptions.
- Assessing if the disclosures within the financial statements are in accordance with the 2025-26 Code's requirements.
- Assess the level of surplus that may be recognised by the Council

# Audit risks and our audit approach

## 3. Management override of controls

### Significant audit risk

**Risk: Fraud risk related to unpredictable way management override of controls may occur**

Professional standards require us to communicate the fraud risk from management override of controls as significant.

Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

We have not identified any specific additional risks of management override relating to this audit.

### Planned response

- Our audit methodology incorporates the risk of management override as a default significant risk.
- Assess accounting estimates for biases by evaluating whether judgements and decisions in making accounting estimates, even if individually reasonable, indicate a possible bias.
- Evaluate the selection and application of accounting policies.
- In line with our methodology, evaluate the design and implementation of controls over journal entries and post closing adjustments.
- Assess the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates.
- Assess the business rationale and the appropriateness of the accounting for significant transactions that are outside the Council's normal course of business or are otherwise unusual.
- 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.
- Identify journal entries and other adjustments with characteristics that indicate that they may be inappropriate or unauthorised and therefore may have been used to manipulate the financial statements (which we refer to as 'high-risk journals and other adjustments'), using high risk criteria and perform procedures to test the appropriateness of these entries and adjustments.

# Audit risks and our audit approach

## 4. Risk from income recognition and expenditure

### Significant audit risk

Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. This requirement is modified by Practice Note 10, issued by the FRC, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

#### *Income*

We consider that the Council's significant income streams, which include taxation and non-specific grant income are likely to be free of management judgement or estimation. At the planning stage, we do not consider recognition of the remaining income sources to represent a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised, and these are not likely to be materially inappropriate.

**We therefore plan to rebut this risk and do not incorporate specific work into our audit plan in this area beyond our standard fraud procedures.**

#### *Expenditure*

We consider that there is not a risk of improper recognition of expenditure in respect of payroll costs (including pension adjustments), financing and investment expenditure, or depreciation. These costs are routine in nature and are at less risk of manipulation. This relates to a significant proportion of council expenditure.

**We have not rebutted the assumed risk in respect of the remaining expenditure of and consider the risk will be most likely to arise in respect of understatement of expenditure around year-end, which at the planning stage we consider could result in a risk around the completeness.**

This arises from a combination of incentives, including the incentive to deliver the overall budget outturn for the year, as well as incentives within services locally to use but not exceed allocated budgets by year-end.

In response to the expected significant risk relating to recognition of non-pay expenditure, we will include procedures to:

- compare the outturn with the in-year budget monitoring, considering variances;
- compare the year-end accruals and payables balances with those recognised at 31 March 2025 to identify any new accruals as well as any recorded in the prior period which have not been recognised at 31 March 2026;
- test expenditure cut-off including a search for unrecorded liabilities; and
- test transactions focusing on the areas of greatest risk in terms of subjectivity, which provide the most opportunity to manipulate the year-end outturn, including creditors, accruals and provisions to challenge completeness of these balances.

# Group audit scope

## Group Companies

The table below shows the entities that the Council have included in the scope of the Group Financial Statements.

Entity
Orkney Islands Council (Parent)
Orkney Ferries Limited (Subsidiary)
Pickaquoy Centre Trust (Subsidiary)
Hammers Hill Energy Limited (Associate)
Orkney Integration Joint Board (Joint Venture)

