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Scottish Environment Protection Agency

Annual Report to Board Members and the Auditor General for Scotland

For the financial year ended 31 March 2014

Board Meeting

30 July 2014

141 Bothwell Street
Glasgow
G2 7EQ

For the attention of the Board
Scottish Environment Protection Agency
SEPA Corporate Office
Erskine Court
Castle Business Park
Stirling
FK9 4TR

30 July 2014

Dear Sirs

We are pleased to enclose our External Audit Annual Report to Board Members and the Auditor General for Scotland for the financial year ended 31 March 2014. This report also discharges our obligations under International Standards of Auditing ("ISA") 260: Reporting to those charged with Governance. We have assumed that the responsibility for governance has been discharged to the Audit Committee by the SEPA Board. A draft version of this report was presented and discussed at the Audit Committee meeting on 24 June 2014.

The primary purpose of this report is to communicate the significant findings arising from our external audit that we believe are relevant to those charged with governance, and to meet our obligations as set out within the Audit Scotland Code of Practice (May 2011).

The scope of our audit and audit risk assessment was set out in our audit plan, presented to the Audit Committee on 10December 2013. We have subsequently reviewed our audit plan and concluded that our original risk assessment remains appropriate. The procedures we have performed in response to our assessment of significant audit risks are set out within this report.

We have completed our year end substantive external audit work on the financial statements and will issue an unqualified opinion following Board approval and a signed letter of representation from the Accountable Officer.

We would like to take this opportunity to thank SEPA staff and management for their cooperation and assistance throughout the audit process.

Yours faithfully

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Contents

Section 1: Executive summary

We have pleasure in presenting this report relating to our external audit of Scottish Environment Protection Agency's (SEPA) financial statements for the year ended 31 March 2014.

We have discussed this report with Jennifer Welsh, Head of Finance, as part of our audit process. The purpose of this report is to update the Audit Committee and Board on the outcome of the audit and of any significant matters that have arisen during the course of our work.

Scope, nature and extent of our audit

Management are responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Our overall responsibility as external auditor of SEPA is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice. In this regard, the Code sets out the need for public sector audits to be planned and undertaken from a wider perspective than in the private sector, involving not only assurance on the financial statements but also consideration of areas such as regularity, propriety, performance and the use of resources. It also sets out the need to recognise that the overall audit process is a co-ordinated approach involving the "appointed auditor" and the Auditor General for Scotland. Our audit has been planned and conducted to take account of these wider perspectives.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260: "Communication of audit matters to those charged with governance", we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This Annual Audit Report to Members, together with previous reports to the Audit Committee throughout the year, discharges the requirements of ISA 260.

Audit status

We received a draft set of financial statements and supporting working papers within the timetable agreed and our audit fieldwork was undertaken over a 3 week period from the week commencing 19 May 2014.

At the date of issuing this report, our work is substantially complete, subject to the following outstanding matters:

- finalisation of our work around the pension liability and directors disclosures;
- finalisation of our review of the non-current assets reconciliation and amendments to the disclosure note;
- finalisation of our overall review of the financial statements, including final audit review over the figures disclosed in section 2 of this report;
- final accounts quality and casting check;
- completion procedures, including subsequent events review; and
- approval of the financial statements and letter of representation.

Opinion

Subject to confirmation there are no post balance sheet events, and a signed letter of representation, we will issue an **unqualified audit opinion** following the Board meeting on 30 July 2014, including regularity of expenditure and income.

Our opinion is unqualified in respect of the Remuneration Report [the section subject to audit] and of the consistency of the Strategic and Board Report with the financial statements.

Significant auditing and accounting matters

Section 4 contains other matters for the attention of those charged with governance, including communication required under International Standard on Auditing “Communication with those charged with governance”. We have included in **Appendix 1** significant accounting adjustments made during the year, all of which have been corrected in the financial statements.

We are also required to communicate with you regarding any significant deficiencies in internal control of which we are aware. Any weaknesses or risks identified are only those which have come to our attention during their normal audit work in accordance with the Code, and may not be all that exist. We identified one recommendation for improving SEPA’s internal control, which is included in **Appendix 2**. We have also followed up on 2012/13 action plan presented in the prior year audit, which is included in **Appendix 3**. However, these are not deemed to be sufficiently significant to impact on SEPA’s Governance Statement.

