

Scottish Environment Protection Agency Financial year ended 31 March 2021

External Audit Plan



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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the organisation or all weaknesses in your internal controls. This report has been prepared solely for your benefit and Audit Scotland (under the Audit Scotland Code of Practice 2016). We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Plan overview

The audit plan for the financial year ended 31 March 2021 sets out our risk based audit approach. This plan is reported to those charged with governance (Audit Committee). Planning is a continuous process and we will continue to review our risk assessment and planned approach.

03

Wider Scope Audit

In accordance with the Code we have identified wider scope risks, at the planning stage and will conclude on these during the audit.

Risks have been identified in relation to the following areas:

- Recovery of financial management arrangements following the cyber attack (Financial management);
- Risk around future financial sustainability recognising financial pressures facing SEPA alongside the financial impact of the cyber attack (Financial sustainability); and
- Governance and decision making during the Covid-19 pandemic and governance arrangements beyond the Cyber attack. (Governance and transparency).

01

Materiality

We have calculated planning materiality using budgeted gross expenditure as our benchmark (same as prior year):

- £ 1.654 million planning materiality.
- Performance materiality of £827,380 (50% of planning materiality reflecting the increased risk of error in the financial statements).
- Trivial is capped at £82,700.
- Lower materiality on Staff and Remuneration Report, set at bandings per the FReM.

04

Other audit matters

We summarise other audit matters for Audit Committee awareness. This includes:

- The revised ISA 540 standard relating to Accounting estimates and the additional considerations required at planning. For SEPA we anticipate material estimates will include: defined benefit pension scheme liabilities; property, plant and equipment valuations; accruals; decommissioning provisions; depreciation; and other estimates including write off of outstanding debtors.
- In accordance with the Code and planning guidance we also complete and submit a number of deliverables in year including sharing intelligence with Audit Scotland.
- Consideration of going concern in accordance with Practice Note 10.

02

Scope of the financial statements audit

The loss of data, including financial records, due to the cyber attack has resulted in management recreating financial records. Therefore we anticipate limitations in our audit scope over certain expenditure and income in-year, which will result in disclaimers within our annual audit opinion.

Financial statement audit risks

At planning, in accordance with the ISAs (UK) and FRC Practice Note 10 we have identified the following significant financial statement audit risks: Management override of controls (ISA UK 240); the risk of fraud and error in revenue recognition; the risk of fraud and error in expenditure; the risk of misstatement of defined benefit pension scheme liabilities; and, the risk of misstatement of land and building valuations.

05

Our Audit Fee

Audit fees were shared by Audit Scotland with SEPA in December 2020. As in prior years the baseline fee set by Audit Scotland can be varied by us as appointed external auditors. Baseline fees can be modified to include a change in risk profile resulting in new risks. Due to the loss of financial records we anticipate an increase in audit work this year, alongside the need for an increased skills-mix and the inclusion of IT/Cyber specialists within our team.

We have set out a proposed fee of £84,570. This is based on our planning assumptions and may be subject to change once we receive unaudited accounts and working papers.

Introduction

Purpose

This document provides an overview of the planned scope and timing of the external audit of Scottish Environment Protection Agency (SEPA) for those charged with governance.

We are appointed by the Auditor General as the external auditors of SEPA for the 6 year period (2016/17 until 2021/22).

Respective responsibilities

Audit Scotland has issued a document entitled Code of Audit Practice ('the Code') dated 2016 covering this audit appointment period. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities, and that of SEPA are summarised in Appendix 1 of this plan. We draw your attention to this and the Code.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on:

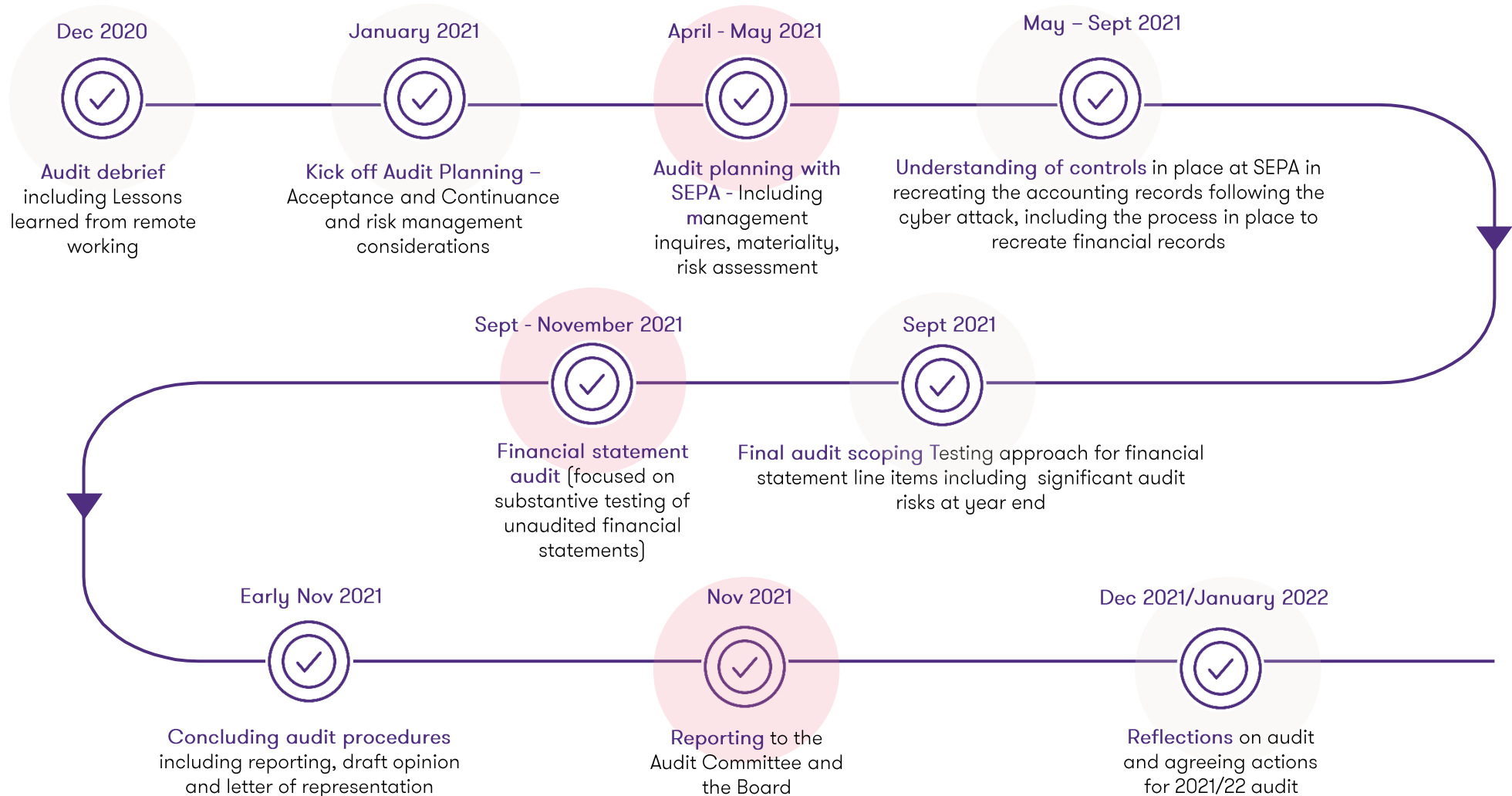
- SEPA's financial statements that have been prepared by management with the oversight of those charged with governance (the Audit Committee)