*Source: 2024-25 OIC Financial Statements*

## Group Audit Scope:

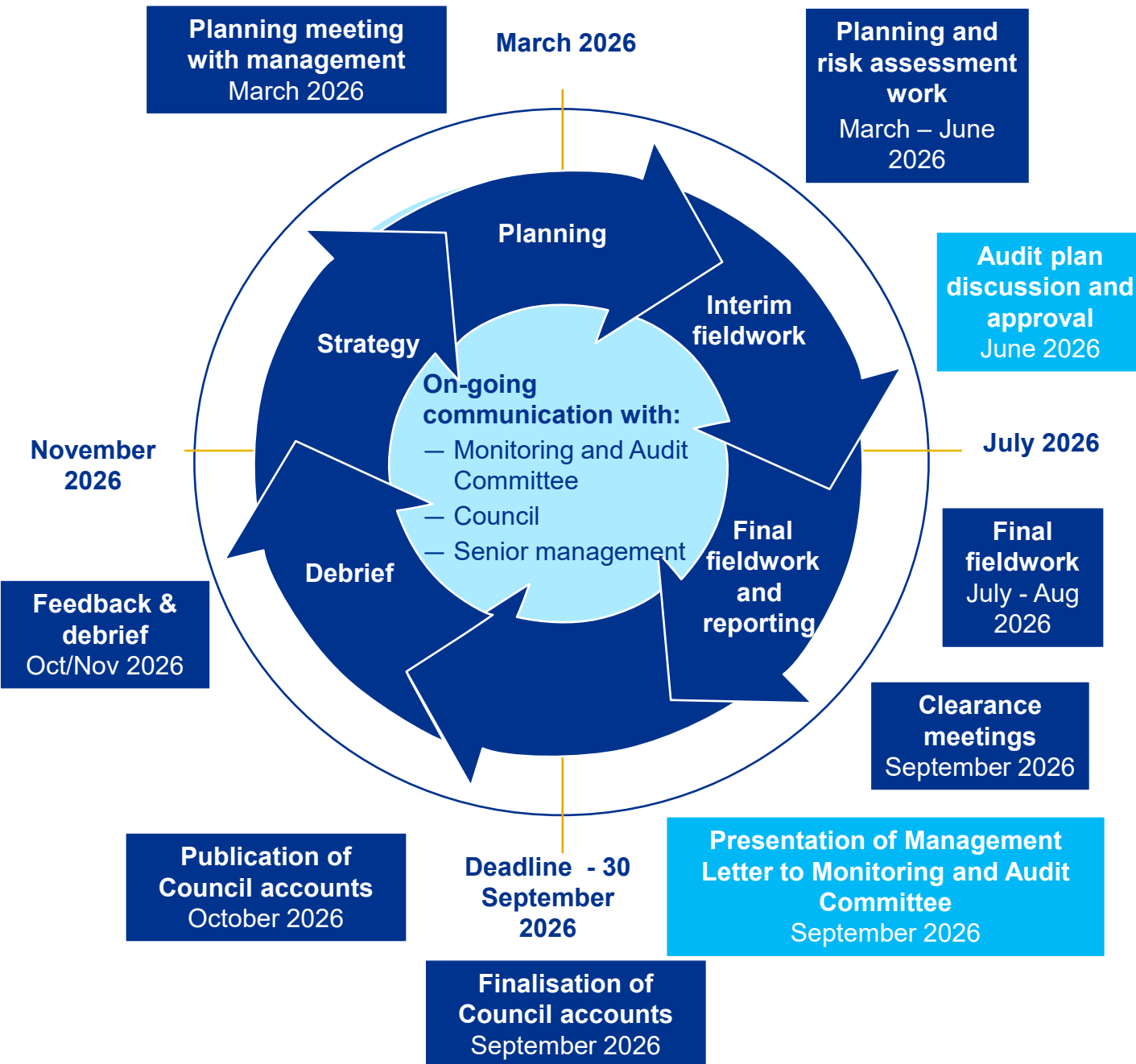
We have assessed from a Group perspective the following:

- Orkney Islands Council (Parent) (**Significant** - Full Audit);
- Orkney Integration Joint Board (**Non-significant** - Full Statutory Audit);
- Orkney Ferries Limited (**Non-significant** - we will consider associated pension balances as we continue risk assessment and planning);
- Pickaquoy Centre Trust (**Non-significant**); and
- Hammers Hill Energy Limited (**Non-significant**).

Where any changes are identified based on draft financial statements for 2025/26, when available, we will amend our audit approach accordingly and communicate this to the Audit Committee.

# Audit cycle and expected timetable

## Our 2025/26 schedule



- Key Events
- MAAC communications



# Wider scope and best value approach

Orkney Islands Council

# Wider Scope and Best Value

## Wider Scope Approach

The Code of Audit Practice sets out four areas that constitute the wider scope of public audit in Scotland: financial sustainability; financial management; vision, leadership and governance; and use of resources to improve outcomes.

We set out below an overview of our approach to wider scope requirements of our annual audit.

### Local Risk assessment

We are required to consider the arrangements in place for the wider-scope areas when undertaking annual risk assessment with a view to preparing the Annual Audit Plan,

As part of our risk assessment, we have considered the arrangements in place for the wider-scope areas and have summarised the results of our assessment and our planned response on the following pages.

### National Risk assessment

Guidance may supplement auditors' own local risk assessments where there are particular areas of national or sectoral risk that the Auditor General and the Accounts Commission wish auditors to consider. However, there are no such risks specified for 2025/26.

