Grant Thornton

External Audit Report for Scottish Environment Protection Agency (SEPA)

Financial year ended 31 March 2022

Prepared for the Board of SEPA and the Auditor General for Scotland

Board meeting 29 November 2022

Contents

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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 external audit 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 Scottish Environment Protection Agency (SEPA) 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.

Introduction

Scope of our audit work

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2022 for SEPA. The scope of our audit was set out in our External Audit Plan which was presented to the Audit Committee in March 2022:

The main elements of our audit work in 2021/22 have been:

- An audit of SEPA's annual report and accounts for the financial year ended 31 March 2022; and
- Consideration of the wider dimensions that frame the scope of public audit as set out in Audit Scotland's Code of Audit Practice 2016 ('the Code') covering: financial management; financial sustainability; governance and transparency and value for money.

Our work has been undertaken in accordance with International Standards of Auditing (ISAs) (UK) and the Code.

This report is addressed to the Board of SEPA and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

Responsibilities

SEPA is responsible for preparing an annual report and accounts which show a true and fair view and that are in accordance with the accounts direction from Scottish Ministers. The Board is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity that enable it to successfully deliver its objectives.

The recommendations or risks identified in this report are only those that have come to our attention during our normal audit work and may not be all that exist. Communication in this report of matters arising from the audit or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Adding value through our audit work

We aim to add value to SEPA throughout our audit work. We do this through using our wider public sector knowledge and expertise to provide constructive, forward looking recommendations where we identify areas for improvement and encourage good practice around financial management and sustainability, risk and performance.

In so doing, we aim to help SEPA promote improved standards of governance, better management and decision making, and more effective use of resources.

Similar to prior year we have continued to be flexible, working closely with SEPA, following the cyber attack and loss of data. We have had ongoing communication during the year and welcome Management's openness to working with audit and supporting the audit process.

Audit of the annual report and accounts

Key messages and judgements

We have issued our audit opinion on the Annual Report and Accounts. This recognises the disclaimer opinion in prior year, given comparatives are within the 2021/22 financial statements.

We have identified 1 adjusted and no unadjusted audit misstatements to the financial statements. Disclosure corrections identified during our audit have been detailed in Appendix 1.

We have also raised recommendations for management as a result of our audit work in Appendix 2.

Our follow up of recommendations from the prior year's audit are detailed in Appendix 3.

Our audit opinion

For the financial year ended 31 March 2022 we have issued a modified opinion on the annual report and accounts. The opinion does reference the prior year disclaimer opinion (2020/21 accounts), as balances as at 31 March 2021 are included in these statements, as prior year comparatives. As reported in the independent auditor's report:

In our opinion, except for the possible effects on the corresponding figures of the matter described in the Basis for qualified opinion section of our report, the accompanying financial statements:

- give a true and fair view and were properly prepared in accordance with the financial reporting framework;
- expenditure and income were incurred in accordance with applicable enactments and guidance;
- the audited part of the Remuneration and Staff Report, Performance Report and Governance Statement are all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

The audit process

In accordance with our annual external audit plan, our audit work commenced late August 2022 and we received the unaudited financial statements in line with our agreed timetable. The draft financial statements were of a good quality. Our 2021/22 external audit work was completed remotely, with the audit team and SEPA management team working together effectively via Teams.

There was 1 audit adjustment to the draft primary financial statements and no unadjusted audit misstatements have been identified as a result of our audit procedures. We have however identified disclosure adjustments in respect of the draft financial statements, a full listing of which is detailed in Appendix 1.

We have raised recommendations for management as a result of our audit work in Appendix 2. Our follow up of recommendations from the prior year's audit are detailed in Appendix 3.

We thank management and the finance team for their support and assistance during the audit process in particular their timely response to audit queries.

Audit of the annual report and accounts

Materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Our audit approach was set out in our audit plan communicated to the Audit Committee and finalised and submitted to Audit Scotland.

We updated our audit materiality to reflect your 2021/22 draft financial statements. Materiality was set at £1.817 million, representing 1.8% of total expenditure in the 2021/22 unaudited accounts. In updating our materiality we also revised the % benchmarks within our audit plan. On reflection, recognising the increased interest in SEPA, by stakeholders and users of the accounts, following the Cyber attack we adjusted our overall materiality, using a baseline of 1.8% compared to the 2% set out in the audit plan. This resulted in an overall change in materiality of £270k (planned materiality vs new materiality).

We report to management any differences identified over £90,900 (trivial set at 5% of overall materiality).

We applied a lower materiality threshold of £25,000 for Senior Officers' Remuneration for disclosures within the Remuneration and Staff Report to ensure that Senior Officers' Remuneration has been disclosed appropriately.

Internal control environment

In accordance with ISA requirements we have developed an understanding of SEPA's control environment. Our audit is not controls based and we have not placed reliance on controls operating effectively as our audit is substantive in nature however we have assessed the design and implementation of key controls in relation to significant risk areas. Recognising the Cyber attack, we sought to understand relevant control environment changes during the year, as the financial ledger was re-built, as the control environment was redeveloped during the year.

We identified no material weaknesses or areas of concern from this work which would have caused us to alter the planned approach as documented in our plan. Areas of recommendation have however been identified over the course of the audit and have been outlined in Appendix 2 of this report.

Responding to significant financial statement risks

Significant risks are defined by the International Standard on Auditing (UK) (ISAs) 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.

Risks identified in our Audit Plan	Commentary

Management override of controls
 	
As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. 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's internal controls, related to individual transactions.
 	
Our work focuses on critical estimates and judgements as set out within the financial statements, where management override could be possible and/or more susceptible to override.
 	
In addition, we specifically consider the existence of revenue during the financial year (non-Grant-in-Aid from Scottish Government) and the use of manual journals during the year and in creating the financial statements where controls may be overridden by management.
	In response to this significant risk, our audit response was as follows:
	• We considered the design of controls in place over key accounting estimates and judgements through performance of walkthrough procedures.
	• We reviewed accounting estimates for management bias/indication of fraud that could result in material misstatement. This included review of estimates as at 31 March 2022 and retrospective review of those estimates as at 31 March 2021.
	• Journals testing including:
	  • Assessment of the design of controls in place over journal entries, including journal preparation, authorisation and processing onto the financial ledger;
	  • Risk assessment of the journals population to identify large or unusual journal entries, such as those that are not incurred in the normal course of business, or those entries that may be indicative of fraud or error that could result in material misstatement. We tested these journals to ensure they were appropriate and suitably recorded in the financial ledger;
	  • Target testing of transactions and journals posted around the financial year end, reviewing to understand the rationale for these entries.
	