Section 2: Financial performance

Financial performance 2013/14

EXPENDITURE	2013/14	2012/13
	£m	£m
Staff costs	(53.653)	(50.120)
Depreciation and impairments	(3.092)	(3.007)
Other operating charges	(24.142)	(23.555)
	(80.887)	(76.682)
INCOME		
Income from charging schemes	35.843	35.151
Other Income	4.938	3.280
Interest receivable and similar income	0.004	0.003
Interest payable net cost of IAS 19 assets and liabilities	(2.143)	(0.638)
Comprehensive net expenditure before interest	(42.245)	(38.884)
Net gain on revaluation of property plan and equipment	255	(715)
EXCESS OF COMPREHENSIVE EXPENDITURE OVER INCOME FOR THE YEAR FUNDED BY GIA[1]	(41.990)	(39.599)

* As extracted from the 2013/14 Comprehensive Expenditure statement.

The £4.2 million increase in expenditure for 2013/14 is driven primarily by an increase of £3.5 million in staff costs. This is mainly due to payroll costs for salaried staff increasing by £2.2million as a result of the increase in staff numbers, inflationary pay rises and staff progressions, as well as an increase in the IAS 19 pension charge of £1.7 million. Staff costs included one off payments of £0.4 million (2012/13 - £1.134 million) relating to the 2013/14 voluntary severance exercise, which was taken up by 17 employees (2012/13 - 15 employees).For any employees who took voluntary severance and also met the criteria of early retirement under pension scheme rules, pensions strain costs are also included within the one off payments. Pension strain costs represent the additional costs incurred by the pension scheme for paying a pension before the normal retirement age.

Income from charging schemes has increased from the prior year due to uplifts in fee charges. There was an increase of £1.7 million from other income from the prior year, relating to recovery costs for activities undertaken for other public sector bodies. This is offset by a reduction in GiA cash funding of £2.4 million.

SEPA was not set an official specific efficiency savings target in 2013/14 however it has been recognised that there is an expectation that each public sector body should aim to deliver annual operating efficiency savings of at least 3%. SEPA reduced running costs by £1.2 million as part of the budget setting exercise equating to 3 .6% of GiA funding towards operating costs.

[1] Grant in Aid ("GIA")

Capital expenditure in the year included further improvements to the Angus Smith Building of £1.1million. SEPA staff transferred to the building in summer 2013 and the facility has provided the opportunity for SEPA to rationalise its laboratories.

Performance against budget[2]

	Actual 2013/14 £m	Budget 2013/14 £m	Variance £m
Grant in Aid	40,394	40,394	-
Income from Charging Schemes	35,842	36,125	(284)
Other Income	4,497	4,380	117
Total Income	**80,733**	**80,900**	**(167)**
Staff Costs	49,009	49,153	144
Other Operating Costs	25,826	25,836	10
Depreciation	3,236	3,212	(24)
Total Expenditure	**78,071**	**78,201**	**129**

Throughout the year SEPA continued to monitor performance against budget. There were no significant variances noted. SEPA's resource limit outturn for 2013/14 was as follows:

	Outturn	Budget	Variance
DEPARTMENT EXPENDITURE LIMIT	**£000**	**£000**	**£000**
Total Capital Resource	2,692	2,700	8
Operating Expenditure (Cash)	34,155	34,142	(13)
Depreciation / Impairments (Non-cash)	3,433	3,553	120
Total Operating Resource	37,588	37,695	107
TOTAL EXPENDITURE	40,280	40,395	115
ANNUALLY MANAGED EXPENDITURE LIMIT	4,402	-	(4,402)

Financial outlook – 2014/15 and beyond

The 2014/15 budget estimates total revenue of £76.797 million, comprising £38.424 million from Grant in Aid, £36.833 million from charging schemes and £1.540 million of other income. Compared to 2013/14, this represents an anticipated reduction in Grant in Aid of £1.97 million, a reduction in other income of £2.957 million, coupled with an increase in income from charging schemes of £0.991 million.

Ministerial approval has been gained to increase fees on a number of Scottish charging schemes in 2014/15 and 2015/16. The following schemes will not have increased charges applied:

[2]*SEPA Consolidated Portfolio Finance Report for the period ended 31 March 2014*, Agency Board Reports 27 May 2014.

