

# Scottish Environment Protection Agency Financial year ended 31 March 2022

Final External Audit Plan

Audit Committee on 22 March 2022



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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.

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# Plan overview

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The audit plan for the financial year ending 31 March 2022 sets out our risk based audit approach. This plan is reported to those charged with governance (Audit Committee on behalf of the Scottish Environment Protection Agency (“SEPA”) Board). Planning is a continuous process and we will continue to review our risk assessment and planned approach.

## 01 Materiality

We have calculated planning materiality using forecast expenditure as our benchmark: £1.79 million planning materiality. Performance materiality of £1.163 (65% of planning materiality); Trivial is capped at 5% of the above thresholds (£89,500); and, Lower materiality (£20,000) on Staff Remuneration Report

## 02 Limitations in the scope of our audit as a result of the cyber attack

We issued a disclaimer of opinion on the 2021 financial statements as we were unable to verify the completeness and accuracy of income and deferred income as a result of the cyber attack and resultant loss of accounting records. While financial records have been established for 2021/22 it is unlikely we will be able to obtain sufficient assurance around the completeness of income in the current year in the absence of assurances over prior year closing balances.

## 03 Financial statement audit risks

At planning, we have identified the following significant financial statement audit risks:

- Management override of controls (ISA UK 240);
- Risk of fraud in revenue (ISA 240);
- Risk of fraud in expenditure (cut-off) (FRC PN10);
- Valuation of property, plant and equipment; and,
- Valuation of defined benefit pension scheme liabilities.

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## 04 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:

- Financial management including the extent to which SEPA has developed effective systems of internal financial control;
- Financial sustainability with particular focus on how the organisation has incorporated the cost of the cyber attack and its recovery into financial plans as well as maximising the use of resources, in particular the impact on service delivery and cost of bringing forward digital projects, ensuring these represent value for money investments;
- Governance and transparency arrangements during the recovery period including the recruitment process of a new chief executive; and
- Value for money risk in relation to SEPA's ability to utilise resources to support the re-establishment of its core services and meet regulatory requirements following the cyber attack.

As part of our wider scope work we will follow up on SEPA's progress in implementing Management's Action Plan in response to the cyber attack.

## 05 Other audit matters

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

- 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 FRC Practice Note 10 (for the Public Sector)
- In accordance with Audit Scotland planning guidance we will consider the risk of fraud in procurement. We will consider Audit Scotland's: Procurement Red Flags (2019) when undertaking our assessment and report our conclusions within our Annual Audit Report.

## 06 Our Audit Fee

Our fee is £66,620 for the audit of SEPA. We reserve the right to review our fee during the audit should significant delays be encountered and/or new technical matters arise.

# Introduction

## Purpose

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

We are appointed by the Auditor General as the external auditors of SEPA. This is the sixth year of our appointment under the Auditor General for Scotland.