	Conclusion
	We can confirm that we did not find evidence of management override of controls in our testing of journal transactions or any instances of material error. Furthermore, we did not identify any indication of fraud or inappropriate management bias in accounting estimates that could result in a material misstatement.
	We note that an appropriate level of segregation of duties exists between the journal preparers and reviewers, however, following the rebuilding of the financial system after the cyber-attack, journals are added to a queue to be processed within the Agresso system. On a daily basis, these are entered into the financial reporting system by the Agresso Team, with journals processed based upon receipt (see Action plan 2).

Risks identified in our Audit Plan	Commentary
Risk of fraud in revenue recognition 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, 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 (as outlined in the audit plan). We therefore focus our significant risk of material misstatement on income from contracts. We consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of income from contracts where there may be greatest incentive and opportunity for misstatement. Notwithstanding the identified limitations over revenue as a result of the cyber attack, in response to the significant risk our testing will consider the occurrence of income recorded at the year end.	In response to this significant risk, our audit response was as follows: • Performed walkthroughs of the controls and procedures in place over Revenue (non-Scottish Grant-in-Aid); • Performed detail sample testing of revenue transactions throughout the year ended 31 March 2022 to verify the existence and accuracy of these transactions and confirmed that transactions had been recognised in the correct financial period; • Reviewed the judgements and estimates made by management when recognising material accrued and deferred income at year end within the financial statements and where appropriate challenged management accordingly; and • Tested material debtor balances to gain assurance over the occurrence and accuracy of these balances as at year end. **Conclusion** Through audit procedures performed we did not identify any exceptions in relation to the occurrence, accuracy or completeness of revenue recognised by SEPA during 2021/22, either as a result of fraud or error. No exceptions were identified as a result of focused testing performed in relation to the existence of revenue transactions or revenue journals posted throughout the financial year. As a result of our substantive procedures and sample testing we did not identify any revenue which was not in accordance with the nature of SEPA (regularity testing). We have gained assurance in relation to the recoverability of year end debtor balances and are satisfied that these balances have been recorded accurately.

Risks identified in our Audit Plan	Commentary
IAS 19 Defined Pension Liability – Valuation risk 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 in 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.	• From year end planning review our risk focused predominantly around the key assumptions used in the actuarial valuation, where there was an increased risk of material misstatement. • We performed walkthroughs of the controls and procedures over the valuation of defined benefit pension liabilities, including Management oversight of the valuation. • We considered the work of the actuary (Hymans Robertson UK 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 obtained assurances from Ernst & Young LLP as Auditors of the Pension Fund over the information supplied to the actuary in relation to the SEPA, including assets held and membership data, and confirm joint assurances in respect of employer and employee contributions in the year. • We performed substantive analytical procedures in the year over the pension fund movements, investigating any deviations from audit expectation. • We reviewed the accounting entries and disclosures made within SEPA's financial statements in relation to IAS 19. **Conclusion** Through our audit procedures performed we did not identify any exceptions in our review and testing over IAS 19 defined benefit pension liabilities recognised in the financial statements. Through considering the work performed by PwC, we are satisfied that the assumptions applied by the actuary are reasonable. The IAS 19 defined benefit liability decreased from £189.6 million in 2020/21 to £121 million 2021/22. In 2021/22, asset values had increased reflecting market performance of investments held by the pension fund, whilst the value of liabilities decreased driven primarily through increase in discount rates and salary and pension increases. In the immediate aftermath of Russia's invasion on Ukraine, there was a significant fall in the Fund's asset values. However, over the remainder of March 2022, the Fund's assets have broadly recovered to similar levels to before the invasion. The overall movement is consistent with other LGPS participating bodies.

Risks identified in our Audit Plan	Commentary
Valuation of Property, Plant and Equipment (PPE) In accordance with the Financial Reporting Manual (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 [per audit plan]. 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. 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.	In response to this significant risk, our audit response was as follows: • Walkthroughs of the controls and procedures over the valuation of PPE; • Evaluation of the competence, capability and objectivity of SEPA's professional valuers who represent management's experts under ISA 500; • Confirmed the completeness and accuracy of underlying information provided by SEPA and used by their valuers in arriving at the valuation of PPE as at 31 March 2022; • Agreed the valuation report provided by the valuers to the underlying accounting entries made by SEPA in the 2021/22 financial statements; • Challenged the appropriateness of the assumptions adopted by the valuers and management, in particular in respect of gauging stations; • Challenged management's assessment of potential impairment of assets including consideration of any indicators of impairment within gauging stations in particular; and • Used our auditor's valuation expert in order to challenge SEPA's management of the valuation instructions issued and approach adopted by SEPA in valuing PPE assets as at 31 March 2022. **Conclusion** Based on our testing, we conclude that SEPA's PPE assets have been valued in accordance with the FReM and that the assumptions adopted by management and their valuer are deemed reasonable. SEPA undertake annual valuations and commission independent valuations. SEPA have appointed Cushman and Wakefield to value land, buildings and gauging stations whilst Century Marine Services Limited are appointed to value the Sir John Murray vessel. All such valuations are conducted by independent, registered valuers, in accordance with the Royal Institute of Chartered Surveyors (RICS) requirements.

Risks identified in our Audit Plan	Commentary
Valuation of PPE(continued)	SEPA's gauging stations as at 31 March 2022 were valued at £21.255 million. The last formal independent valuation was completed in 2018 where an independent valuer, valued 20% of the assets, and extended that valuation, to give an overall valuation of all gauging stations. On advice of the valuer, on an annual basis management apply the Building Cost Information Service (BCIS) indices to the gauging stations, with a full valuation planned every 5 years. The next full valuation is 2022/23. Given the increasing impact of inflation and general construction prices, the BCIS rate used, resulted in an increase in gauging station value of £4.016 million in year. Given the valuation increase, we sought to challenge management further, applying audit professional scepticism: - Existence of the gauging stations given the narrative in the annual report and accounts on limitations, in some cases, for SEPA to access the gauging station, and a question over SEPA ownership of the land, on which the gauging station rests; - Ongoing maintenance and repair of gauging stations, to support management's impairment considerations; - Future use of the gauging station and whether the valuation method of depreciated replacement cost was the most suitable basis for valuation, compared with modern equivalent use, recognising the improvements in technology - Future SEPA strategy on gauging stations including use. **Conclusion** Through our audit procedures, and from review of published gauging station data, we gained comfort over the existence of SEPA's gauging stations. We challenged management over the impairment of these stations alongside their future use to gain assurance over the accuracy of the valuations as at 31 March 2022. We note the specialised nature of gauging stations and that SEPA have yet to identify a suitably skilled and experienced valuer to undertake the full valuation required under FReM for the 2022/23 financial statements. Given the nature of these assets SEPA may need to explore whether an engineering firm (or equivalent) may be best placed to assist. Without a suitable valuer, and a full-in-year valuation, SEPA would not be in compliance with the FReM (see Action plan 1)

Detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, to detect material misstatements in respect of irregularities, including fraud. Owing to the inherent limitations of an audit, there is an unavoidable risk that material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs (UK).