- Special Waste Notifications
- Producer Responsibility (Packaging Waste)
- Emissions Trading
- RSAB&C

SEPA is currently developing a new charging scheme in consultation with key stakeholders which is expected to be implemented in April 2016.

From 1 April 2015, Landfill tax will be separately collected in Scotland, with responsibility for the administration and collection of taxes being empowered to Revenue Scotland (RS), a tax collection agency established by the Scottish Government for this purpose. RS in turn has delegated powers to SEPA for the administration of this Scottish Landfill tax.

As part of their annual audit work, Audit Scotland is planning to assess the progress of the Scottish Government and SEPA in preparing for these new powers and intends to report publicly on preparations for the implementation of financial measures in the Scotland Act, towards the end of 2014. PwC has prepared a paper in consultation with SEPA management on the landfill tax regime and its implications for SEPA, including consideration of SEPA's taskplan and readiness for the project. A copy of our report is provided in **Appendix 4**.

Staff costs have been budgeted at full establishment less budgeted turnover savings of £1.5million. A 1% inflationary uplift has been applied. As of 1 September 2013, SEPA introduced automatic enrolment to SEPA's pension scheme. In devising the 2014/15 budget, an increase in superannuation costs associated with this has been estimated at £177k.

Section 3: Key areas of audit focus

Our audit followed the strategy set out in our Audit Plan which was presented to the Audit Committee on 10 December 2013. We confirm that there has been no cause for us to vary the planned scope of our work.

Our response to the areas of audit focus identified in the audit plan:

Significant risk	Audit response
Management override of controls	We have reviewed management's overall fraud arrangements and policies. We have reviewed a sample of significant journal entries (based on our assessment of risk) and examined management's accounting estimates for bias. We also carried out unpredictability testing on immaterial petty cash balances to determine the controls and procedures in place. **This work did not identify any errors that required adjustment to the financial statements. We did identify a control weakness as a result of our manual journals testing, as discussed in Appendix 2.**
Risk of fraud in Revenue recognition	We updated our understanding of the revenue and receivables process as well as the accounting policies in place during our planning and audit fieldwork. We performed substantive testing on a sample of income transactions, both charging scheme fees and other income, agreeing to supporting documentation and assessing the accounting treatment as being in line with policy. We also performed testing over manual journals entries to obtain comfort that manual journals processed were appropriate and that they were supported by a clear business rationale. **This work did not identify any errors that required adjustment to the financial statements.**
Risk of fraud in Recognition of operating expenditure	We updated our understanding of the operating expenditure and payables process during our planning and audit fieldwork. We performed substantive testing on a sample of expenditure transactions and reviewed management's estimates of future expenditure, such as accruals and provisions. We have undertaken specific cut-off testing to identify potentially unrecorded liabilities. **This work did not identify any errors that required adjustment to the financial statements.**

Other areas of audit focus

During the audit, we also performed various procedures for other areas of audit focus as determined through our initial review of the draft accounts presented by management.

Bad debt provision

We reviewed the bad debt provision, paying particular attention to an unusual variance between prior and current year. The main driver of this movement related to £409k in respect of costs incurred by SEPA for the clean-up of a polluted site caused by the actions of a financially struggling company. With the direction of the Scottish Government, SEPA has utilised their legislative powers to pursue the company in order to recoup the costs incurred for the environmental clean-up, and therefore has raised a debtor balance. The Company has applied to wind itself up and SEPA have objected to this, however at this stage the likelihood of recovering these costs is considered low, resulting in a 100% provision of this debtor balance. Considering the detailed circumstances surrounding the issue, we have reviewed the current treatment and consider the treatment is reasonable.

Non-current assets – Vessels

We reviewed management's latest valuation of the Sir John Murray vessel asset and considered the treatment of the upward change in valuation identified during the year by external valuers. This was originally presented in the financial statements as being held at revalued cost; however this is not in line with SEPA's approved accounting policy for this type of asset, which is stated as being held at historic cost, adjusting for any identified impairments. This resulted in a corrected adjustment (see **Appendix 1**) to reflect the increased valuation as a reversal of the prior year impairment rather than a revaluation gain and this change was processed by management.