# Wider Scope and Best Value

## Wider Scope Approach (continued)

### Financial Management

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

#### Risk Assessment

As part of our previous year audit, we noted that:

- Council has established budget setting and monitoring systems.
- There are established procedures for preventing and detecting fraud.
- Council has an established Internal Audit system.
- Based on above we have not identified any significant risks in relation to financial management.

#### Planned Audit Response

We will continue to review the financial management arrangements in place.

# Wider Scope and Best Value

## Wider Scope Approach (continued)

### Financial Sustainability

**Financial Sustainability** looks forward to the medium and longer term to consider whether the Council is planning effectively to continue to deliver its services or the way in which they should be delivered.

#### Risk Assessment

As part of our previous year audit we noted that the Council has a number of arrangements in place, in relation to financial sustainability, including a medium-term financial strategy, capital programme and reserves strategy.

We made recommendations in prior years with respect of aspects of the above relating to:

- development of specific plans to bridge the gap identified as part of the medium-term financial strategy in a sustainable manner; and
- sustainable use of the strategic reserve fund.

Based on above a possible risk in relation to financial sustainability may exist.

#### Audit Approach

- We will continue to consider the Council's long term financial plans, as well as underlying specific plans, and its ability to adapt to the changing landscape in local government funding. This will involve consideration of the 2026-27 budget and longer-term financial plans including approach to, and planned use of reserves.
- We will inquire with officers regarding reporting to members surrounding the assumptions and judgements made in forecasting future funding and expenditure pressures.
- We will follow-up on the progress made in relation to our recommendations from prior years.

# Wider Scope and Best Value

## Wider Scope Approach (continued)

### Vision, Leadership and Governance

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

#### **Risk Assessment**

As part of our previous year audit we noted that:

- Council has an established strategic planning process.
- Directorate Delivery plans have been developed.
- Governance arrangements are in place and operative.
- Arrangements are in place in relation to scrutiny, challenge and transparency

Based on above we have not identified any significant risk in relation to the Council's arrangements around vision, leadership and governance dimension of the wider scope audit.

#### **Audit Approach**

We will continue to review the arrangements in place in relation to vision, leadership and governance.

# Wider Scope and Best Value

## Wider Scope Approach (continued)

### Use of Resources to Improve Outcomes

**Use of Resources to Improve Outcomes** is concerned with demonstrating economy, efficiency, and effectiveness through the use of financial and other resources and reporting performance against outcomes.

#### Risk Assessment

As part of our prior year audit we noted that Performance management arrangements are in place to provide a basis for improvement. We made a recommendation that the Strategic Planning and performance Framework was set in 2019 and needs to be updated to align with the new Council plan.

We further noted the availability of the performance related information on the Council's webpage.

Based on above we have not identified any significant risk in relation to the Council's arrangements around use of resources to improve outcomes.

#### Audit Approach

- We will continue to review the relevant arrangements in place including arrangements in place in relation to compliance with the effective of performance reporting requirement as part of the best value audit.
- We will follow-up on the progress made in relation to our prior year recommendation.

# Wider Scope and Best Value

## Best Value Approach

Local government bodies have a duty under the Local Government in Scotland Act 2003 to make arrangements which secure Best Value. Best Value is continuous improvement in the performance of the body's functions.

Local government bodies are required to follow statutory guidance in respect of their Best Value duties.

The wider scope of core annual audit activity in local government includes the statutory duty of auditors under section 99(1)(c) of the Local Government (Scotland) Act 1973 (the 1973 Act) to be satisfied that bodies have made proper arrangements to secure Best Value.

Paragraph 60 of the Code of Audit Practice (2021) extends this responsibility to other sectors and requires auditors to consider the arrangements put in place by Accountable Officers to meet their Best Value obligations. The audit of Best Value in councils is fully integrated within the annual audit work.

There are the following five aspects to auditors' work:

- Following up previous improvement actions.
- Risk based evaluation of the arrangements in place to secure Best Value.
- Assessing the arrangements for statutory performance information, and reporting a summary of the indicators reported by the local authority.
- Thematic reviews.
- Contributing to Controller of Audit reports.

### Follow up

This involves follow up on Accounts Commission findings, Controller of Audit recommendations and any outstanding improvement actions reported in Best Value Assurance Reports, Best Value thematic reports and Annual Audit Reports.