## 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:

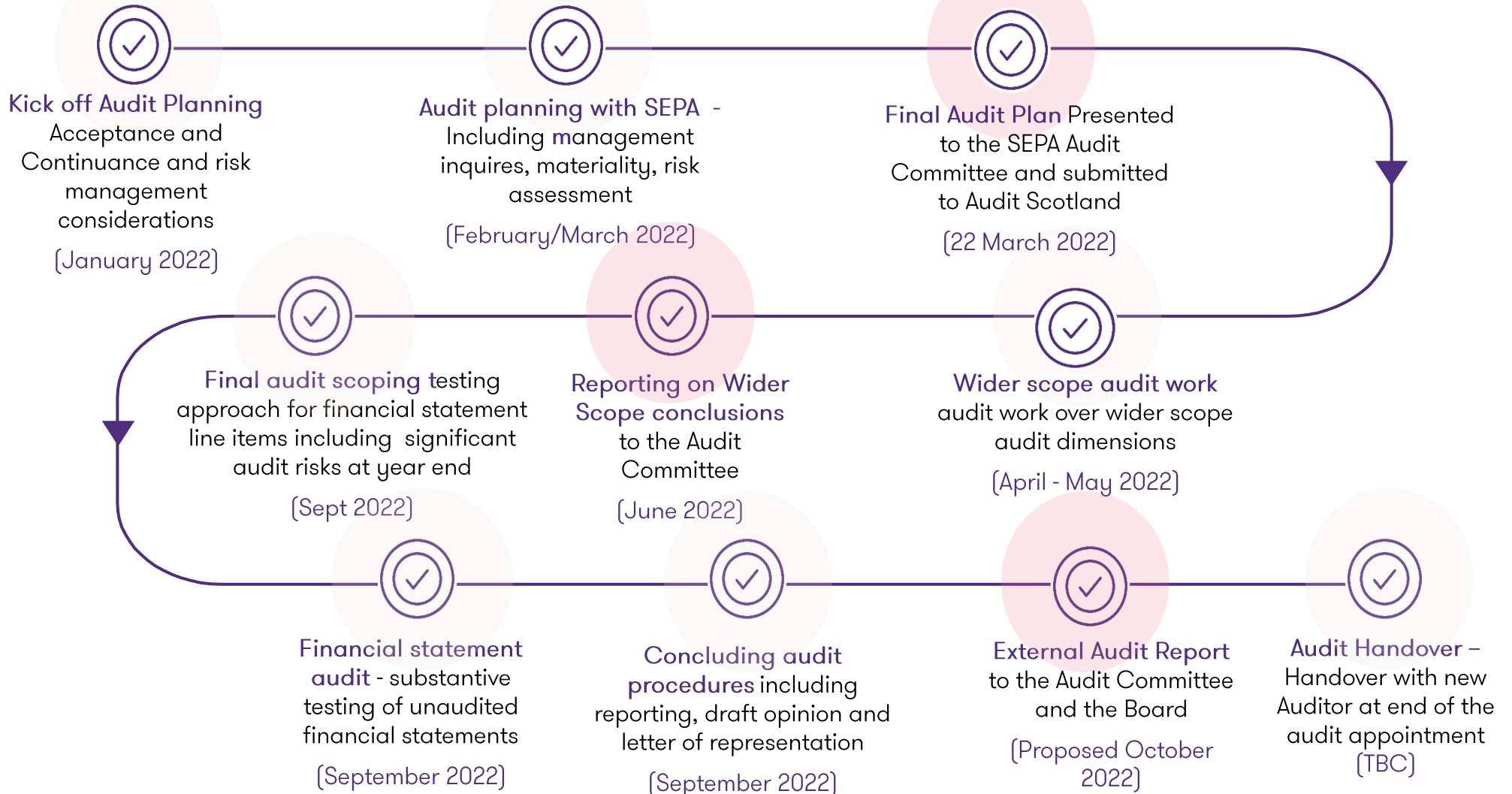
- SEPA financial statements that have been prepared by management with the oversight of those charged with governance (the Audit Committee).

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 understanding of SEPA and is risk based.



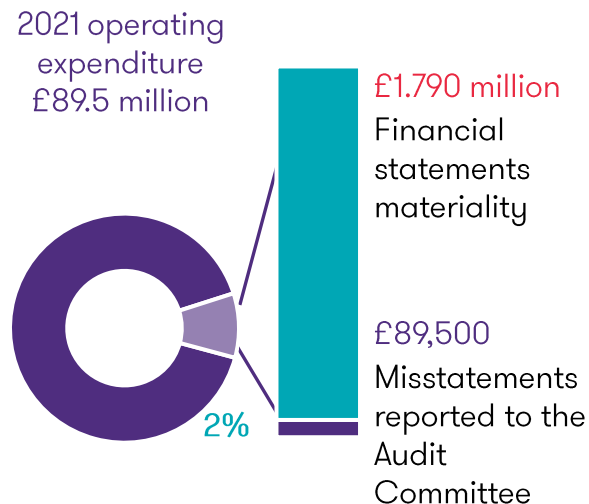
# Audit approach

To provide management with sufficient time to prepare the financial statements and completion of our audit procedures, including the additional procedures as a result of the cyber attack, we have agreed with Management to undertake our detailed audit testing in September 2022 with final reporting in October 2022. A final report to the Board on 25<sup>th</sup> October in order to have the accounts finalised by 31 October 2021 deadline. We propose undertaking our wider scope audit work in advance of the year end and reporting in June.