The audit of the financial statements does not relieve management or the Audit Committee of your responsibilities. It is the responsibility of SEPA to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We will consider how the SEPA is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of SEPA and is risk based.



Audit approach



Cyber attack and our audit response

Background

On 24 December 2020 SEPA was subject to a cyber security attack which had a significant impact on the internal systems and processes. This included access to core systems including the financial ledger. SEPA has estimated that over 1.2 GB of data has been stolen from the organisation and the complexity and sophistication of the attack has meant that SEPA has been unable to recover files, including back-up accounting records prior to the attack.

Management response and the impact on accounting records

SEPA enacted business continuity arrangements and initiated steps to limit the impact of the cyber-attack. SEPA has been working with relevant authorities including the Scottish Government, Police Scotland, the National Cyber Security Centre and the Information Commissioner's Office and a formal police investigation has been launched into the incident. SEPA established an Emergency Management Team (EMT) consisting the Agency Management Team (AMT) and other relevant heads of service to manage the overall response to the cyber-attack and recovery process. Since the incident SEPA have sought to re-establish its priority systems and processes through core workstreams: Organisation; Regulation; Flooding; Cyber Response; EU Exit; and, COVID-19 Response.

Impact on the accounting records and financial statements

SEPA have established emergency arrangements for priority financial processes including payment of suppliers, payroll and core accounting such income recognition, transaction recording and reconciliations. Management are in the processes of developing new financial systems including ledger, purchasing, income and payroll systems.

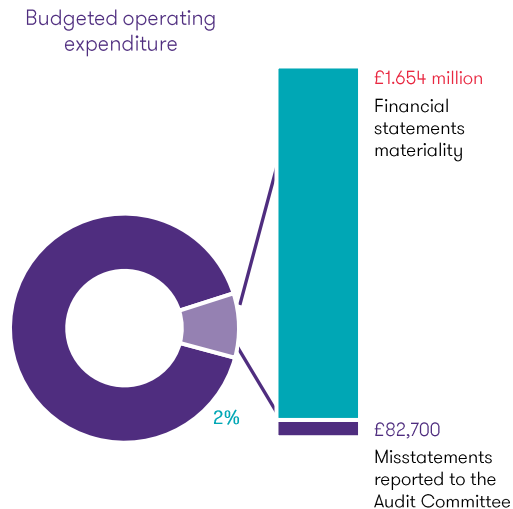
For the 2020/21 financial year, the Finance Team working with budget holders have sought to recreate the underlying financial records up to 24 December 2020. This includes using bank transaction records to recreate income and expenditure transactions. The restatement process involves manual journal processing to recreate accounting records. This information will then be combined with the records maintained since the attack to create closing balances as at 31 March 2021. Following discussion with Management we have changed our usual year-end auditing timeline, from May to September/October.

Impact on our opinion

We have not fully determined the nature of our opinion that will be issued on the 2020/21 financial statements. However, there remains a strong possibility that we will need to issue a disclaimed audit opinion due to the limitations in the completeness and accuracy of the accounting records maintained by SEPA, in particular the ability for us to gain sufficient assurance there is no risk of material misstatement or error within certain income and expenditure transactions shown in the SOCNE, and related disclosures. This is also likely to have an impact on our regularity aspect of our opinion.

Materiality

Financial statement materiality is determined based on a proportion of the total operating expenditure. We have determined **planning materiality** to be £1.654 million, which equates to approximately 2% of your budgeted total operating expenditure. Our overall materiality is set as what we consider would influence the economic decisions of the primary users of the accounts.