Changes in disclosure regulations

There have been various changes made through new company regulations (as interpreted by the 2013/14 FReM) coming into effect for the current year end in terms of the annual report and the remuneration report. We reviewed the disclosures presented in the draft accounts and compared this to the requirements as per the FReM to consider compliance with the required changes. The two key areas of focus included the following:

Strategic Report

The FReM has incorporated within its guidance the new company regulations which came into effect for this financial year end regarding the Strategic Report. This requires a separate and distinct report to be presented, along with a Directors' Report (or equivalent), which focuses mainly on financial performance and future strategies of the entity. This was not originally presented in the draft accounts provided and thus we advised management on these disclosures to ensure FReM guidance is fully complied with for 2013/14 year. This has been corrected in the annual report included with the financial statements presented for approval.

Directors' Pension Disclosure

The FReM has not changed its guidance to coincide with the new company regulations which came into effect for this financial year end regarding the defined benefit pension disclosures for directors within the remuneration report. The original disclosures presented in the draft accounts, as provided by SEPA's actuary, were in line with the new company regulations and thus not in compliance with FReM guidance. We advised management of this discrepancy to ensure FReM guidance is fully complied with for the 2013/14 year. This has been corrected in the remuneration report included with the financial statements presented for approval.

Pensions

We reviewed the pension assumptions and data used by the actuary in calculating the pension liability as at year end. We made queries to the actuary, requesting further details on items such as a change in methodology for calculating the discount rate as well as an unusual salary figure disclosed within the data input section of the actuarial report.

For the discount rate methodology change, we considered whether this change in methodology constituted a change in significant accounting estimates as this would require disclosure of the impact of the change as per IAS 8. Upon further review and in consultation with management and the actuary, no changes were deemed to be required.

We challenged the salary figures used as this was not in line with prior year movements and was considered unusual. Prior movements in pensionable salary have been typically £1 million year on year; however, the increase from 13/14 and 14/15 estimate reported by the actuary was an increase of £4 million. We reviewed the pensionable salary data utilised by the actuary and agreed the increase was primarily caused by an increase in pension members due to auto-enrolment implementation on 1 October 2014.

There has also been a significant change in disclosure requirements resulting from an update to IAS 19 coming into effect for the current year. The disclosures presented in the financial statements have been reviewed and agreed as in line with the latest accounting standards.

Section 4: Significant audit and accounting matters

Required communications on significant matters

The following table contains communication required under ISA 260 (revised and re-drafted) “Communication with those charged with governance”.

Requirement	Delivery of requirement
Uncorrected and corrected differences	Differences identified during the audit process requiring adjustment to the financial statements have all been corrected by management and included in **Appendix 1**.
Significant accounting principles and policies	Significant accounting principles and policies are disclosed in the notes to the financial statements. We have asked the Accountable Officer to represent to us that they have considered the accounting policies and that there have not been any material changes in the accounting principles and policies used during the year.
Significant qualitative aspects of accounting practices and financial reporting, management’s judgments and accounting estimates	We reviewed management’s judgements and accounting estimates in respect of land and buildings valuations, the pension liability, the provisions for the unfunded pension liability and bad debts. We are satisfied with management’s methodology and use of experts in both the estimating the market value of non-current assets as well as the pension liability and unfunded pension provision. We consider the bad debt provision to be sufficient in the current year and will continue to review the assumptions used in estimating the bad debt provision to ensure that it remains appropriate in future years.
Deficiencies in the internal control environment	The purpose of our audit was to express an opinion on the financial statements. The audit included consideration of internal controls relevant to the preparation of the financial statements in order to design audit procedures that were appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. Any deficiencies in internal controls identified during our current year audit have been reported in **Appendix 2**and a follow up to prior year recommendations are provided in Appendix 3.
Details of material uncertainties related to events and conditions that may cast significant doubt on SEPA's ability to continue as a going concern	We have not encountered any material uncertainties which cast doubt upon the ability of SEPA to continue as a going concern.
Significant difficulties encountered during the audit	We did not encounter any significant difficulties which would prevent us from undertaking the audit.

Requirement	Delivery of requirement
Confirmation of audit independence	We confirm that, in our professional judgment, as at the date of this document, we are independent auditors with respect to SEPA within the meaning of UK regulatory and professional requirements and that the objectivity of the audit engagement leader and the audit staff is not impaired.

Section 5: Governance, accountability and internal control

As part of our wider external audit remit, stemming from our responsibilities under Audit Scotland's Code of Audit Practice, we are required to consider SEPA's governance and accountability arrangements in our audit work.