# Materiality

Financial statement materiality is determined based on a proportion of the total operating expenditure. We have determined **planning materiality** to be £1.790 million, which equates to approximately 2% of total operating expenditure based on the prior year audited 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 65% of planning materiality (£1.163 million). This is based on our understanding of SEPA reflecting the increased risk of misstatement due to accounting systems and processes being established during the year.

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 at (£20,000) where we would consider of such magnitude to be material to the user of the accounts in relation to the Remuneration and Staff Report disclosures.

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 £89,500 being 5% of financial statement materiality.

**We will update our materiality based on the unaudited 2021/22 financial statements. During the course of our audit engagement, we will continue to assess the appropriateness of our materiality.**

# Impact of the cyber attack on our 2021/22 financial statements audit

## Audit assurances in the current year with new financial systems

Following the cyber attack in SEPA established temporary financial processes including income, expenditure and payroll. These arrangements were in place during April and May 2021 (current financial year). Management sought to limit the number of transactions being processed during this period, including delaying the invoicing processes for annual licences until September 2021. In May 2021, SEPA implemented a new version of Agresso (version 2). The Agresso system supports financial reporting and recording of journals and allowed SEPA to move to more permanent controls. The manual records from April and May were subsequently input into the Agresso system. The closing balances from the year ended 31 March 2021 will also be uploaded to the new system for processing prior to the year end.

## Impact on testing approach in the current year

We considered the design of the temporary financial processes SEPA had established since the cyber attack in our prior year audit. We will walkthrough the controls in place over key financial processes in April and May 2021 to ensure the design of these controls is appropriate. We also consider the design of controls in place since May when the new financial system was implemented.

We will review the processes in place over the transfer of manual records to the new Agresso V2 to ensure completeness of the ledger, recognising increased risk of misstatement arising from the transfer of data.

## Impact of prior year disclaimer on our 2021/22 audit

As a result of the cyber attack, in 2020/21 we issued a disclaimer audit opinion over assurance of the occurrence of income from contracts. As a result we do not have assurance over opening deferred income balances and the occurrence of income from contracts in the prior year. During 2021/22, we will consider the impact of the prior year disclaimer of opinion on our audit. There is an increased risk that there may be limitation in the assurance obtained over the Completeness of Income.

We will look to undertake procedures to gain assurance over the completeness over Income from Contracts in the current year, including agreeing to underlying customer records in order to gain sufficient assurance over the Completeness of Income in the current year. Our audit work in 2021/22 will consider the initial annual billing run in September 2021 and linking back to payments and customer details in year. Our testing will look to gain assurance over the completeness of Income from Contracts in the current year, including that there is no indication that income recognised in the prior year relates to 2021/22.



# 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.

## 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. 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. Journals entries will be selected using computer-assisted profiling based on areas which we consider to be of increased risk.

Our work focuses on critical estimates and judgements as set out within the financial statements, including accounting policies. In addition, we specifically consider journals used around the year end in creating the financial statements where controls may be overridden by management. We will also consider the process in place for retrospectively recording financial transactions between April 2021 and May 2022 initially recorded manually on to the Agresso (V2) system. These are inherently the areas in which management has the potential to use their judgement to influence the financial statements. 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, that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

## Risk of Fraud in Expenditure Recognition (as recommended within Practice Note 10) (completeness)

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 (2020/21: £16.615 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. We consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of these expenditure streams where there may be greatest incentive and opportunity for misstatement.

Our testing includes a specific focus on year end cut-off arrangements, where it may be advantageous for management to show an enhanced/different financial position in the context of reporting in-year to Scottish Government and the need to achieve the financial targets set in the current and future years.

# Significant audit risks (continued)

**Risk of Fraud and error in revenue recognition (as required within Auditing Standards – ISA 240)**  
(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 2020/21 SEPA's operating income consisted of income from contracts of £42.092 million and other income of £1.8 million (not considered a significant risk of material misstatement). We therefore focus our significant risk of material misstatement on income from contracts.

**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. 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. In particular, our risk focuses on the suitability of the underlying assumptions used in the valuation.

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)

### (Valuation)

In accordance with the FReM, 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 2021, 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, buildings and gauging stations. The risk is less prevalent in other PPE including equipment, fixtures and fittings, and vehicles, as these are generally held at depreciated historic cost, as a proxy of fair value and therefore less likely to be misstated. In addition, the Sir John Murray vessel and land held by SEPA are not material and valuations have remained broadly consistent over the last five years. Therefore, we do not consider these assets of significant risk of material misstatement. We focus the risk of material misstatement on buildings and gauging stations.