Performance materiality represents the amount set for the financial statements as a whole to reduce the probability that the aggregate of uncorrected and undetected misstatements exceed materiality. We use this to determine our testing approach to the financial statements. We have set this at 50% (2019/20:75%) of planning materiality (£827,380). This has been reduced from the 75% benchmark set in the prior year reflecting the inherently increased risk of material misstatement in the draft accounts this year due to an absence of accounting records.

Materiality reflects our professional judgement of the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements.

On this basis we apply a separate **lower materiality level** to the Remuneration and Staff Report. This is set per one banding as set out in the FREM.

Under ISA 260 (UK) 'Communication with those charged with governance', we are required by auditing standards to report uncorrected omissions or misstatements other than those which are '**clearly trivial**' to those charged with governance. We have determined this threshold to be £82,700 being 5% of financial statement materiality.

We will revisit our materiality based on the unaudited 2020/21 financial statements. During the course of our audit engagement, we will continue to assess the appropriateness of our materiality.

Significant audit risks

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Risk of Fraud and error in Revenue Recognition (as required within Auditing Standards – ISA 240) (completeness, accuracy and occurrence)

Auditing standards require us to consider the risk of fraud in Revenue. This is considered a presumed risk in all entities. SEPA receives Grant in aid funding direct from the Scottish Government. The risk of management manipulation and fraud is therefore limited. We will also be able to gain sufficient assurance this year, from our audit procedures, of the completeness and accuracy of this income source.

During 2019/20 SEPA's operating income consisted of income from contracts of £44.024 million and other income of £2.4 million (not considered a significant risk of material misstatement). We therefore focus our significant risk of material misstatement on income from contracts.

Given the cyber security breach and resultant data loss, Management's process for recreating income records is through bank receipts. This reduces the risk of overstatement of income up to the cyber attack. We therefore focus our risk and audit testing on year end cut-off arrangements, where it may be advantageous for management to show an enhanced/different financial position in the context of financial performance being focused on outturn position against grant-in-aid funding.

In light of data loss as a result of the cyber attack and management recreating accounting records, there is an increased risk of error in the completeness and accuracy of income from contracts recognised. We therefore focus our testing on the occurrence of revenue recognised at year end including existence of receivables at the year end and the completeness and accuracy of income from contracts during the year.

Significant audit risks (continued)

Management Override of Controls (as required within Auditing Standards – ISA 240)

Our risk focuses on the areas of the financial statements where there is potential for management to use their judgement to influence the financial statements alongside the potential to override SEPA internal controls, related to individual transactions. The risk is heightened in the current year with all transactions effectively being recorded as journals (to recreate accounting records). Our work will consider the processes and controls established to ensure transactions recorded are complete, accurate and authorised. We will test the design of controls in place over journal entry processing and risk assess journals and select items for detailed follow up testing.

With effectively all transactions being recorded as journals, including income and expenditure accounts which may have limited supporting documentation, there are inherent limitations over the assurances we can provide over these transactions. We will obtain an understanding of the business rationale of significant transactions that we become aware of that, based on our audit knowledge and understanding, are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Risk of Fraud and error in Expenditure (as recommended in FRC Practice Note 10 for Public Sector entities) (completeness, accuracy and occurrence)

Operating expenditure is understated or not treated in the correct period (risk of fraud in expenditure). As payroll expenditure is well forecast and agreeable to underlying payroll records, there is less opportunity for the risk of misstatement in this expenditure stream. Similarly, depreciation costs, impairment and finance costs have limited opportunity for material misstatement in the accounts. We therefore focus on other operating charges (2019/20: £19.355 million). Recognising financial performance is scrutinised against the delivery against grant in aid funding levels, we consider the greatest incentive being the risk of fraud in understating expenditure. As a result of the data loss from the cyber attack there is an increased risk around the accuracy and occurrence of expenditure.

Notwithstanding the identified limitations over expenditure as a result of the cyber attack, in response to the significant risk our testing will consider the completeness, accuracy and occurrence of expenditure recorded in the year. We will have a specific focus on year end cut-off arrangements.

Significant audit risks (continued)

IAS 19 Defined Benefit Pension Liabilities (valuation)

SEPA participates in the Falkirk Pension Fund, a local government pension scheme (LGPS). The scheme is a defined benefit pension scheme and in accordance with IAS 19: Pensions, SEPA is required to recognise its share of the scheme assets and liabilities on the statement of financial position. As at 31 March 2020 SEPA had pension fund liabilities of £116.806 million.

Hymans Robertson LLP provide an annual IAS 19 actuarial valuation of SEPA's net liabilities in the pension scheme. There are a number of assumptions contained within the valuation, including: discount rate; future return on scheme assets; mortality rates; and, future salary projections. Given the material value of the scheme liabilities and the level of estimation in the valuation, there is an inherent risk that the defined benefit pension scheme liability could be materially misstated within the financial statements.

We will consider the work of the actuary (Hymans Robertson LLP), including the assumptions applied, using the work performed by PricewaterhouseCoopers (PwC) (commissioned on behalf of Audit Scotland to review actuarial assumptions proposed by LGPS actuaries), as well as local audit assessment. We will liaise with Ernst and Young LLP as Auditors of the Pension Fund to provide assurances over the information supplied to the actuary in relation to SEPA, including assets held and membership data, and confirm joint assurances in respect of employer and employee contributions in the year. We will review and test the accounting entries and disclosures made within SEPA's financial statements in relation to IAS 19.