The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to SEPA and determined that the most significant which are directly relevant to specific assertions in the financial statements are those related to the reporting frameworks; International Financial Reporting Standards and the 2021/22 HM Treasury Financial Reporting Manual (FReM).
- We enquired of management and the Audit Committee, concerning SEPA's policies and procedures relating to the identification, evaluation and compliance with laws and regulations; the detection and response to the risks of fraud; and the establishment of internal controls to mitigate risks related to fraud or non-compliance with laws and regulations.
- We enquired of management and the Audit Committee, whether they were aware of any instances of non-compliance with laws and regulations or whether they had any knowledge of actual, suspected or alleged fraud.
- We assessed the susceptibility of SEPA's financial statements to material misstatement, including how fraud might occur, by evaluating management's incentives and opportunities for manipulation of the financial statements. This included the evaluation of the risk of management override of controls. We determined that the principal risks were in relation to journal entries that altered SEPA's financial performance for the year and potential management bias in determining accounting estimates in relation to the valuation of PPE assets, in particular gauging stations, as at 31 March 2022. Our audit procedures are documented within our response to the significant risk of management override of controls.
- These audit procedures were designed to provide reasonable assurance that the financial statements were free from fraud or error. However, detecting irregularities that result from fraud is inherently more difficult than detecting those that result from error, as those irregularities that result from fraud may involve collusion, deliberate concealment, forgery or intentional misrepresentations. Also, the further removed non-compliance with laws and regulations is from events and transactions reflected in the financial statements, the less likely we would become aware of it.
- The team communications in respect of potential non-compliance with relevant laws and regulations, included the potential for fraud in revenue recognition and significant accounting estimates.
- In assessing the potential risks of material misstatement, we obtained an understanding of:
  - SEPA's operations, including the nature of its operating revenue and expenditure and its services and of its objectives and strategies to understand the classes of transactions, account balances, expected financial statement disclosures and business risks that may result in risks of material misstatement.
  - SEPA's control environment, including the policies and procedures implemented by SEPA to ensure compliance with the requirements of the financial reporting framework.

Significant estimates and judgements

SEPA's financial statements include the following significant accounting estimates and judgements impacting on the annual accounts:

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Property, Plant and Equipment Valuations	In accordance with the FReM, SEPA is required to value property, plant and equipment on the basis of current value in existing use. For land, buildings and vessels, Management appointed independent valuers to undertake a valuation of these assets. For gauging stations, these assets are valued every five years with indexation applied in intervening years. The valuer has conducted the valuation in accordance with the FReM and RICS guidance and the valuation movements are reflected in the accounts.	We are satisfied that the approach adopted by SEPA is reasonable in estimating the value of property, plant and equipment and that there is no indication of management bias in the approach adopted. For land and buildings and vessels, Management obtained independent valuations of these assets as at 31 March 2022. For gauging stations, Management used publicised BCIS rates. We challenged Management on the suitability of these rates who obtained independent assurance from Cushman and Wakefield that the rates applied were suitable.	● Light purple

Assessment

● Dark Purple We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated

● Blue We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic

● Grey We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious

● Light Purple We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant estimates and judgements

SEPA's financial statements include the following significant accounting estimates and judgements impacting on the annual accounts:

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
IAS 19 Defined Benefit Pension Liabilities	SEPA engage Hymans Robertson UK LLP to provide an annual IAS 19 actuarial valuation of the Authority'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. These key assumptions are discussed with the actuary to inform the report. These are predominantly informed by the actuaries recommended assumptions. The Head of Finance reviews the draft actuarial valuation to ensure appropriate and any significant movements or unusual entries are discussed with the actuary.	As noted in our response to significant risk section, using the work of PwC we reviewed the key assumptions underpinning the actuarial valuation. We are satisfied that the assumptions adopted were appropriate for SEPA and that those applied were considered reasonable i.e. within our acceptable tolerances. We did not identify any indication of management bias in the underlying assumptions applied in the estimate and found that Management have disclosed the key sensitivities surrounding these in the draft financial statements.	● Light purple
Allowance for Expected Credit Losses	Following the cyber-attack in December 2020 and the recreation of the 2020/21 financial records, the net outstanding debtors balance at 31 March 2021 reflected the payments received post 1 April 2021, relating to services provided in 2020/21. In 2021/22, SEPA issued customer statements outlining their outstanding balance as per their records and have continued to work through customer queries, correcting balances where appropriate.	We are satisfied that the approach adopted by SEPA is reasonable. SEPA have made an allowance for expected credit losses for all outstanding debt as at 31 March 2021 as this is not expected to be recovered. For 2021/22, SEPA have reviewed any new debt to identify on an individual basis what should be provided for and this is deemed to be reasonable.	● Light purple

Significant estimates and judgements (continued)

As set out in our Audit Plan, to ensure compliance with ISA 540 revised we also requested further information from management in relation to the following estimates (which have not been considered significant by management as described above):

- Evidence used to assess impairment within Trade Receivables
- Estimated cost of decommissioning

We would consider this an area of application of accounting policy rather than areas of judgement in applying accounting policies. IAS 1 requires disclosure of significant estimates where there is a risk these could materially change over the next 12 months. Whilst the financial statements cover those areas of critical judgement and estimation, there is an opportunity to enhance disclosures made in accordance with IAS 1. This includes providing the reader clarity around the key assumptions and areas of estimation that could result in a material change in the coming period and sensitivities around these. In addition, the note should disclose where judgement has been made in applying accounting policy (not included within estimates). We would not consider decommissioning costs to meet this definition. See Appendix 2.

Other key elements of the financial statements

As part of our audit there were other key areas of focus during the course of our audit. Whilst not considered a significant risk, these are areas of focus either in accordance with the Audit Scotland Code of Audit Practice or ISAs or due to their complexity or importance to the user of the accounts:

Issue	Commentary
Matters in relation to fraud and irregularity	It is SEPA's responsibility to establish arrangements to prevent and detect fraud and other irregularity. As auditors, we obtain reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error. We obtain annual representation from management regarding management's assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement. We have also made inquires of internal audit around internal control, fraud risk and any known or suspected frauds in year. We have not been made aware of any incidents in the period and no issues in relation to these areas have been identified during the course of our audit procedures.
Accounting practices	We have evaluated the appropriateness of SEPA's accounting policies, accounting estimates and financial statement disclosures. We confirm these are aligned to prior year and in accordance with the FReM.
Matters in relation to related parties	We are not aware of any related parties or related party transactions which have not been disclosed.
Matters in relation to laws and regulations	You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
Other information	We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. No inconsistencies have been identified and we have issued an unmodified opinion in this respect. We do note that the annual report is extensive and very detailed. We recognise, in following the FReM, there can be areas of duplication, within the performance report. However, there is an opportunity for 2022/23 to re-review the content of the upfront annual report narrative to ensure it is succinct, focuses on SEPA performance and outcomes, and supports the user of the financial statements to understand SEPA's purpose and achievements in-year. In being more succinct, the impact will be greater, and key messages will not be lost in the detail. See Action point 6.