SEPA appointed Cushman and Wakefield to value land, buildings and gauging stations (Century Marine for the John Murray vessel). In 2021/22 land, buildings and vessels will be subject to valuation and annual indexation of gauging stations. We will review the work performed by Management in ensuring that property, plant and equipment are valued in accordance with the FReM as at 31 March 2022. In particular, where valuations have been obtained we will review the work performed by independent valuers and focus on any significant movements in value in the year or where there has been a change in the basis of valuation. Where assets have been indexed in the year, we will review the suitability of the indices used and how Management has assurances around the condition of the assets and that there is not any indication of impairment.

**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.**

# 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: 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 (2021/22). Where relevant we refer to them here, or within our wider audit plan.

## Financial management

As part of SEPA's cyber attack recovery programme, the organisation has sought to re-establish its financial control environment. This has included underlying financial controls as well as financial reporting and monitoring arrangement. There is a risk that given the scale of the operational challenges facing SEPA it does not have sufficient capacity or resources to ensure that financial systems and processes, including financial monitoring arrangements are developed effectively to provide robust systems of internal financial control.

In response to the wider scope risk, we will consider the financial management arrangements established by Management to support the organisation remobilise its services including financial monitoring and reporting arrangements. Our work will build on our understanding of key financial systems from our financial statement audit work as well as assessing wider financial management arrangements in place. We will consider the work performed by Management to ensure financial systems and processes are designed and implemented effectively as well as independent assurances provided by Internal Audit.

# 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 a worse case budget gap of £17.9 million (worst case scenario). Following the cyber attack, SEPA has been re-establishing its financial forecasts. A key part of SEPA's recovery programme is to accelerate the planned strategic investment in underlying processes and systems. This investment underpins a wider strategic plan to deliver more efficient and effective ways of working. A key challenge for SEPA is balancing the development and implementation of a range of new systems and processes whilst focusing on establishing core systems and effectively utilising the resources available, including staffing resources where the cyber attack may have significantly impacted on their ability to work effectively.

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. Our wider scope audit work will look at how SEPA manages the level of significant IT procurement activity, and the extent to which this investment demonstrates value for money and is supported through clear business cases and planning.

## Governance and transparency

In January 2022, the Chief Executive resigned from his role at SEPA. SEPA has established interim arrangements, including the Chief Officer acting as Chief Executive as the recruitment process is underway. Given the challenges facing SEPA it is important that the organisation has the capacity and capability across its Leadership team. We will review the leadership and governance arrangements in place at SEPA following and the capacity within the organisation to support SEPA's recovery from the cyber attack and delivery of its core services.

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# Wider scope risks identified in planning (continued)

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## Value for money

Following the cyber attack SEPA has been implementing a programme of recovery as it looks to re-establish its core services. In doing so, SEPA looked to prioritise those relating to public health and safety, including flood alerts. It is important that SEPA looks to establish its wider services, including those relating to its statutory functions as environment regulator.

We will consider the extent to which SEPA can demonstrate the effective use of resources, including staff, in re-establishing its core services. In particular, how management focus on those services and operations that ensure SEPA can meet its regulatory requirements as environmental regulator. We will review the plans in place at SEPA through its recovery activity and longer term planning.

## Other wider scope areas

### Cyber attack Management Action Plan

In 2020/21 Management developed a detailed response (Action Plan) to the cyber attack, with progress monitored through the Agency Management Team and Board. In 2020/21 we reported in the progress being made by SEPA in implementing these actions. In 2021/22 as SEPA focuses on recovery and re-establishment of services, we will monitor the progress made by Management against this action plan, including any additional areas of improvement identified during its implementation.

### Risk of fraud in procurement

Audit Scotland's Planning Guidance 2021/22, requires us to consider the risk of fraud in procurement across our audited bodies. In addition to the wider scope risks set out above, we will consider specific risk of fraud within procurement during 2021/22. We will consider Audit Scotland's: Procurement Red Flags (2019) when undertaking our assessment and report our conclusions within our Annual Audit Report.