Significant audit risks (continued)

Valuation of property, plant and equipment (land and buildings)

In accordance with the HM Treasury Financial Reporting Manual (FRM), subsequent to initial recognition, SEPA is required to hold property, plant and equipment (PPE) on a valuation basis. The exact valuation basis depends on the nature and use of the assets. Specialised land, buildings and gauging stations are held at depreciated replacement costs, as a proxy for fair value. Non-specialised land, buildings and vessels, are held at fair value. There are further modifications to values depending on the nature and use of assets to ensure PPE is approximately stated. As at 31 March 2020, SEPA held PPE of £35 million. Given the value of PPE held by SEPA and the level of complexity and judgement in the estimation valuations, there is an inherent risk of material misstatement in the valuation of land and buildings and vessels. The risk is less prevalent in non land and buildings assets as these are generally held at depreciated historic costs, as a proxy of fair value and therefore less likely to be misstated. SEPA appoint Cushman and Wakefield to value land, buildings and gauging stations. Century Marine value the Sir John Murray vessel. In 2019/20, Cushman and Wakefield's valuation was subject to a material valuation uncertainty, reflecting the greater uncertainty in markets on which the valuations were based as a result of COVID-19.

We have considered the overall **Impact of Covid-19 on the Financial Statements**, in particular whether there is a financial statement level significant risk, whether there is a significant risk relevant to specific balances or line items e.g. valuation of PPE and trade and other receivables, whether any risk factors should be considered when determining the audit strategy and designing audit tests and whether there are any audit risks due to the impact of the pandemic on the financial statements. We have concluded that there is no additional significant risk, in addition to those already captured, in relation to the impact of COVID-19 on the financial statement as a result of our consideration.

We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Annual Report to those Charged with Governance and the Auditor General in concluding our audit.

Wider scope risks identified in planning

As set out in the Code we are required to consider significant wider scope risks that impact on SEPA. Where we identify risks, similar to financial statement audit risks, we are required to devise a suitable programme of testing to allow us to conclude on SEPA's arrangements. There are four wider scope dimensions we consider: Financial management, financial sustainability, governance and transparency and value for money. Wider scope risks are a matter of auditor judgement, and what we judge to be significant, considered on a risk basis. In addition to wider scope risks there may be other areas that Audit Scotland require us to consider. These requirements are set out in the planning guidance (2020/21). Where relevant we refer to them here, or within our wider audit plan.

Our previous Annual Reports have highlighted a number of challenges impacting on SEPA including achieving financial sustainability through focusing resources on the organisation's key strategic outcomes through the change programme, continuing to enhance performance management arrangements through the use of more outcome based measures, and working with key strategic partners to deliver outcomes. Following the cyber security attack in December 2020, the key priorities for SEPA have focused on managing the impact of the attack through prioritising critical systems and processes while looking to establish key systems and processes and ways of working. Our wider scope risk assessment has therefore built on our cumulative audit knowledge of SEPA whilst focusing on the priorities, challenges and risks facing the organisation. SEPA's focus over the next 12-18 months is on recovery and remobilisation of services and establishing internal processes and controls. We therefore reflect this in considering our wider scope focus in 2020/21.

Financial Management The cyber attack has had a significant impact on SEPA's financial management arrangements including financial processes, systems and controls. As part of SEPA's recovery programme, the organisation is looking to re-establish its financial control environment. SEPA established interim arrangements to support critical services following the attack including basic payroll functionality and payment of suppliers. A key challenge for SEPA is to establish systems and processes, with sufficient and robust testing, while continuing to operate.

With various workstreams underway as the organisation looks to establish key services it will be important that there is sufficient capacity and oversight to ensure appropriate financial controls are in place to support effective and efficient use of resources while delivering key services, alongside the delivery of a range of projects.

In response to the wider scope risk, we will consider the financial management arrangements established by Management in response to the cyber attack as well as the arrangements developed to support the organisation remobilise its services including financial monitoring and reporting arrangements.

Wider scope risks identified in planning (continued)

Financial sustainability SEPA's 2020-2024 Financial Strategy contained scenario based forecasts over the period of the strategy. SEPA projected that by 2024 there was an estimated budget gap of between £6,000 (best case scenario) and £17.9 million (worst case scenario). SEPA were in the process of implementing a strategic change programme, aiming to ensure resources are prioritised on key strategic outcomes. Part of this was the removal of 50 Full Time Equivalent posts and reducing staff costs by approximately £2.5 million per annum alongside alignment of regulatory expenditure with charging.

SEPA has estimated that the cost in addressing the cyber attack is approximately £1.2 million up to 31 March 2021, with potentially further costs in 2022. In addition, Management has estimated that it will need to write off approximately £2 million of revenue in the year that it will be unable to collect in fees due to loss of underlying records. Alongside these initial financial impacts SEPA is likely to face additional costs as it looks to establish its financial systems, coupled with likely significant delays in delivering strategic change projects as resources are focused on the cyber response, it will be critical that SEPA works with key stakeholders including the Scottish Government and service users as it looks to deliver financially sustainable operating model going forward. We will consider the extent to which SEPA have incorporated the financial implications of the cyber attack, including direct and indirect costs incurred as a result of the attack as well as lost revenue into financial plans over the coming years. We will consider the extent to which the impact of the cyber attack or remobilisation of services has impacted the strategic change programme or delivery of savings plans.

Governance and transparency

For SEPA, we consider an area of risk around ensuring effective governance, accountability, scrutiny and resilience during the pandemic as priorities and the way services are delivered change. In addition to the challenges of Covid-19, SEPA has established emergency management arrangements in response to the cyber attack. While the Board and Audit Committee meetings have continued to operate, the loss of data and access to the Board's information systems has resulted in limitations on the performance information that can be provided to the Board.