We provide brief comment on SEPA's governance systems and structures below.

Corporate governance and internal control

The Board is responsible for ensuring that SEPA fulfils the aims and objectives set by Scottish Ministers. The role of the Board includes establishing the overall strategic direction, monitoring performance against agreed objectives and ensuring that statutory requirements for the use of public funds are complied with. The latest corporate plan developed by the Board is for the period2012-2017.

The Board is supported by the Audit Committee, which has responsibility for monitoring risk and internal control, and the Strategy Committee, which considers matters such as planning, finance, human resources and remuneration.

As your external auditors, we are required to review the governance statement before publication and report as to whether the statement complies with relevant guidance, is misleading, or is inconsistent with other information obtained during the audit. We do not consider whether the statement covers all risks and controls, or form an opinion on the effectiveness of internal control or risk management arrangements. We have reviewed the governance statement and confirm that there are no matters to report.

We have considered internal control as it concerns the key financial systems and to an extent based on our audit risk assessment. The purpose of our audit is for us to express an opinion on the financial statements. This includes consideration of internal control relevant to preparation of the financial statements in order to design appropriate audit procedures. It does not extend to expressing an opinion on the effectiveness of internal control.

We are required by ISA 265 to report to those charged with governance and management deficiencies in internal controls that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

We have not identified any significant weaknesses in the current system of internal controls, except from those matters which are raised within **Appendix 2 and 3**.

Prevention and detection of fraud

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. As part of our external audit, we have reviewed SEPA's high level arrangements for preventing and detecting instances of fraud and corruption. There are no matters we wish to bring to your attention concerning fraud.

SEPA's internal control environment is designed to prevent and detect instances of fraud, specifically through segregation of duties and authorisation processes. All fraud is communicated to the Board and Audit Committee.

Following the identification of a small petty cash fraud as well as non-compliance with SFI's by other local offices during the 2012/13 year, various changes and improvements were made to the controls around cash at the local offices in the 2013/14 year. We reviewed the procedures in place in terms of the central controls over cash at the local offices and did not identify any issues in terms of design or operation.

Standards of conduct

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. We have not become aware of any issues concerning SEPA's arrangements that we need to identify in this report.

Audit Scotland National Reports

At the request of Audit Scotland, we are required to follow up on Audit Scotland's National Report 'Managing ICT contracts: An audit of three public sector programmes'. The results from this follow up will be reported in a separate letter.

Any relevant Audit Scotland National Performance reports issued in the year are discussed at the Audit Committee, including any actions arising.

Internal Audit

As described in our Annual Plan, International Standard on Auditing (UK and Ireland) 610: "Using the work of internal auditors" requires us to:

- Consider the activities of Internal Audit and the extent that their work can be relied upon for external audit procedures;

- Obtain sufficient understanding of internal audit activities and the effectiveness of the function to enable us to identify areas of risk and develop an effective and targeted audit approach; and

- Evaluate and test the quality and timeliness of internal audit work, where we seek to rely on the findings, in order to confirm its adequacy for our purposes.

Throughout the year, we have liaised with KPMG, SEPA's internal auditors. PwC staff has attended Audit Committee meetings where internal audit reviews were presented by KPMG. We assessed the internal audit reports issued during the year and considered any potential impact on our audit.

Risk Management Arrangements

Within SEPA each Portfolio, and the Chief Executive's Office, have a risk register which is considered at least quarterly by the Portfolio Management Teams. For some of the larger departments in Portfolio, departmental risk registers are also maintained.

SEPA's Risk Management procedures ensure that all risks are regularly reviewed by the Risk Management Group every six months. Management of risk is reported quarterly to the Agency Management Team (AMT) and annually to SEPA's Audit Committee and Board. The Risk Management Group also reviews Portfolio, Single Change Programme and Project risk registers periodically to ensure that these areas of SEPA are carrying out routine risk management and reporting activities.

Appendices

Appendix 1: Corrected misstatements

The following are misstatements which have been identified during our audit and corrected within the financial statements.