We will establish the progress made against the actions, make judgements on the pace and depth of improvements and report judgements in the Annual Audit Report where relevant.

### Evaluation of arrangements in place

The statutory guidance which councils are required to follow sets out seven Best Value themes. The guidance details for each of the themes what a council should be able to demonstrate to achieve Best Value. The wider scope areas referred to in Section 3 of the planning guidance are aligned with the Best Value themes.

consideration by appointed auditors of the wider scope areas also means de facto consideration of all the Best Value themes.

# Wider scope and Best Value

## Best Value Approach (continued).

### Arrangements for statutory performance management

Commission issued a new Statutory Performance Information Direction in 2024 which applies in 2025/26 for the first time. Complying with the Direction is fundamental to councils fulfilling their duty to secure Best Value.

The Direction expects indicators from the Local Government Benchmarking Framework (LGBF) be used as the primary means of facilitating comparisons.

Audit Scotland has issued guidance to assist councils in understanding and meeting the requirements of the Direction. The guidance provides further information and explanation regarding aspects of the Direction, and a set of examples of good practice

In evaluating a council's arrangements in 2025/26, we will evaluate compliance with the Direction using the supporting guidance.

### Thematic review

We are required to report on Best Value or related themes prescribed by the Accounts Commission. The thematic work for 2025/26 is on the subject of asset management.

We will consider how the Council is managing its assets to ensure high quality services whilst also responding to challenges around financial sustainability and climate change.

We are required to report our findings on the thematic review in a separate management report.

### Controller of Audit reports

The Controller of Audit also reports to the Accounts Commission on each council's performance in meeting its Best Value duties at least once over the five-year audit appointment.

The reporting on the Council was completed in a prior year.

# Wider Scope and Best Value

## Linkages with other audit work

There is a degree of overlap between the work we do as part of the wider scope and Best Value audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Council's organisational control environment, many aspects of which are relevant to our wider scope and Best Value audit responsibilities.

We seek to avoid duplication of audit effort by integrating our financial statements, wider scope and Best Value work.

## Reporting and concluding on wider scope and Best Value

At the conclusion of the wider scope and Best Value work we include relevant observations and recommendations in the Annual Audit Report.

We will update our assessment throughout the year and should any issues present themselves we will report them in our Annual Audit Report.

We will report on the results of the wider scope and Best Value audit through our Annual Audit Report and the best value management report. This will summarise any specific matters arising, and the basis for our overall conclusion.

# Other core annual audit activities

## Other Audit Outputs

Paragraph 81 of the Code of Audit Practice (2021) advises that the following other outputs may be required from appointed auditors as core annual audit activity in accordance with guidance from Audit Scotland:

- Certificates on grant claims and similar returns prepared by audited bodies.
- Assurance statements for Whole of Government Accounts returns or other consolidation schedules.
- Reports on summary financial information.

## Information Returns

Paragraph 104 of the Code of Audit Practice requires appointed auditors to complete information returns as a core annual audit activity. The information returns required for 2025/26 are as follows:

Contributions to performance audit work

Current Issues Returns

Fraud Returns

Contributing to Technical Guidance Notes (TGNs).

Further core annual audit activity undertaken by appointed auditors and their teams also includes the responsibilities and activities set out in chapter 7 of the Guidance on planning the annual audit 2025/26 annual audits of public bodies.



# Appendices

# Mandatory communications

Type	Statement
Management's responsibilities (and, where appropriate, those charged with governance)	<p>Prepare financial statements in accordance with the applicable financial reporting framework that are free from material misstatement, whether due to fraud or error.</p> <p>Provide the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.</p>
Auditor's responsibilities	Our engagement letter with Audit Scotland communicates our responsibilities to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
Auditor's responsibilities - Fraud	This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.
Auditor's responsibilities – Other information	Our engagement letter with Audit Scotland communicates our responsibilities with respect to other information in documents containing audited financial statements. We will report to you on material inconsistencies and misstatements in other information.
Auditor's responsibilities – wider scope and best value	Our wider scope and best value methodology slide on pages 13 - 20 set out our responsibilities for reporting on wider scope and best value. We have set out on these pages the methodology we will adopt in discharging our responsibilities in these areas.
Independence	Our independence confirmation on page 24 discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff.

## Confirmation of independence

We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Partner and audit staff is not impaired.