SEPA has commissioned a joint review of the cyber attack. The review will involve Police Scotland, Scottish Business Resilience Centre, NCC Group, and Azets. The review will consider what led to the incident and why, what impact the incident had on SEPA; what improvements are required in SEPA's recovery to avoid a repeat of this incident; what went well in SEPA's response and learning lessons for the management of future incidents. It is expected that this review will finalise in July 2021.

We will consider the adequacy of the governance arrangements in place during the Covid-19 outbreak. We will also consider the findings of the joint review the cyber attack and SEPA's response to any findings and actions emerging from the review.

Other matters

Auditor Responsibilities

We have a number of audit responsibilities as set out in the Code and planning guidance:

- We audit parts of your Remuneration and Staff Report in your Annual Report and check whether these sections of your Annual Report have been properly prepared (opinion)
- We read the sections of your Annual Report which are not subject to audit and check that they are consistent with the financial statements on which we give an opinion (opinion)
- We carry out work to satisfy ourselves that disclosures made in your Annual Governance Statement are in line with requirements set out in FReM (opinion)
- We consider our other duties under the Code and planning guidance (2020/21), as and when required, including:
 - Supporting Audit Scotland in Section 22 reporting.
 - Providing regular updates to Audit Scotland to share awareness of current issues
 - Notifying Audit Scotland of any cases of money laundering or fraud
 - Review of Central Government Technical guidance prior to issue by Audit Scotland

Internal control environment

Throughout our audit planning and fieldwork we will continue to develop our understanding of the overall control environment (design) as related to the financial statements. As a result of the cyber attack there are limitations in evidencing the controls, as supporting evidence of the operation of certain controls is no longer available and the accounting records are being retrospectively produced through journal entries. We will however undertake the following:

- Consider procedures and controls this year around related parties, journal entries and other key entity level controls.
- Consider the processes and controls in place in recreating accounting records following the cyber attack, including oversight and scrutiny arrangements.
- Perform walkthrough procedures on key controls established since the cyber attack around identified risk areas. This includes in particular property plant and equipment, payroll, pension arrangements, income and expenditure

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure".

All other material balances and transaction streams will therefore be audited where possible, or will be limited in scope. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

Going concern assessment

As auditors, we are required to obtain sufficient appropriate audit evidence regarding, and conclude on:

- whether a material uncertainty related to going concern exists; and
- the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

The Public Audit Forum has been designated by the Financial Reporting Council as a "SORP-making body" for the purposes of maintaining and updating Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom (PN 10). It is intended that auditors of public sector bodies read PN 10 in conjunction with (ISAs) (UK).

PN 10 has recently been updated to take account of revisions to ISAs (UK), including ISA (UK) 570 on going concern. The revisions to PN 10 in respect of going concern are important.

In particular, PN 10 allows auditors to apply a 'continued provision of service approach' to auditing going concern, where appropriate. In considering going concern we will refer to Audit Scotland's Going Concern publication (December 2020).

Within our wider scope work we will conclude on SEPA's arrangements to ensure financial sustainability.

Accounting estimates

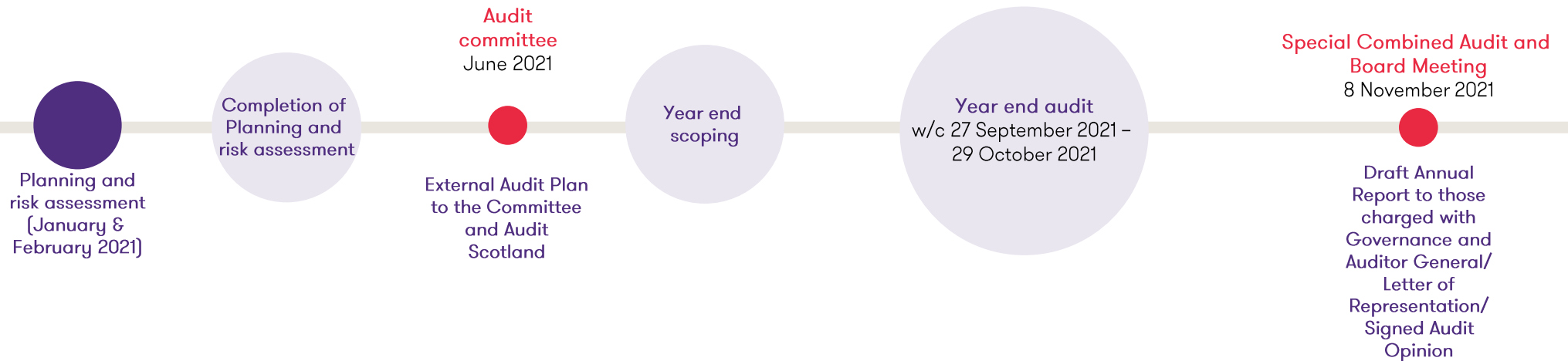
Under ISA (UK) 540 auditors are required to understand and assess an entity's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge;
- How the entity's risk management process identifies and addresses risks relating to accounting estimates;
- The entity's information system;
- The entity's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

To ensure compliance with this revised auditing standard, we will be requesting further information from management and those charged with governance during our audit. Based on our knowledge of SEPA we have identified a number of material accounting estimates for which this is likely to apply including defined benefit pension liabilities and valuation of property, plant and equipment.

Further detail is set out on pages 25 and 26.

Audit timeline



Client responsibilities

Where clients do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other clients. Where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit to the agreed timescales. In addition, delayed audits will incur additional audit fees. The above timeline may be subject to change depending on the limitations in our scope, and the quality of the financial statements and underlying supporting records.