Other key elements of the financial statements (continued)

Issue	Commentary
Remuneration and Staff report	We are required to give an opinion on whether the parts of the Remuneration and Staff Report subject to audit have been prepared properly in accordance with the Accounts Direction issued by Scottish Government and in a form directed by Scottish Ministers in accordance with the Scottish Public Finance Manual. We have audited the elements of the Remuneration and Staff Report , as required by the Code and are satisfied that these have been properly prepared in accordance with applicable legislation.
Governance report	The Governance Report is set out on pages 72 to 85 of the Annual Report and Accounts. The report sets out how SEPA has been governed during 2021/22, including SEPA's Board and Audit Committee members and how they support the achievement of SEPA objectives and includes the Statement of Accountable Officer's Responsibilities. In accordance with the Scottish Public Finance Manual (SPFM), the Accountable Officer has a specific responsibility to ensure that arrangements have been made to secure Best Value for SEPA as well as Value for Money for the public sector as a whole. Through our audit work over the wider scope audit dimensions: financial management; financial sustainability; governance and transparency; and, value for money, we have considered the arrangements in place at SEPA for securing and evidencing Best Value. Following the cyber-attack, SEPA rebuilt their core enterprise system which is used to support finance, procurement and human resources. Further development of the system restored key financial reports, provided budget holders online access and the fixed asset module was implemented however, reporting at portfolio level and online access to budgets was not reinstated until 2022/23. Due to organisational challenges caused by COVID-19 and the cyber attack, SEPA have extended their Corporate Plan until 2023, which is supported by the Annual Operating Plan. Up to December 2021, SEPA reported performance monthly to the Agency Management Team and this has reverted back to quarterly reporting from January 2022.
Matters on which we report by exception	We are required by the Auditor General for Scotland to report to you if, in our opinion: adequate accounting records have not been kept; or the financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records; or we have not received all the information and explanations we require for our audit, or there has been a failure to achieve a prescribed financial objective. We have nothing to report in respect of these matters.

Issue	Commentary
Written representations	A letter of representation will be requested from SEPA, which was included in the Audit Committee papers. Specific representations were requested from management in respect of the significant assumptions used in respect of gauging stations, in particular future use, as well as the standard areas we require, within management representations, to sign the audit opinion.
Going concern	In performing our work on going concern, we have had reference to Statement of Recommended Practice – Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom (Revised 2020). The Financial Reporting Council recognises that for particular sectors, it may be necessary to clarify how auditing standards are applied to an entity in a manner that is relevant and provides useful information to the users of financial statements in that sector. Practice Note 10 provides that clarification for audits of public sector bodies. Practice Note 10 states that if the financial reporting framework provides for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies the continued provision of service approach set out in Practice Note 10. The financial reporting framework adopted by SEPA meets this criteria, and so we have applied the continued provision of service approach. In accordance with Audit Scotland guidance: Going concern in the public sector, we have therefore considered Management's assessment of the appropriateness of the going concern basis of accounting and conclude that: • a material uncertainty related to going concern has not been identified; and • management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate.
Regularity	The Accountable Officer is responsible for ensuring the regularity of expenditure and income. We are responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000. In our opinion, in all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Wider scope audit

As set out in our Audit Plan, public audit in Scotland is wider in scope than financial audit. This section of our report sets out our findings and conclusion on our audit work on the wider scope audit dimensions. We take a risk based audit approach, utilising our cumulative audit knowledge of SEPA and understanding of its risks and priorities. Within our audit plan we identified four significant wider scope risks. As part of our audit work we have not identified any further wider scope audit risks.

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Financial Management Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively	Significant risk identified: Our wider scope risk at planning focused on the extent SEPA reintroduced suitable systems of internal financial controls post the Cyber attack, as financial systems were re-built and reinstated.	Response to significant risk: We have considered the financial management arrangements established by Management to support the organisation in remobilising its services including financial monitoring and reporting arrangements. Financial controls We have not identified any significant control deficiencies through our understanding of key financial processes and controls including those over payroll, income and expenditure. Following the cyber attack in December 2020, Management have re-established systems of internal control, including the development of the new version of the Agresso financial accounting system. Management recognised the importance of having the budget in place prior to the start of the financial year but the recovery from the cyber-attack limited the detail of initial budgeting and ability to scrutinize and challenge financial delivery during the year. Management sought to mitigate the risk through minimizing income and expenditure activity prior to establishing the budget and Agresso system (and financial monitoring arrangements), including delaying the annual billing process until September. Financial planning and monitoring As a result of the cyber-attack, Management's focus in early 2021 had been the recoverability of services. Reflecting on the need to re-establish services, including investment in IT and infrastructure, the Annual Operating Plan (AOP), including budget and Corporate Plan were revisited. The AOP and Corporate Plan were approved at the Strategy Board meeting on 29th June 2021 and its approval homologated at the full Board meeting on 27th July.	SEPA have made progress in re-establishing its financial management arrangements. Controls have been established over key financial processes. However, as a result of the cyber-attack, financial planning and monitoring controls were not fully operational until the second quarter of the year. Consequently, the initial budget and financial reporting arrangements were limited at the start of the financial year. The forecast underspend against budget for the year reflected a challenging operating year, where there was considerable uncertainty around the timing and cost of remobilisation of services and the impact of in year Scottish Government funding proposals.

Wider scope dimension	Plan risk	Wider scope audit response and findings	External Audit conclusion
Financial management Continued…	Continued…	Response to significant risk continued…. Following the development of the Agresso system subsequent more detailed quarterly reports (Q2 and Q3) were presented to Management and the Board. As SEPA's Agresso system was established the depth of financial reporting improved to support effective scrutiny and challenge. Financial performance The annual budget for 2021/22 (as part of the Annual Operating Plan) had an underspend of £6.2 million, with the surplus being agreed with Scottish Government to support capital investment. As at 31 March 2022, SEPA achieved an overall surplus position of £5.701 million. The surplus position is primarily due to underspends across budget codes and the in-year proposed reduction in grant-in-aid funding from the Scottish Government (savings) of £640,000, being reversed late in the year which resulted in SEPA being unable to fully utilize this funding. Financial resources and capacity SEPA had a well-established finance function. This provided valuable support in re-establishing financial processes and controls following the cyber-attack. During the year the SEPA's Head of Finance retired, and the Chief Finance Officer is due to retire in the coming year. While the organisation has recruited internally to the Head of Finance position and a new Chief Finance Officer appointed in October 2022, these retirements will result in the departure of a significant level of knowledge and experience from the organisation. It is important that as the organisation looks towards implementing its new Corporate Plan, against a backdrop of increasing financial pressures, that it ensures that it has the capacity and capability within the finance team to meet these challenges.	As the organisation considers the impact of the recent Scottish Government Revenue Spending Review on its resources, it will be important that the organisation has clear control around financial spend in the year to ensure it maximises the use of resources available. With the retirement of the former Head of Finance and pending departure of the Chief Finance Officer, it will be important that the organisation ensures it has the capacity and capability to meet the financial and operational challenges over the coming years.