### To the Monitoring and Audit Committee members

#### Assessment of our objectivity and independence as auditor of the Orkney Islands Council (“the Council”)

Professional ethical standards require us to provide to you at the planning stage of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP’s objectivity and independence, the threats to KPMG LLP’s independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP’s objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

#### General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings.

Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews

We are satisfied that our general procedures support our independence and objectivity.

#### Independence and objectivity considerations relating to the provision of non-audit services

There are no non-audit services applicable.

#### Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit Committee.

#### Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the partner and audit staff is not impaired.




This report is intended solely for the information of the Monitoring and Audit Committee and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully  
KPMG LLP

# Audit team and rotation

Your audit team has been drawn from our specialist public sector audit department and is led by key members of staff who will be supported by auditors and specialists as necessary to complete our work. We also ensure that we consider rotation of your audit director and firm.

	<p>Michael Wilkie is the partner responsible for our audit. He will lead our audit work, attend the Monitoring and Audit Committee and be responsible for the opinions that we issue.</p>
	<p>Taimoor Alam is the lead senior manager responsible for our audit. He will co-ordinate our audit work, and Wider Scope and Best Value work, attend the Monitoring and Audit Committee and ensure we are co-ordinated across our accounts and wider scope work.</p>
	<p>Michelle Ho is the in-charge responsible for our audit. She will be responsible for our on-site fieldwork. She will complete work on more complex section of the audit.</p>

To comply with professional standard we need to ensure that you appropriately rotate your external audit director. There are no other members of your team which we will need to consider this requirement for:



This will be Michael's fourth year as your engagement lead. He can therefore complete a further 6 years before rotation.

## Appendix four

# Fees

An expected fee is calculated by Audit Scotland to each entity within its remit. This expected fee is made up of four elements:

- Auditor remuneration (average of Tender values)
- Audit Scotland Pooled costs
- Contribution to PABV costs
- Audit Scotland sectoral cap adjustment

The expected fee for each body assumes that it has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for the audit.

Entity	2025/26	2024/25
Auditor Remuneration	£238,910	£230,170
Pooled Costs	£8,240	£5,780
PABV Contribution	£47,390	£46,960
Sectoral Cap Adjustment	-£41,190	-£40,100
<b>TOTAL AUDIT FEES</b>	<b>£253,350</b>	<b>£242,810</b>

**Source: Audit Scotland**

## Billing arrangements

Fees will be billed by Audit Scotland in accordance with a billing schedule as outlined in correspondence with management.

## Basis of fee information

In line with our standard terms and conditions the fee is based on the following assumptions:

- The Group's audit evidence files are completed to an appropriate standard (we will liaise with management separately on this);
- Draft statutory accounts are presented to us for audit subject to audit and tax adjustments;
- Supporting schedules to figures in the accounts are supplied; A trial balance together with reconciled control accounts are presented to us;
- All deadlines agreed with us are met;
- We find no weaknesses in controls that cause us to significantly extend procedures beyond those planned;
- Management will be available to us as necessary throughout the audit process; and
- There will be no changes in deadlines or reporting requirements.

We will provide a list of schedules to be prepared by management stating the due dates together with pro-forms as necessary. Our ability to deliver the services outlined to the agreed timetable and fee will depend on these schedules being available on the due dates in the agreed form and content.

If there are any variations to the above plan, we will discuss them with you and agree any additional fees before costs are incurred wherever possible.

# Responsibility in relation to fraud

We are required to consider fraud and the impact that this has on our audit approach. We will update our risk assessment throughout the audit process and adapt our approach accordingly.

## Management responsibilities

Adopt sound accounting policies.  
With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.  
Establish proper tone/culture/ethics.  
Require periodic confirmation by employees of their responsibilities.  
Take appropriate action in response to actual, suspected or alleged fraud.  
Disclose to Monitoring and Audit Committee and auditors:

- Any significant deficiencies in internal controls; and
- Any fraud involving those with a significant role in internal controls

## KPMG's response to identified fraud risk factors

Accounting policy assessment.  
Evaluate design of mitigating controls.  
Test effectiveness of controls.  
Address management override of controls.  
Perform substantive audit procedures.  
Evaluate all audit evidence.  
Communicate to Audit and Risk Committee and management.

## KPMG's identification of fraud risk factors

Review of accounting policies.  
Results of analytical procedures.  
Procedures to identify fraud risk factors.  
Discussion amongst engagement personnel.  
Enquiries of management, Monitoring and Audit Committee, and others.  
Evaluate broad programmes and controls that prevent, deter, and detect fraud.