Our requirements

To minimise the risk of a delayed audit, you need to ensure that you:

- produce draft financial statements of good quality by the deadline you have agreed with us, including all notes, the Annual Report and the Annual Governance Statement
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples for testing
- ensure that all appropriate staff are available (or as otherwise agreed) over the planned period of the audit
- respond promptly and adequately to audit queries.

Quality and adding value through the audit

Our overall approach for the audit is clear and upfront communication, founded on our public sector credentials and a methodology to ensure delivery of a quality audit.

The diagram opposite summarises our key approach to adding value to you throughout our audit.

Our methodology is risk based. We comply with Auditing standards and as a Firm we are regulated by the FRC. We taking findings on audit quality seriously and continue to invest as a Firm through our audit investment plan. The audit investment plan is supported by a specific national Public Sector audit plan.

We comply with Audit Scotland's quality arrangements including submitting an annual quality report over our Audit Scotland portfolio. As part of Audit Scotland's quality arrangements, ICAS review our work on a rotational basis. Audit Scotland's quality report can be found at www.audit-scotland.co.uk

Our wider quality arrangements are set out in our annual transparency reports which are available on our website (www.granthornton.co.uk).

Project management

- Use of Inflo to track progress and deliverables throughout the audit
- Clear roles and ownership of responsibilities within our team
- Clarity over expectations and timetable
- Track record delivering public sector audits on behalf of Audit Scotland

Clear reporting

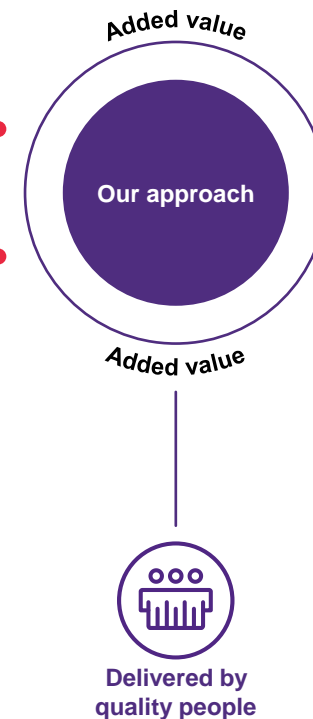
- Clear audit outputs at planning and within our final Annual Report
- Practical, risk based, recommendations for you to take forward
- Our judgements and conclusions set out transparently and in clear language

Pragmatism and early attention of issues

- Accessible and proactive engagement team
- Working with you to reach the right solution – flexing the workplan, recognising Covid-19
- Audit Partner takes ultimate decision on technical matters, consulting with our technical experts where required

Public sector understanding

- Using our public sector insight to inform our audit and identify improvements you could make
- Regular meetings throughout the year sharing our observations and wider sector knowledge
- Engagement Team who specialise in Public Sector Audit including specific training and experience on public sector audits.



Audit Fees

Across all sectors and firms, the FRC has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing. This includes the revised ISA (UK) 540 (revised): Auditing Accounting Estimates and Related Disclosures.

As a firm, we are absolutely committed to meeting the expectations of the FRC over audit quality and public sector financial reporting. This includes, for Audit Scotland contracts, meeting the expectations of the Audit Scotland Quality Team and the ICAS quality framework.

Audit Scotland reviews the expected fee each year and adjusts it, if necessary, based on auditors' experience, new requirements, or significant changes to audited bodies. The audit fee is calculated in accordance with guidance issued by Audit Scotland and provides Auditors to agree uplifts where additional audit work is expected in response to specific risks.

Relevant professional standards

Audit Scotland set the baseline audit fee. We can increase the fee, from the baseline, for the inclusion of additional risks, new technical matters or specific client matters identified. We are required to consider all relevant professional standards, including paragraphs 4.1 and 4.2 of the FRC's Ethical Standard (revised 2019) which state that the Engagement Lead must set a fee sufficient to enable the resourcing of the audit with partners and staff with appropriate time and skill to deliver an audit to the required professional and Ethical standards.

We have discussed an initial fee variation with Management recognising the impact of the cyber attack on underlying accounting records and the additional work which will be required this year. This is provisional and will be quantified on receipt of the unaudited financial statements and supporting working papers.

Proposed Audit fees for 2020/21

Service	Fees £
External Auditor Remuneration* Note 1	72,590
Pooled Costs	9,810
Contribution to Audit Scotland costs	2,170
Contribution to Performance Audit and Best Value	-
2020/21 Fee	84,570

Note 1: We have proposed an increase in the external auditor remuneration of £30,000. This is proposed at this stage, and will be further considered as the audit progresses, in light of the accounting records that are produced and the availability of supporting audit evidence. Reasons for the increased fee this year include:

- The reduction in performance materiality (75% to 50%) resulting in increased sample testing
- The increased seniority within the Audit team, increasing the skills-mix which also includes IT/Cyber audit skills. In addition, due to additional work we require a larger audit team than in prior year.
- The limitations in scope and the increased need for consultation on a disclaimed opinion, including the inclusion of a review Partner
- Additional work required on understanding the controls established alongside the arrangements to produce accounting records this year, and additional work over completeness, occurrence and accuracy of records .
- Increased testing on journals – as everything is journaled this year as records are recreated.

Fee assumptions

In setting the fee for 2020/21 we have assumed that the SEPA will:

- prepare a good quality set of accounts, supported by comprehensive and well-presented working papers which are ready at the start of the audit
- provide appropriate analysis, support and evidence to support all critical judgements and significant judgements made in preparing the financial statements
- provide early notice of proposed complex or unusual transactions which could have a material impact on the financial statements.