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability Financial sustainability looks forward to the medium and longer term to consider whether SEPA is planning effectively to continue to deliver its services or the way in which they should be delivered.	Significant risk identified: Our risk focused on SEPA's recovery from the Cyber attack, in particular the funding of the attack and systems re-establishment alongside future financial plans, to plan in the medium term, SEPA's longer-term financial sustainability.	In March 2022 SEPA, in the interests of transparency, published the known associated cost of the cyber attack. Costs reported were £3.963 million, including all known costs, including investigation of the cyber attack, lessons learned and recovery. To support SEPA in the recovery Scottish Government were flexible, in the SEPA budget allowing future forecasted spend linked to digital improvements to be brought forward. Management prepared an interim draft budget in March 2022 for approval. This budget set out a £3.6million deficit. In June 2022 a final budget paper was approved, Within the budget, SEPA's income is forecast at £90.818million with expenditure of £86.718 million. This included £5.3millon for depreciation and impairments and generated a surplus of £4.1 million to funds SEPA's capital expenditure programme. SEPA will continue to receive, up until at least December 2022, additional Covid funding in support of waste water sampling. Other covid related funding is forecast to cease during the year. Savings were identified, to balance the budget, which included: - Each SEPA portfolio to identify and achieve a 3% vacancy target - Active management of new and ongoing recruitment - Review of the general contingencies in the early budget - Targeted reduction in supplies and services of 2.5% SEPA continue to receive additional capital money compared to forecast, in 2022/23 through to 2024/25 to fund the digital programme and recovery (an additional £7.9million over these two years compared to what was planned)	SEPA have initial future financial forecasts which have been shared with the Board to shape future financial planning and likely funding and cost reduction scenarios. A significant proportion of SEPA's costs are staff and without an increase in funding to meet pay awards, the level of additional savings SEPA will require to make, could be substantial. To date many of the savings have been through good vacancy management which is not sustainable and only results in a non-recurring saving, unless the post is no longer required.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability (continued)		The budget paper summarised in brief the forward financial plan, forecasting key balances including income and expenditure up until 2026/27. These were indicative only, designed to give the Board a sense of the future financial pressures and the respective unknowns. At the time (June 2022) the Resource Spending Review it was forecast that SEPA would receive a flat cash settlement. In doing this, it was forecast that SEPA would as a result need to absorb inflation, any pay bill constraints and return a 3% efficiency savings year-on-year. Based on the forecast through to 2026/27, on an annual basis SEPA would have a deficit of between £2.5million to £3.5million per annum. The SEPA forecasts were undertaken at a point in time, following discussions with Scottish Government. Scottish Government requested that no inflation or pay increases should be included as they would model this centrally. This was before the significant increase in cost of living and the level of pay negotiation pressure being experienced across the public sector. SEPA continues discussions with Scottish Government Sponsor Department on the significantly increasing forward financial pressures and the impact of these on service delivery.	SEPA need to continue to use the capital funding to fund digital improvements, bringing these forward where possible. The continued digitalisation of SEPA activities, will in turn support the financial savings SEPA need to make, with the two areas key to SEPA's future financial sustainability.

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Governance and transparency Governance and transparency is concerned with the adequacy of governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	**Significant risk identified:** Governance during the recovery period and the recruitment of the new Chief Executive	**Response to significant risk:** We reviewed the leadership and governance arrangements in place at SEPA following the departure of the Chief Executive. In December 2021, SEPA's Corporate Solicitor was made aware of allegations about the Chief Executive of inappropriate conduct. While the allegations were not raised through the formal whistleblowing processes and that no formal complaints were raised, the allegations were treated in accordance with the policy. Given the sensitive nature of the allegations, the Corporate Solicitor discussed the allegations with the Chair of the SEPA Board. The Chair, in consultation with external legal advice, approved a Management lead investigation of the allegations. On 6th January 2022, prior to the conclusion of the Management investigation, the Chief Executive went on unpaid leave and ultimately resigned from SEPA on 19th January 2022 with no notice period. The Chief Executive did not receive any payment in lieu of notice. As a result of the departure SEPA were unable to formally conclude on the investigation. SEPA have obtained legal advice that as no formal complaint has been made and that the Management lead investigation is not able to conclude no further action can be undertaken or is necessary.	SEPA have reflected on the events surrounding the Chief Executive's departure, including ensuring that there is inclusive culture within the organisation that enables employees to highlight concerns and issues and ensure equality within the workplace. To support this, SEPA approved the establishment of a People Committee to support management in the development of the corporate and wider organisational culture necessary to drive transformational change. It is too early for us to determine the effectiveness of the Committee. However, we do recognise the importance being placed on people and culture within the organisation.

Wider scope dimension	Plan risk	Wider scope audit response and findings	External Audit conclusion
Governance and transparency Continued…	Continued…	Governance arrangements Following the resignation, interim arrangements have been established with the Chief Officer of Performance and Innovation acting as Chief Executive. From discussions with members of the Agency Management Team (AMT), we understand that whilst the departure of the former Chief Executive has resulted in a significant loss of leadership, skills, and experience to the organisation, the AMT have shared responsibility for the Leadership for the organisation including collaborative working across AMT. Enhancing governance arrangements SEPA have reflected on the events surrounding the Chief Executive's departure, including ensuring that there is inclusive culture within the organisation that enables employees to highlight concerns and issues and ensure equality within the workplace. To support this, SEPA approved the establishment of a People Committee (Board Strategy on 26th September). The Committee will support management in the development of the corporate and wider organisational culture necessary to drive transformational change and to develop a people strategy that will underpin the consistent delivery of One Planet Prosperity. Recruitment of New Chief Executive In April 2022, SEPA launched the recruitment process of the new Chief Executive Officer. SEPA have partnered with an external company to support the recruitment process. A new, permanent, Chief Executive was appointed, and they started with SEPA in October 2022.	