## KPMG's identified fraud risk factors

—Whilst we consider the risk of fraud at the financial statement level to be low for the Council, we will monitor the following areas throughout the year and adapt our audit approach accordingly:

- Income recognition;
- Cash;
- Procurement;
- Management control override; and
- Assessment of the impact of identified fraud.

# Audit Scotland code of audit practice – responsibility of auditors and management

## Responsibilities of management

### Financial Statements

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation;
- maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures;
- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council;
- maintaining proper accounting records; and
- preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer- term financial sustainability of the body.

Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

Audited bodies are responsible for providing the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.

# Audit Scotland code of audit practice – responsibility of auditors and management

## Responsibilities of management

### Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

### Corporate governance arrangements

Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Audit and Risk Committees or equivalent) in monitoring these arrangements.

### Financial position

Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and their future use;
- how they plan to deal with uncertainty in the medium and longer term; and
- the impact of planned future policies and foreseeable developments on their financial position.

### Best Value, use of resources and performance

The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

# Audit Scotland code of audit practice – responsibility of auditors and management

## Responsibilities of auditors

### Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, ISAs, professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards;
- provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
- review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns;
- notify the Auditor General when circumstances indicate that a statutory report may be required;
- participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
- demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies:
  - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
  - suitability and effectiveness of corporate governance arrangements; and
  - financial position and arrangements for securing financial sustainability.

Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.

# Audit Scotland code of audit practice – responsibility of auditors and management

Responsibilities of auditors
<p><b>General principles</b></p> <p>This Code is designed such that adherence to it will result in an audit that exhibits these principles.</p>
<p><b>Independent</b></p> <p>When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the FRC ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour.</p> <p>Our independence confirmation letter (<b>Appendix two</b>) discloses matters relating to our independence and objectivity including any relationships that may bear on the firm’s independence and the integrity and objectivity of the audit engagement partner and audit staff.</p> <p>We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Director and audit staff is not impaired.</p>
<p><b>Proportionate and risk based</b></p> <p>Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies’ self-assessment and self - evaluation evidence when assessing and identifying audit risk.</p>
<p><b>Quality focused</b></p> <p>Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.</p>

# Audit Scotland code of audit practice – responsibility of auditors and management

## Responsibilities of auditors

### Coordinated and integrated

It is important that auditors coordinate their work with internal audit, Audit Scotland, other external auditors and relevant scrutiny bodies to recognise the increasing integration of service delivery and partnership working within the public sector. This would help secure value for money by removing unnecessary duplication and also provide a clear programme of scrutiny activity for audited bodies.

### Public focussed

The work undertaken by external audit is carried out for the public, including their elected representatives, and in its interest. The use of public money means that public audit must be planned and undertaken from a wider perspective than in the private sector and include aspects of public stewardship and best value. It will also recognise that public bodies may operate and deliver services through partnerships, arm's-length external organisations (ALEOs) or other forms of joint working with other public, private or third sector bodies.

### Transparent

Auditors, when planning and reporting their work, should be clear about what, why and how they audit. To support transparency the main audit outputs should be of relevance to the public and focus on the significant issues arising from the audit.

### Adds value

It is important that auditors recognise the implications of their audit work, including their wider scope responsibilities, and that they clearly demonstrate that they add value or have an impact in the work that they do. This means that public audit should provide clear judgements and conclusions on how well the audited body has discharged its responsibilities and how well they have demonstrated the effectiveness of their arrangements. Auditors should make appropriate and proportionate recommendations for improvement where significant risks are identified.

# KPMG's Audit Quality framework

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.

To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.

Responsibility for quality starts at the top through our governance structures as the UK Board is supported by the Audit Oversight Committee, and accountability is reinforced through the complete chain of command in all our teams.



## ■ Commitment to continuous improvement

- Comprehensive effective monitoring processes
- Significant investment in technology to achieve consistency and enhance audits
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

## ■ Performance of effective & efficient audits

- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching, including the second line of defence model
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Insightful, open and honest two way communications

## ■ Commitment to technical excellence & quality service delivery

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights

## ■ Association with the right entities

- Select entities within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management

## ■ Clear standards & robust audit tools

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- KPMG Clara incorporating monitoring capabilities at engagement level
- Independence policies

## ■ Recruitment, development & assignment of appropriately qualified personnel

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members and specialists

Source: KPMG





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