Additional Fees (Non-Audit Services)

Service	Fees £
At planning stage we confirm there are no non-audit fees	Nil

Independence

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons, relating to our independence.

We encourage you to contact us to discuss these or any other independence issues with us.

We will also discuss with you if we make additional significant judgements surrounding independence matters.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention.

We have complied with the Financial Reporting Council's Ethical Standard (Revised 2019) and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Ethical Standard.

Our team complete annual fit and proper declarations including independence confirmations on a client by client basis as well as completing timesheets. The work of our Ethics team is overseen by the Ethics partner and all staff undergo ethics training in year.



Appendices

Responsibilities

The Code sets out auditor responsibilities and responsibilities of the audited body. Key responsibilities are summarised below. Please refer to the Code for further detail.

SEPA

Responsibilities include:

- Preparing financial statements that give a true and fair view
- Maintaining accounting records
- Establishing and maintaining systems of internal control
- Effective internal controls including controls to achieve objectives and secure value for money
- Establish arrangements for proper conduct of affairs including legality of transactions
- Arrangements for prevention and detection of fraud, error, irregularity, bribery and corruption
- Appropriate corporate governance arrangements and arrangements to monitor the effectiveness of governance

External Audit

Responsibilities include:

- Comply with professional engagement and ethical standards
- Provide an ISA compliant audit and opinion on the financial statements including regularity of transactions
- Demonstrate compliance with the wider scope public audit as detailed in the Code and applicable guidance
- Liaise with and notify Audit Scotland when circumstances indicate a statutory report may be required. This includes sharing awareness of current and/or sector issues
- Notify Audit Scotland of any known or suspected frauds greater than £5,000
- Contribute to relevant performance studies (as set out in the planning guidance for the year)



Communication

ISA (UK) 260 as well as other ISAs set out prescribed matters which we are required to report to those charged with governance (we assume this to be the Audit Committee on behalf of the Board). Our reporting responsibilities are set out below. We communicate all matters affecting the audit on a timely basis, to management and/or the Audit Committee.

	Audit Plan	Annual Report (considered our ISA 260 Report)
Our communication plan		
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	•	
Confirmation of independence and objectivity	•	•
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	•	•
Significant matters in relation to going concern	•	•
Views about the qualitative aspects of SEPA's accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures		•
Significant findings from the audit		•
Significant matters and issues arising during the audit and written representations that have been sought		•
Significant difficulties encountered during the audit		•
Significant deficiencies in internal control identified during the audit		•
Significant matters arising in connection with related parties		•
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		•
Non-compliance with laws and regulations		•
Unadjusted misstatements and material disclosure omissions		•
Expected modifications to the auditor's report or emphasis of matter – Expected limitation in scope – disclaimer opinion		•

Fraud responsibilities

The term fraud refers to intentional acts of one or more individuals amongst management, those charged with governance, employees or third parties involving the use of deception that result in a material misstatement of the financial statements. In assessing risks, the audit team is alert to the possibility of fraud at SEPA.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relations to management override of controls.
- leading a discussion with those charged of governance (for the Scottish Environment Protection Agency this is assumed to be the Audit Committee) on their view of fraud. Typically we do this when presenting our audit plan and in the form of management and those charged with governance questionnaires.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit.

As auditors we obtain reasonable assurance the financial statements as a whole are free from material misstatement, whether due to fraud or error.

We will obtain annual representation from management regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement. We also make inquires of internal audit around internal control, fraud risk and any known or suspected frauds in year.

Anti-Money Laundering Arrangements

As required under the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017 there is an obligation on the Auditor General (as set out in the planning guidance) to inform the National Crime Agency if he knows or suspects that any person has engaged in money laundering or terrorist financing. Should we be informed of any instances of money laundering at SEPA we will report to the Auditor General as required by Audit Scotland.

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance including establishing and maintaining internal controls over the reliability of financial reporting effectiveness and efficiency of operations and compliance with applicable laws and regulations.

It is SEPA's responsibility to establish arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity.

Throughout the audit we work with SEPA to review specific areas of fraud risk, including the operation of key financial controls. We also examine the policies in place, strategies, standing orders and financial instructions to ensure that they provide a strong framework of internal control.

In addition, as set out in the Audit Scotland Code of Audit Practice we have a role in reviewing SEPA's arrangements in response to the National Fraud Initiative.

All suspected frauds and/or irregularities over £5,000 are reported to Audit Scotland by us as your auditors on a quarterly basis.

Auditing Accounting Estimates and Related Disclosures (ISA 540 revised)

Introduction

Under ISA (UK) 540 (Revised December 2018) auditors are required to understand and assess an entity's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge related to accounting estimates;
- How the entity's risk management process identifies and addresses risks relating to accounting estimates;
- The entity's information system as it relates to accounting estimates;
- The entity's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

As part of this process auditors also need to obtain an understanding of the role of those charged with governance, which is particularly important where the estimates have high estimation uncertainty, or require significant judgement.

Specifically do [Audit Committee](#) members:

- Understand the characteristics of the methods and models used to make the accounting estimates and the risks related to them;
- Oversee management's process for making accounting estimates, including the use of models, and the monitoring activities undertaken by management; and
- Evaluate how management made the accounting estimates?