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Value for money Value for money is concerned with using resources effectively and continually improving services.	**Significant risk identified:** A focus on SEPA's ability to utilise resources to re-establish core services and meet regulatory requirements, following the loss of data.	**Response to significant risk:** The cyber attack had a significant impact on SEPA operations and the ability of SEPA to deliver all services. The loss of data also significantly impacted on SEPA's ability to deliver its full range of services. SEPA's focus throughout its recovery and response has been on: - Protecting the environment, communities and staff. - Ensuring critical service delivery on flooding and environmental regulations. - Recovery focused on the SEPA organisation of the future, building in redesign. SEPA chose not to rebuild and recover all the old systems but where relevant and appropriate build new systems, linked to the SEPA strategy. In the initial aftermath of the cyber attack SEPA sough to stabilise those systems that they agreed were key, and focus on new business and flooding systems. SEPA produce quarterly updates to the Board on the performance of SEPA including operational status.	SEPA continue to track operational performance against the measures agreed, and the broad approach to recovery. There are risks, that SEPA have made decisions to priortise certain activities over others, and these could be made clearer in the reporting. In addition the reporting to the agency board, whilst including dashboards and trends (where available) for each measure, on reading the narrative it is not always clear the exact status of delivery, and what regulatory services are being provided, and what is outstanding or sought.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Value for money (continued)		Response to significant risk (continued): The annual operating plan for 2022/23 has 10 performance measures. These include 5 focused on regulation, 6 related to flood warning and 2 on organisation (Health and wellbeing and reduction in direct greenhouse gas emissions). Of the 5 under regulation 2 were reported as green in the first quarter – no deterioration in length of time it takes to determine licences, and implementation of a registration system to support the Deposit Return Scheme (due for implementation 1 January 2023). The rest remain at amber. For regulation strategic monitoring plans have been developed, which have a priortised list of environmental monitoring activities. Good progress is reported by SEPA in monitoring the bathing waters programme, monitoring to assess the effectiveness of river basin management improvement measures. The challenge that remains is as a result of the cyber attack SEPA lost the existing Lab management system. This is the system that schedules, analyses and reports samples. A new lab system is under development and until this is ready interim, work-around arrangements are in place. For flooding of the 3 indicators one is green (warning and alerts issued for all significant flooding events); one amber (new flood warning information system is operational) and one red (launch of the Carron flood warning scheme). This is red due to the project being on hold due to unavailability of some modelling and the dependency on the early flood warning system and unavailability of standalone system required for performance.	

Other areas of focus

In accordance with Audit Scotland Planning Guidance, as part of our audit work in 2021/22 we consider SEPA's arrangements for equality and fairness as well as considering the risk of fraud in procurement. We did not identify any significant wider scope audit risks in these areas. Utilising Audit Scotland's Best Value guidance we considered the arrangements at SEPA.

Risk of fraud in procurement

In accordance with Audit Scotland's planning guidance, we considered the risk of fraud and corruption within the procurement function. Through our audit procedures performed, we have not identified any significant risks or deficiencies in relation to SEPA's arrangements over fraud and corruption within procurement.

During 2021/22, there has been various procurement policy and procedure activity. In November 2021, ongoing work was completed in relation to the Contracts Register (which details contracts including name of supplier, period of contract, award date and value which have gone through the formal tendering process) and in December 2021, the 2021-2024 Procurement Operating Plan was presented to the Agency Board for approval. Subsequently, both documents have been published on the SEPA website to provide greater transparency of procurement operations.

At the beginning of February 2022, SEPA submitted their Annual Procurement Report to the Scottish Government. This was within the final deadline set by the Scottish Government however, the drafting was delayed until the completion of the prior year annual accounts as spend information for the financial year was a central aspect of the report.

We were unable to look into further procurement arrangements in detail as SEPA have been re-establishing controls and operations following the cyber attack.

In addition, SEPA participate in National Fraud Initiative (NFI). Due to the cyber attack, SEPA in the prior year were unable to fully participate in the NFI data matching exercise. During 2021/22, SEPA had four reports of fraud (two in 2020/21), however, there was no direct financial value attributed to them and were investigated as appropriate.

We have not identified any risks or significant deficiencies in relation to procurement fraud within SEPA.

Equality and fairness

In accordance with Audit Scotland's Code of Audit Practice and Audit Scotland Planning Guidance, as part of our 2021/22 external audit we considered the Fairness and Equality characteristics and the arrangements in place at SEPA.

SEPA have produced equality outcomes for the 4-year period from 2022 to 2026 which are commitments to work to address long-standing or significant issues of inequality or underrepresentation, requiring the organisation to take action and go beyond basic compliance. These outcomes include:

1. To increase the number of people from currently underrepresented groups in applicants, staff and those who progress within the organisation.
2. People with lived experience of inequality, related to a protected characteristic or socio-economic status, access and use of SEPA's services without barriers.
3. Staff with lived experience of inequality and barriers and with a wide variety of needs, feel listened to and respected as SEPA meet those needs.
4. Decrease the gender pay gap and occupational segregation related to gender, disability and ethnicity.

SEPA's 2022/23 Annual Operating Plan included a commitment to have embedded the new equality outcomes by March 2023. The Annual Operating Plan is published, alongside the Equality Outcomes 2022-26 report on the SEPA website. In 2021, SEPA published an Equality Mainstreaming and Outcome Report which detailed the successes and challenges in mainstreaming equality and progressing the equality outcomes.

SEPA have confirmed within the 2021/22 Annual Report that a lived experience group for staff who face barriers accessing the organisation's digital services. The group helps to understand where issues are, inform solutions, and helps to build digital accessibility into future projects. Additionally, in 2021/22, SEPA ran 15 Equality, Diversity and Inclusion workshops which were attended by 156 managers.

We have not identified any further risks or significant deficiencies in relation to equality and fairness arrangements within SEPA.

Climate change

Climate change is a fundamental part of the SEPA's work, as the Environmental regulator. SEPA supports organisations across Scotland in their climate change initiatives and monitoring climate change. For example, through SEPA's work in regulating carbon emissions and through tracking climate change in its flood management systems alongside flood warning. In addition, SEPA continues to look at its own role in reducing emissions and positive contributions to the climate emergency.

SEPA has in place a route map, with actions between now and 2030. The goals and key actions are captured in SEPA's annual operating plan and 5-year corporate plan. Ultimately, SEPA as an organisation aims to move beyond net-zero to a regenerative organisation by 2030.

SEPA's targets include:

- Reduce greenhouse gas emissions to net-zero by 2025
- Reduce indirect greenhouse gas emissions to net-zero by 2030
- SEPA's waste production to be net-zero by 2030
- Cut water use to net-zero by 2030

During the year, papers on how SEPA plan to reach regenerative status have been presented to the SEPA Board and the Agency Management team. Climate change is an area which external audit will continue to consider and report on, during the 2022/23 external audit.