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# Other matters

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## 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, a new Report for SEPA as required under the FReM, 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, a new Report for SEPA as required under the FReM, are in line with requirements set out in FReM (opinion)

We consider our other duties under the Code and planning guidance (2021/22), as and when required, including:

- Supporting Audit Scotland in Section 22 reporting.
- Reporting on SEPA's participation in the National Fraud Initiative through the Audit Scotland NFI checklist (31 March 2022).
- Notifying Audit Scotland of any cases of money laundering or fraud.
- Review of Central Government Technical guidance prior to issue by Audit Scotland

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## 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. In particular we will:

- Consider procedures and controls around related parties, journal entries and other key entity level controls.
- Perform walkthrough procedures on key controls around identified risk areas including Income from contacts, payroll expenditure, material non-pay expenditure streams, journal entries and material areas of management estimate and judgement including the valuation of property, plant and equipment and IAS 19 defined benefit liabilities.

Our focus is design and implementation of controls only. We do place reliance on controls when it comes to our year end financial statement audit work.

## 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. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

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## 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).

In considering going concern, we will consider the applicability of PN 10 to SEPA.

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## 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.



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## Other financial reporting developments - Changes in the FReM for 2021/22

One of the changes to the FReM 2021/22 is to expanded requirements for Fair Pay Disclosures within the remuneration and staff report. This is in line with changes made to the FReM for 2021/22. The main changes are:

- A new requirement to disclose the percentage year on year changes in salary and allowances, and performance pay and bonuses, for the highest paid director and for the employees of the entity taken as a whole.
- total pay and benefits, and the salary component separately, for the 25th, 50th and 75th percentiles (previously just the median remuneration). This should be based on annualised, full-time equivalent remuneration of all staff (including temporary and agency staff) as at 31 March 2022. For the purpose of this disclosure, pay and benefits excludes the value of pension benefits and severance payments.
- a summary for 2021/22 explaining:
  - whether movement in the ratios is attributable to a change in the highest paid director's remuneration or the employees, or a change in the body's employment models;
  - trends in the median pay ratio; and,
  - whether the body believes that the median pay ratio reflects the pay, rewards and progression policy for employees as a whole.

We will review SEPA's Remuneration and Staff report disclosures in the draft financial statements to evaluate whether the disclosures are complete, clear, concise, and free from material misstatement.

# Audit timeline



## Client responsibilities

Where audited bodies 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 audited bodies. 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.

## 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 and able to respond promptly and adequately to audit queries.

# 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.

The audit fee is calculated in accordance with guidance issued by Audit Scotland. Audit Scotland issued the baseline fee to SEPA in December 2021. In accordance with Audit Scotland guidance, we can increase this fee by up to 20% depending on our audit risk assessment and planned additional audit work in this area. We have agreed with the Chief Officer, Finance to increase our fee by £11,000. This reflects the additional audit work in the current year as a result of SEPA implementing new finance processes in year and additional testing over these including engagement with our internal quality specialists. The Audit fee includes Audit Scotland pooled costs and audit Scotland support costs.

## Relevant professional standards

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.

## Audit fees for 2021/22

Service	Fees £
External Auditor Remuneration for the audit of Scottish Environment Protection Agency	54,500
Pooled Costs	10,060
Contribution to Audit Scotland costs	2,060
Contribution to Performance Audit and Best Value	-
<b>2021/22 Fee</b>	<b>66,620</b>

## Additional Fees (Non-Audit Services)

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

## Fee assumptions

In setting the fee for 2021/22 we have assumed that 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.

# 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 SEPA). 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)
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		•

# 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 Scottish Environment Protection Agency.

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 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.



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.

### 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.

# Accounting estimates and related disclosures

The Financial Reporting Council issued an updated ISA (UK) 540 (revised): *Auditing Accounting Estimates and Related Disclosures* which includes significant enhancements in respect of the audit risk assessment process for accounting estimates. The first year this impacted on was the 2020/21 financial year.

## 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

To ensure our compliance with this revised auditing standard, we will be requesting again this year further information from management and those charged with governance during our audit for the year ended 31 March 2022. These are included within our planning inquiries. Upon receipt of these we will conclude our audit planning and risk assessment over accounting estimates.