Additional information that will be required for our March 2021 audits

To ensure our compliance with this revised auditing standard, we will be requesting further information from management and those charged with governance during our audit for the year ended 31 March 2021. Based on our knowledge of SEPA we have identified limited material accounting estimates for which this is likely to apply:

- Defined benefit pension scheme liabilities
- Accruals – including holiday pay
- Decommissioning provision
- Valuation of property, plant and equipment
- Impairment write offs as a result of the cyber attack
- Depreciation

SEPA's Information systems

In respect of SEPA's information systems we are required to consider how management identifies the methods, assumptions and source data used for each material accounting estimate and the need for any changes to these. This includes how management selects, or designs, the methods, assumptions and data to be used and applies the methods used in the valuations.

When the models used include increased complexity or subjectivity, as is the case for many valuation models, auditors need to understand and assess the controls in place over the models and the data included therein. Where adequate controls are not in place we may need to report this as a significant control deficiency and this could affect the amount of detailed substantive testing required during the audit.

If management has changed the method for making an accounting estimate we will need to fully understand management's rationale for this change. Any unexpected changes are likely to raise the audit risk profile of this accounting estimate and may result in the need for additional audit procedures.

Estimation uncertainty

Under ISA (UK) 540 we are required to consider the following:

- How management understands the degree of estimation uncertainty related to each accounting estimate; and
- How management address this estimation uncertainty when selecting their point estimate.

For example, how management identified and considered alternative, methods, assumptions or source data that would be equally valid under the financial reporting framework, and why these alternatives were rejected in favour of the point estimate used.

The revised standard includes increased emphasis on the importance of the financial statement disclosures. Under ISA (UK) 540 (Revised December 2018), auditors are required to assess whether both the accounting estimates themselves and the related disclosures are reasonable.

Where there is a material uncertainty, that is where there is a significant risk of a material change to the estimated carrying value of an asset or liability within the next year, there needs to be additional disclosures. Note that not all material estimates will have a material uncertainty and it is also possible that an estimate that is not material could have a risk of material uncertainty.

Where there is material estimation uncertainty, we would expect the financial statement disclosures to detail:

- What the assumptions and uncertainties are;
- How sensitive the assets and liabilities are to those assumptions, and why;
- The expected resolution of the uncertainty and the range of reasonably possible outcomes for the next financial year; and
- An explanation of any changes made to past assumptions if the uncertainty is unresolved.

Planning enquiries

As part of our planning risk assessment procedures have made formal inquiries of management. We would appreciate a prompt response to these enquiries in due course.

Further information

Further details on the requirements of ISA (UK) 540 (Revised December 2018) can be found in the auditing standard on the Financial Reporting Council's website:

[https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-\(UK\)-540_Revised-December-2018_final.pdf](https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-(UK)-540_Revised-December-2018_final.pdf)

Areas of potential limitation of audit scope

Audit area	Potential limitation of scope identified at planning	Description of potential limitation	Impact on audit scope
Income from contracts (SoCNE)	Yes	Due to limitations in the control environment in relation to income transactions prior to the cyber attack as well as expected limited supporting evidence of underlying transactions we will consider the limitations on the scope of the audit work and assurance we can provide of this financial statement line item, including regularity of transactions, and related notes and disclosures in the financial statements.	Limited audit assurance over this financial statement line item. Limited substantive testing over the income stream on transactions during the year
Other income (SoCNE)	None	No specific limitations expected through our audit planning as the balance is primarily through grant funding which should have limited impact as a result of the cyber attack.	None
Staff costs	Disclosure	No specific limitations in auditing the account balance. We will consider the impact on Management's ability to ensure complete and accurate disclosures (split of staffing costs) within the accounts.	Potential limitations around disclosure notes if underlying information is not available to support disclosure.
Depreciation and impairment of non-current assets (SoCNE)	None	No expected limitations in our audit work.	None
Other operating charges (SoCNE)	Yes	Due to limitations in the control environment in relation to income transactions prior to the cyber attack as well as expected limited supporting evidence of underlying transactions we will consider the limitations on the scope of the audit work and assurance we can provide of this financial statement line item, including regularity of transactions and related notes and disclosures in the financial statements.	Limited audit assurance over this financial statement line item. Limited substantive testing over the income stream on transactions during the year
Finance income & expenses (SoCNE)	None	No expected limitations in our audit work.	None
Other comprehensive expenditure	None	No expected limitations in our audit work.	None

Areas of potential limitation of audit scope

Audit area	Potential limitation of scope identified at planning	Detail	Impact on audit scope
Property, plant and equipment	None	No expected limitations in our audit work.	None
Intangible assets	None	No expected limitations in our audit work. However, we do anticipate impairment of intangibles as a result of the data loss.	None
Trade and other receivables	None	No expected limitations in our audit work.	Additional procedures around completeness, accuracy and existence of balances recognised.
Cash and cash equivalents	None	No expected limitations in our audit work.	None
Trade and other receivables (current and non-current)	None	No expected limitations in our audit work.	Additional procedures around completeness, accuracy and existence of balances recognised.
Provisions & IAS 19 liabilities	None	No expected limitations in our audit work.	None
Reserves & Statement of changes in taxpayers equity	None	No expected limitations in our audit work. However, we will consider the impact of work over income and expenditure accounts on our opinion.	None
Cash flow statement	None	No expected limitations in our audit work. However, we will consider the impact of work over income and expenditure accounts on our opinion.	None
Grant-in-aid	None	No expected limitations in our audit work.	None
Disclosures	Yes	Due to limitations detailed above there may be specific disclosures including related parties, Income from contracts notes, operating charges or staff costs notes where the scope of our work may be limited.	We will consider the information obtained by Management in recreating accounting records to support disclosures in accounts. We will consider the account disclosures made in the draft accounts but consider the completeness of these.