No	Description	Adjustment		
1	Incorrect treatment of an impairment reversal of the Sir John Murray vessel.	DR	Revaluation gain on PPE – Other comprehensive expenditure	(51k)
		CR	Impairments – Expenditure	(51k)
2	Incorrect disclosure within the Financial Commitments note.	This is a separate disclosure of future liabilities which does not impact the balance sheet, thus there are no adjusting journal entries to process the required corrections, rather the table below shows the correct disclosure compared to the original draft accounts:		

Capital Commitments	**Year to 31 March 2014 £000**	
	Original	Corrected
Contracted for but not provided	-	-
Not later than 1 year	845	-
Later than 1 year but less than 5 years	23	
Total	868	-

Total future aggregate minimum lease payments:	**Land and Buildings 2014 £000**	
	Original	Corrected
Payable within 1 year	1,631	1,879
Later than 1 year but less than 5 years	6,301	7,336
After 5 years	16,971	21,187
Total	24,903	30,402

Appendix 2: Current year action plan

We have identified one area for development during the course of our audit. Our recommendation for improvement is as follows:

No	Finding	Risk	Recommendation
1	Two individuals within the SEPA finance team have AGRESSO systems database access to post manual journals for unclaimed staff expenses at the year end. This is outwith the standard authorisation workflow process and no audit trail of whether these postings have been reviewed and authorised outside of the system by senior management is maintained. The journals processed during the 13/14 year have been reviewed and discussed with management to determine whether this access is required. Due to the significant volume of line items it is deemed inefficient to process this manually through the standard workflow, therefore the individual transactions are 'forced' onto the system via a batch upload.	Override of standard controls over manual journal postings, leading to inappropriate or inaccurate postings made to the ledger.	Regular downloads of the journals posted by the two individuals provided with this access should be generated by management and each journal reviewed and agreed as appropriate, with any inconsistencies investigated on a timely basis. This should be documented, either through an email confirmation by appropriate senior management or through physical print and sign off of the downloaded report. The review process interval should be agreed by management taking into consideration the expected frequency of these journal postings, i.e. monthly, quarterly, etc. **Management response:** All future journals will be authorised Periodic checks will be carried out to make sure all journals are authorised **Responsible Officer:** Head of Finance **Implementation date:** Immediate

Appendix 3: Follow up on prior year action plan

We identified three areas for development during the course of our prior year audit. Our recommendations for improvement and current year follow up are as follows:

No	Finding	Risk	Recommendation
1	In future years the draft financial statements would benefit from additional review before audit work commences to ensure that all balances correctly cast and agree to the trial balance, are consistent throughout the financial statements and all disclosures are in line with the FReM. This would reduce the number of versions of accounts produced and increase the efficiency of the audit process.	Additional audit time is incurred/inefficient year end process/risk errors/omissions are missed	Finance staff should perform a check of the financial statements prior to audit work commencing to check for internal consistency and ensure figures cast correctly. In order to minimise version control, a complete draft set of financial statements should be available for audit work commencing. **Management response:** We will review future years accounting changes complexity and amend timetable accordingly. **Responsible Officer:** Jennifer Welsh, Head of Finance **Implementation date:** 1 November 2013

2014 update

The draft accounts received on day one of our audit visit were of a reasonable standard. We are pleased to note that we have seen some improvement in the quality of the draft accounts received as compared to prior years however we would note some additional observations for the current year as follows:.

- The Non-current assets note required changes to the presentation and disclosure, specifically regarding the vessels category and the subsequent movement in valuation. Whilst we acknowledge that management made a conscious decision to discuss this with PwC to avoid additional changes being required, we noted a number of errors and incorrect disclosures in the audit support file received and draft 1of the financial statements which required adjustments to be posted and rework to the note disclosures. As a result a significant amount of additional time was spent agreeing the proposed changes and performing additional reviews of the disclosures.
- The financial commitments note required significant changes to be made as the working papers used to populate this disclosure had incorrect underlying data. We discussed the errors with management and advised on the changes required which were subsequently amended. The impact of this disclosure adjustment is noted in Appendix 1.
- The Directors' Pension Disclosure was not finalised during the initial audit period due to ongoing discussions with the actuary in terms of the required disclosures not being in line per the FReM. PwC advised that changes to the disclosure were required and this was updated by management.
- The annual report included with the financial statements did not reflect the new FReM guidance regarding the new Strategic and Directors' Reports. Per discussion with management a decision was taken to discuss these changes with PwC prior to amending the financial statements and the proposed treatment was advised and updated in subsequent drafts.