Appendices

1. Audit Adjustments

We are required to report all non-trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted misstatements

We can confirm that there were 1 adjusted misstatement greater than trivial (£90,900) during the 2021/22 audit [subject to conclusion of audit work and review of updated financial statements]

Detail	Statement of Comprehensive Net Expenditure £'000	Statement of Financial Position £' 000
Being adjustment to recognise SEPA acting as agent with regards to the collection of civil penalties.		
Dr Trade Payables		12,147
Cr Trade Receivables		(12,147)
Overall impact	-	-

We are required to report all non-trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Misclassification and disclosure changes

The table below provides details of substantive misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements. This is not a complete list, as this does not include minor changes requested by the audit team, including typos and formatting requests.

Disclosure	Auditor recommendations	Adjusted?
Critical Judgements	International Financial Reporting standards prescribe the required disclosures in relation to critical judgements. It also requires separate consideration of accounting estimates. Significant estimates relate to assumptions and estimate at 31 March that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Judgements relates to areas that aren't significant estimates. In the draft accounts, management have combined critical estimate and judgements. It is unclear from the disclosure what critical judgements have been applied. For significant estimates, it is unclear where management consider the key assumptions where there is an increase risk of a material change in the estimate over the next 12 months. There is an opportunity to enhance the disclosure to focus on those key areas of estimation that may have a significant risk of material misstatement in the next 12 months. This should focus on those key areas of assumptions such as pension fund discount rate or key assumptions in the valuation.	No – Audit are satisfied that this is not a material disclosure misstatement to the financial statements.
Capital Commitments	The Capital Commitments note did not show the amounts SEPA were committed to as at 31st March 2022 for future periods.	Yes – capital commitments note has been appropriately updated.

Misclassification and disclosure changes (Continued)

Disclosure	Auditor recommendations	Adjusted?
Related Parties	NHS Lothian has been identified by SEPA as a related party, due to one non-executive member of the Board also sitting as the Chairman on the NHS Lothian Board however, there was no quantification of the transaction amount with the health board.	Yes – related parties note has been updated to reflect the transaction amount.
Remuneration Report	The appropriate section of the Remuneration and Staff Report that are audited were not clearly identified as being audited. Additionally, several bandings within the Single Figures of Remuneration table and the Fair Pay Disclosure percentile figures were updated from the initial figures.	Yes – disclosures have been appropriately updated.
Financial Instruments	No financial instrument disclosure note was included providing clear classification of financial instruments into the categories as specified by IFRS 9.	Yes – financial instruments disclosure noted added.

2. Action plan and recommendations

Recommendation	Agreed management response
1. Valuation of Gauging Stations Due to the specialised nature of gauging stations, SEPA have yet to appoint a suitably skilled and experienced valuer to undertake the full valuation which is required under the FReM for the 2022/23 financial statements. Given the nature of these assets, SEPA may need to explore whether an engineering firm (or equivalent) may be best placed to assist. Without a suitable valuer, and a full-in-year valuation, SEPA would not be in compliance with the FReM.	Management response: Cushman & Wakefield have been procured to undertake this work. Action owner: Chief Officer Finance Timescale for implementation: Complete
2. Journals Following the rebuilding of the financial system following the cyber-attack, journals are added to a queue to be processed within the Agresso system. On a daily basis, these are entered into the financial reporting system by the Agresso Team, with journals processed based upon receipt. From testing, we noted within the general ledger, it is not possible to identify who within SEPA has prepared the journals, with the majority of user IDs being Hennessy IT individuals. As such, as the end SEPA user is not identifiable, management should review the current system processes and update to ensure that the individuals preparing, reviewing and posting journals can be easily seen.	Management response: Hennessy IT do not enter journals in normal processing – as this was also the implementation of the system, we did post opening balance journals to create the balance which would have been prepared / reviewed by SEPA personnel. The recommendation is part of the 2022/23 Agresso Development Plan, which requires the new Systems Manager to be in post to take forward. The post will be filled in early December. Action owner: Chief Officer Finance Timescale for implementation: 31 March 2023
3. Related Parties As part of our audit work, we completed a review over the register of interest forms completed by Board members. We identified instances where the description and supporting narrative on the form, whilst complete, could have been clearer. This resulted in follow up queries, which were then resolved, with no matters identified. Therefore there is an opportunity to look at training and the related party form, that Board members complete, to ensure it is clear and to support Board members in its completion.	Management response: We agree with this recommendation and working with members we will review and revise the process as required to ensure full disclosure of all appropriate related parties. Action owner: Chief Officer Finance Timescale for implementation: 31 March 2023

2. Action plan and recommendations

Recommendation	Agreed officer response
4. Bad Debt Policy SEPA do not have a specific policy in place around the allowance for expected credit losses and the basis behind the calculation. All outstanding debt as at 31 March 2021 has been provided for, as this is not expected to be recovered and management have completed a review at year-end of new debt to identify on an individual basis what should be provided for. Management should review their approach and document into a formal policy.	Management response: We agree with this recommendation and will document a formal bad debt provision policy. We do apply the simplified Expected Credit Loss model, debts are provided based on age of the debt, history of the customer and any changes in the companies circumstances which may impact on our ability to recover the debt. Action owner: Chief Officer Finance Timescale for implementation: 31 March 2023
5. Annual Accounts From review of SEPA's annual report, it was noted that the report is extensive and very detailed. It is recognised, in following the FReM, there can be areas of duplication within the performance report. However, there is an opportunity for 2022/23 to re-review the content of the upfront annual report narrative to ensure it is succinct, focuses on SEPA's performance and outcomes, and supports the user of the financial statements to understand SEPA's purpose and achievements in-year. In being more succinct, the impact will be greater, and key messages will not be lost in the detail.	Management response: We agree with this recommendation and the Chief Officer Finance will work with other Senior Management Colleagues to review the performance report with the aim of making it more succinct. Action owner: Chief Officer Finance Timescale for implementation: 31 March 2023

2. Action plan and recommendations

Recommendation	Agreed officer response
6. Remuneration Committee SEPA do not have an established Remuneration Committee in place. It is recommended that a review is undertaken to determine whether a Remuneration Committee should be established in 2022/23, or whether those responsibilities rest with the People Committee or the Board, and that these arrangements still represent good governance. The Remuneration Committee would have responsibility for reviewing workforce remuneration and related policies, a remit which currently sits with the Board.	Management response: Management in consultation with the Agency Board Chair will review this recommendation, clarifying how the Board will strengthen oversight of workforce remuneration and related policies. An option that will be explored is a revision to the terms of reference of the People Committee. The People Committee was established in accordance with Standing Orders for Meetings of the Agency Board and Board Standing Committees, specifically sections 61, 62 and 63 (Ad hoc Committees and Working Groups). Action owner: Chief Officer, People and Property Timescale for implementation: 31 March 2023