Based on our knowledge of the SEPA, in particular prior year, we have identified the following significant accounting estimates, being land building, and gauging station valuations and IAS 19 defined benefit pension scheme liabilities. In addition, SEPA have the following material accounting estimates: Estimated cost of decommissioning and the valuation of life assurance liability.

## 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.

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.

# Financial accounting updates – International Financial Reporting standard 16: Leases

Following the previous deferrals of IFRS 16 *Leases* under the FReM, this accounting standard will now be implemented from 1 April 2022.

The new standard brings significant changes for lessee accounting. Key points that bodies will need to consider on transition include:

- The need to recognise the cumulative effects of initially applying IFRS 16 on 1 April 2022 as an adjustment to the opening balances of taxpayers' equity. (This means prior year comparators will not need to be restated at 31 March 2023).
- The need to recognise the right-of-use asset for leases previously classified as operating leases at an amount equal to the outstanding lease liability.
- No adjustments are needed for leases for which the underlying asset is of low value (less than £5,000 new) or where the lease term ends on or before 31 March 2023.
- Assets where there is no or a below market rate peppercorn lease premium should be recognised as a right-of-use asset measured at current value in existing use or fair value as appropriate. Any difference between this and the lease liability will be recognised as part of the adjustment to the opening balances of taxpayers' equity.
- Irrecoverable VAT should not be included in the lease liability nor the value of the right of use asset.
- Existing finance lease and PFI liabilities that have an element based on an index or other rate will need to be reviewed and possibly amended as such variable payments are incorporated into the measurement of the lease liability under IFRS 16. (HM Treasury is expected to provide further guidance regarding the implementation of changes to accounting for PFI arrangements).

## Impact on 2021/22

The 2021/22 financial statements will need to disclose the anticipated impact of adopting IFRS 16 from 1 April 2022.

We will consider the organisation's progress towards the implementation of IFRS 16 and the completeness and accuracy of disclosures within the financial statements of the impact of the adoption of the new standard.

# Auditing developments

There are changes to the following ISA (UK):

- ISA (UK) 315 (Revised July 2020) ‘Identifying and Assessing the Risks of Material Misstatement’ - This will impact audits of financial statement for periods commencing on or after 15 December 2021.
- ISA (UK) 240 (Revised May 2021) ‘The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements’ This will impact audits of financial statement for periods commencing on or after 15 December 2021.

A summary of the impact of the key changes on various aspects of the audit is included below:

Area of change	Impact of changes
Risk assessment	<ul style="list-style-type: none"> <li>• The nature, timing and extent of audit procedures performed in support of the audit opinion may change due to clarification of:               <ul style="list-style-type: none"> <li>• the risk assessment process, which provides the basis for the assessment of the risks of material misstatement and the design of audit procedures</li> <li>• the identification and extent of work effort needed for indirect and direct controls in the system of internal control</li> <li>• the controls for which design and implementation needs to be assess and how that impacts sampling</li> <li>• the considerations for using automated tools and techniques.</li> </ul> </li> </ul>
Direction, supervision and review of the engagement	<ul style="list-style-type: none"> <li>• Greater responsibilities, audit procedures and actions are assigned directly to the engagement lead, resulting in increased involvement in the performance and review of audit procedures.</li> </ul>
Professional scepticism	<ul style="list-style-type: none"> <li>• The design, nature, timing and extent of audit procedures performed in support of the audit opinion may change due to:               <ul style="list-style-type: none"> <li>• increased emphasis on the exercise of professional judgement and professional scepticism</li> <li>• an equal focus on both corroborative and contradictory information obtained and used in generating audit evidence</li> <li>• increased guidance on management and auditor bias</li> <li>• additional focus on the authenticity of information used as audit evidence</li> <li>• a focus on response to inquiries that appear implausible</li> </ul> </li> </ul>

Area of change	Impact of changes
Fraud	<ul style="list-style-type: none"> <li>• The design, nature timing and extent of audit procedures performed in support of the audit opinion may change due to:               <ul style="list-style-type: none"> <li>• clarification of the requirements relating to understanding fraud risk factors</li> <li>• additional communications with management or those charged with governance</li> </ul> </li> </ul>
Documentation	<ul style="list-style-type: none"> <li>• The amendments to these auditing standards will also result in additional documentation requirements to demonstrate how these requirements have been addressed.</li> </ul>