It should be noted that the items described above did not lead to any material misstatements in the financial statements however a significant amount of additional audit time was invested to work with management to finalise the disclosures. We

No	Finding	Risk	Recommendation

would encourage management to consult with us regarding any concerns as early as possible during the year in order to ensure quicker resolution of potential year end issues.

No	Finding	Risk	Recommendation
2	In the course of our audit work on accounts payable cut-off, we identified three expenditure items which related to 2012/13 but had not been accrued for.	That expenses incurred relating to the financial year but not invoiced are not accrued for thus understating expenses and liabilities for the period.	Finance staff should review all expenditure items, above the £1,000 threshold, posted in the period after year end to ensure that items are accrued for appropriately. **Management response:** Agreed we shall remind budget holders of year end processes and implement robust checks. **Responsible Officer:** Jennifer Welsh, Head of Finance **Implementation date:** 1 November 2013

2014 update

During our normal expenditure testing we focussed attention on the items occurring close to the year end. There has been a noted improvement during our review of April 2014 expenditure items as we only identified one item which related to the 2013/14 year which was posted to the 2014/15 year, however this amount was below the £1,000 threshold and therefore its treatment was deemed appropriate.

We also noted during our review of internal audit recommendations that property related expenditure (i.e. rents and rates) which were not previously included in the standard PO process will now be issued POs to decrease the required level of manual review of post year end invoices and instead rely more on the automated accruals process, therefore decreasing the likelihood of unrecorded liabilities and year end expenditure cut off issues.

No	Finding	Risk	Recommendation
3	Management also assess the recoverability of debt on a case by case basis, using judgement to determine the likelihood of the debt being paid. Following a review during the year, £285,000 of bad debts were written off. However, SEPA have only recognised a provision of £14,000 within their accounts.	Debtor balances are not recoverable.	Finance should continue to review aged debtors periodically to assess the likelihood of recoverability to ensure the level of bad debt provision remains appropriate. **Management response:** We will continue to review aged debtors on a monthly basis to ensure bad debt provision remains appropriate. **Responsible Officer:** Jennifer Welsh, Head of Finance **Implementation date:** Immediate

Follow up

The bad debt provision for the 2013/14 year (£501,000) was significantly higher than in prior year (£14,000). The majority of this was made up of a one off item (£409,000) relating to the legal pursuit of clean-up costs incurred during the year by SEPA as a result of a bankrupt company's actions (as discussed in **Section 3** under the 'Other areas of audit focus' sub heading). However, disregarding this non-standard item, the bad debt provision has still shown an increase of £78,000 from the prior

No	Finding	Risk	Recommendation
	year. During the period, £88,000 items were written off entirely, which is significantly lower than the 2012/13 bad debt write off exercise, but is in line with the 2013/14 year end provision. We reviewed the year end aged debtors listing, taking into consideration SEPA's robust debt collection procedures and policy in terms of providing and writing off debts as discussed in prior years, and feel that SEPA have implemented our ongoing recommendation to ensure the provision does remain adequate and appropriate each year.		

Appendix 4: *Preparation for the introduction of the Scottish Landfill Tax from 1 April 2015*

Introduction

From 1 April 2015, Landfill tax will be separately collected in Scotland with responsibility for the administration and collection of taxes being empowered to Revenue Scotland (RS), a tax collection agency established by the Scottish Government for this purpose. Revenue Scotland in turn has delegated powers to SEPA for the administration of this Scottish Landfill tax.

This report sets out to provide Audit Scotland with an overview of the progress SEPA has made in preparation for the introduction of the Scottish Landfill tax and to identify the key issues to be addressed in the coming months in preparation for the project to be delivered on time and to ensure that all duties and responsibilities are fulfilled.

Audit Scotland has identified four areas of focus for SEPA and we have summarised our findings below based on our discussions with the project management team and our audit testing.

What governance arrangements are in place to manage preparations for the introduction of devolved taxes?

SEPA's goal is to achieve the best results for Scotland through their role in the Scottish Landfill Tax programme and they have introduced a Project Board who has overall responsibility for the delivery of this project. This board, which has been in place since April 2013, meets on a monthly basis and consists of a range of experienced individuals, with a clear project plan and delegated internal roles and responsibilities.