2. Action plan and recommendations

Recommendation	Agreed officer response
7. Climate Change There are currently no specific disclosure requirements on climate change. However, public bodies should be including climate change in their consideration of principal risks and making disclosures accordingly. SEPA need to ensure that their narrative reporting adequately reflects their exposure to climate-related issues and how they are monitoring and managing these risks. Narrative reporting requirements and expectations should relate to both the body's impact on the environment, and the impact climate change may have on the body's future. The FRC completed a thematic review of climate change-related considerations explaining the general requirements of IFRS providing a clear framework for incorporating the risks of climate change into financial reporting and although this review focused on companies, the principles can be applied to public sector bodies.	Management response: SEPA partly agrees with this recommendation. Under the Climate Change (Scotland) Act, SEPA has duties to act in a way best calculated to contributed to Scotland's net zero targets and to the national Adaptation Programme (SCCAP). Every year SEPA since 2014/15 discloses how it has met this public bodies' duty (PBD). All reports are publicly available here. These reports requires SEPA to make a detailed submission about its environmental impacts, most notably its direct greenhouse gas emissions. SEPA has reduced its emissions by 69% since 2007 and has set a target to become net zero by 2030. These reports also require SEPA to disclose how climate risks are taken into account. Steps to take forward recommendation: Through these reports, SEPA has been demonstrating how it has met the requirements of the duty. In 2023 specific proposals on how to expand SEPA's delivery on the PBD will be brought forward for agreement. This will include further proposals on how to consider climate risks within strategy setting, policymaking and regulatory decision taking. Action owner: Chief Officer, Performance & Innovation Timescale for implementation: 1) Annual Reporting in November every year. 2) Proposals on PBD expansion will be brought forward for agreement in 2023/24.

2. Action plan and recommendations

Recommendation	Agreed officer response
8. Performance reporting SEPA are still recovering from the cyber attack. In some cases, systems have been re-built and re-established. In other cases this is work in progress and interim measures are in place to support SEPA in providing services. From a review of the quarterly performance report shared with the Agency Management Team and the Board (Q1 2022/23), it isn't always clear from the narrative what services are being provided, what ones are provided but with a work around/interim arrangements and what is still not operational. Alongside this, we can't see a clear reporting of the prioritisation and an assessment of the risk that SEPA are carrying in not providing and/or providing in an interim way, certain services.	Management response: Management partly agrees with this recommendation, as written, as it conflates three separate but related matters which are reported as appropriately under: performance reporting, the status of services and the risk associated with services that may not be being fully delivered. The performance measures in place are representative of SEPA's overall performance but not designed to update on every service provided by SEPA. Since the cyber-attack, SEPA has provided weekly and more recently fortnightly web updates on the status of our public facing services (Service Status/Scottish Environment Protection Agency (SEPA)). This will continue to be kept up to date until at least the end of 2022/23. Management will take time to consider the recommendation as they are committed to: • improve the quality of reportable performance measures; • maintain regular updates, via the website, on the status of our services; • look for opportunities to develop our risk management framework; • prioritise delivery of our services. Action owner: Chief Executive (given accountability for all services) or Chief Officer Compliance & Beyond and Executive Director Evidence & Flooding Timescale for implementation: 1 April 2023

3. Follow up of 2020/21 recommendations

Recommendation

1. Cash Draw Downs

Original recommendation

Through error, during 2020/21 an additional £2.014 million of cash was drawn down in the year. This is reflected in SEPA's cash and cash equivalent's balance and the Scottish Government issued a revised Grant Funding letter to cover the draw down on the basis the 2021/22 cash funding will be reduced. While we recognise that the cyber attack meant operational arrangements were not in place, it is important that Management ensure there is sufficient oversight of draw downs to mitigate the risk of excess funding in future years and the risk of potentially overspending cash balances available.

Initial Management Response:

We agree with this recommendation, and the recognition of the impact of the cyber attack had on operational arrangements. As soon as we identified the error, we contracted the SG and agreed how this would be handled. In normal operating environment, we had sufficient controls in place to mitigate the risk as outlined in the recommendation, and these have been reinstated.

2021/22 update: CLOSED – Following the cyber attack, management have reinstated controls to mitigate the risks around cash draw downs.

2. Financial Strategy

Following the cyber attack, it is important that SEPA revisit the financial strategy to reflect the financial impact the cyber attack has had on the organisation as well the impact on expediting the implementation of the Digital strategy to ensure there is a clear strategic approach to addressing the financial challenges facing the organisation. This includes understanding the potential savings achieved through the strategic investment in technology and service redesign.

Initial Management Response:

We agree this recommendation. We submitted a response on the 10th September to the SG Commission on the Comprehensive Spending Review for the period 2022 to 2027. In this paper, we articulated our planning assumptions and strategic priorities, that propose spending plans for CSR period and outlined some high level savings plans. The Board noted the income and expenditure position and the level of capital investment required for future years.

This work will inform our financial strategy which will be refreshed as we work through the detail of our 2022/23 budget preparation.

2021/22 update: CLOSED – SEPA have quantified the costs arising from the cyber attack and have an agreed budget for 2022/23 with consideration of financial scenarios for future years being discussed.

4. Audit fees and independence

External Audit Fee

Service	Fees £
External Auditor Remuneration	54,500
Pooled costs	10,060
Contribution to Audit Scotland costs	2,060
Contribution to Performance Audit and Best Value	0
2021/22 Fee	66,620

Fees for other services

Service	**Fees £**
We confirm that for 2021/22 we did not receive any fees for non-audit services	Nil

Client service

We take our client service seriously and continuously seek your feedback on our external audit service. Should you feel our service falls short of expected standards please contact Joanne Brown, Head of Public Sector Assurance Scotland in the first instance who oversees our portfolio of Audit Scotland work (joanne.e.brown@uk.gt.com). Alternatively, should you wish to raise your concerns further please contact Jon Roberts, Partner and Head of Assurance, 30 Finsbury Square, London, EC2A 1AG. If your feedback relates to audit quality and we have not successfully resolved your concerns, your concerns should be reported to Elaine Boyd, Assistant Director, Audit Scotland Quality and Appointments in accordance with the Audit Scotland audit quality complaints process.

Transparency

Grant Thornton publishes an annual Transparency Report, which sets out details of the action we have taken over the past year to improve audit quality as well as the results of internal and external quality inspections. For more details see Transparency report 2021 (grantthornton.co.uk).

Independence and ethics

- 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 Standards and therefore we 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 Financial Reporting Council's Ethical Standard 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 are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.
- We can confirm no independence concerns have been identified.

5. Communication of audit matters

International Standards on Auditing (UK) (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table below.

Our communication plan	Audit Plan	Audit Findings
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		•

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