John Kenny, Head of National Operations at SEPA, is the project executive with overall responsibility and is also a member of the RS Tax Administration Programme Board. The RS Board is responsible for ensuring all parties work closely together to deliver their responsibilities and John's representation on each Board provides clear linkage between both parties. SEPA have a strong relationship with RS and have frequent, ongoing discussions with the Head of RS to discuss their role in this project and resolve any new issues identified.

One of the key governance procedures is to agree the roles and responsibilities for the project with RS. Good progress has been made during May and SEPA now has significantly more detail on the roles and responsibilities from the Scottish tax authorities. This includes a bottom up task plan, supplemented with a top down plan of roles which will allow Mr Kenny, as the head of the project team, to plan the resource needed and identify the work to be undertaken, despite a formal agreement not yet being signed. It is anticipated that the updated version of the roles and responsibilities document will be presented to the RS Tax Administration Project Board in July 2014 for ratification. The final stage of this process will be to prepare a memorandum of understanding and ultimately obtain a formal Schedule of Delegation from the RS Board.

RS originally requested SEPA undertake responsibility for the collection of tax returns however SEPA are no longer expected to perform this role. Their primary focus is expected to be around registration, compliance and enforcement as well as the identification of and assessment of tax liability associated with illegal landfill sites.

The key risk faced by SEPA is the complexity and timing of their role in the regulation of the Landfill Communities Fund. Further clarity of the role is now available to SEPA which indicates that there will be a significant amount work involved in what will be a complex area. The risk to SEPA is whether then can deliver on this given the size of the task and the urgency of the work required. As a result they currently consider this to have a risk RAG status of red, indicating that significant intervention is required to meet the objectives of the task. SEPA are currently urgently identifying what work will be required and what resource will be needed to deliver this work to the required timetable. Additionally, part of the reasoning behind requesting that SEPA take on the role of regulating the SLCF (and December 2013) was SEPA's role with respect to the collection of landfill tax. Given the change in this role, referred to earlier, discussions are taking place with RS to determine who is best placed to undertake/deliver the tasks required with respect to SLCF setup and operation.

What progress has been made in preparing for the introduction of the Scottish Landfill Tax?

SEPA monitor the ongoing status of the project through monthly report scorecards. The scorecard identifies the status of the project and the key risks and issues faced, detailing progress to date and planned actions going forward. Each work stream has a responsible lead individual, with a specific target date and RAG status, allowing SEPA to monitor progress on an ongoing basis.

Risks identified, as discussed above, include:
1. Key priority to resolve roles and responsibilities (RAG status amber)
2. Complexity and tight timescales in SEPA's role in the regulation of the Landfill Communities Fund (RAG status red)

Original total budgeted costs for 2013/14/15 were £625k and the project delivered on budget for 2013/14 with actual spend of £118k. An updated financial memo has been submitted to RS as set up and running costs are expected to be significantly reduced due to the proposed scope changes on ICT for SEPA. The final budget at this stage is still to be agreed.

What progress has been made developing the necessary ICT systems in Revenue Scotland and SEPA for the collection of the Scottish Landfill Tax?

The development of ICT systems are currently under revision due to the changes in responsibilities noted above. It is anticipated there will be a significant reduction in IS work for SEPA as a result of the points noted above. As a result SEPA do not anticipate significant ICT development but will have a role to play in the registration of taxpayers and in the interface requirement between their systems and RS. Although SEPA's IS role is reduced, tax collection by Revenue Scotland is dependent on SEPA's IS registration process and is therefore important to the success of the project.

What consideration has SEPA given to the staff resources (number, skills and experience) needed to collect and administer the Scottish Landfill Tax?

As noted above, SEPA will no longer be responsible for the collection of the Scottish Landfill tax.

SEPA has established a Project Board with appropriate skills and experience to ensure they are ready for the implementation of administering the Landfill tax. The project budget includes estimates of running costs based on the staff required to fulfil the roles and responsibilities. In addition a significant amount of the start-up costs incurred in 2013/14 related to staff costs.

Costs have been allocated in the budget for ongoing training and development of staff, based on the requirements of their role. SEPA are also working closely with HMRC and other appropriate operators to identify training and development requirements and have also visited Revenue Ireland to observe how they operate and will incorporate learning from this study visit into the training programme.

The overall project plan includes a work stream for recruitment, including an oversight of when recruitment will be required, what job specifications need to be put in place and the financial implications. This is an ongoing process which is expected to progress over the next year.