



Scottish Environment Protection Agency (SEPA)

External Audit Plan for the financial year ending 31 March 2018

Audit Committee 12 December 2017 and finalised February 2018

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Our audit at a glance



Performance materiality is set at 75% and trivial is 5% of materiality. This reflects minimal audit adjustments in prior year and our understanding of SEPA in a year 2 audit cycle.



Materiality is set at 1.6% of gross expenditure based on 2016/17 audited information (£1.338 million). Previous year it was 1% of gross expenditure



Significant audit risks are: management override of controls; and the risk of fraud in revenue as set out in International Auditing Standards (ISAs UK)

An audit underpinned by quality and adding value to you



We fulfil our responsibilities per International Standards of Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice throughout our work.



At the planning stage we have identified other audit risks as being the risk of fraud in expenditure recognition as set out in Practice Note 10; and the Valuation of Property, Plant and Equipment (specialist assets)



Our audit is undertaken in accordance with the Code of Audit Practice and reflects the wider scope nature of public audit. Our wider scope risks identified are: Financial sustainability over the medium term and value for money.

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Overarching principles of our audit

Our audit is risk based and undertaken in accordance with the relevant International Auditing Standards (ISAs) (UK) and the Audit Scotland Code of Audit Practice 2016.

Our overall objective is a robust, quality-focused external audit which adds value through wider insights and challenge. Our audit foundations are:

- professional scepticism
- a focus on audit risks and key areas of management judgement
- sharing our wider insights across the sector (Scotland and UK)
- use of specialists to support our work where relevant
- using IDEA our data analytical software to effectively and efficiently test your balances
- clear and upfront communications, with regular communication during the year
- Reporting with focused actions which will support you in improving your controls/operations
- We will aim to not duplicate the work of your internal auditors. We will consider the internal audit plan for 2017/18 and identify any particular areas of risks that we either need to reflect in our approach or are relevant to our wider scope audit work. We will continue to review internal audit work throughout the year and maintain an ongoing, open, dialogue with internal audit.

Specific areas we will look to add value to SEPA during 2017/18, identified as part of our planning work and reflection on prior year include:

- We will actively share relevant Audit Scotland and Grant Thornton publications with Senior Management and the Audit Committee, identifying particular areas for consideration.
- Should any new accounting changes or governance updates emerge during the year we will be providing a briefing for the Audit Committee. We will also pro-actively work with management during the year to discuss any emerging matters and seek to reach agreement on the treatment of these in advance of year-end.
- We will share the Scottish Public Sector Transparency report we produced for Audit Scotland at the end of December 2017, alongside our UK Grant Thornton Transparency Report.



External Audit deliverables for 2017/18 – Audit Committee

- External Audit Plan (this document)
- Governance and Transparency report and audit quality briefing (Issued to Audit Committee Members)
- Audit progress report on interim testing and control walkthroughs – including where relying on controls (March 2018)
- Annual Report to those Charged with Governance and the Auditor General for Scotland (June 2018)
- Audit opinion (June/July 2018)
- Management letter of representation (June/July 2018)



2017/18 Deliverables as set out in the Audit Scotland planning guidance (October 2017)

- Confirmation of agreed fee by end of February 2018
- National Fraud Initiative - completed Auditor checklist (February 2018)
- Current issues return for Central Government to Audit Scotland (19 January 2018 and 20 July 2018)
- Submission of fraud returns to Audit Scotland – 27 April 2018



Planned Audit Scotland publications which may be relevant to SEPA

- Digital developments and projects – risks and issues
- Supporting Scotland's economic growth (Spring 2018) – Auditors impact assessment return

Audit approach and materiality

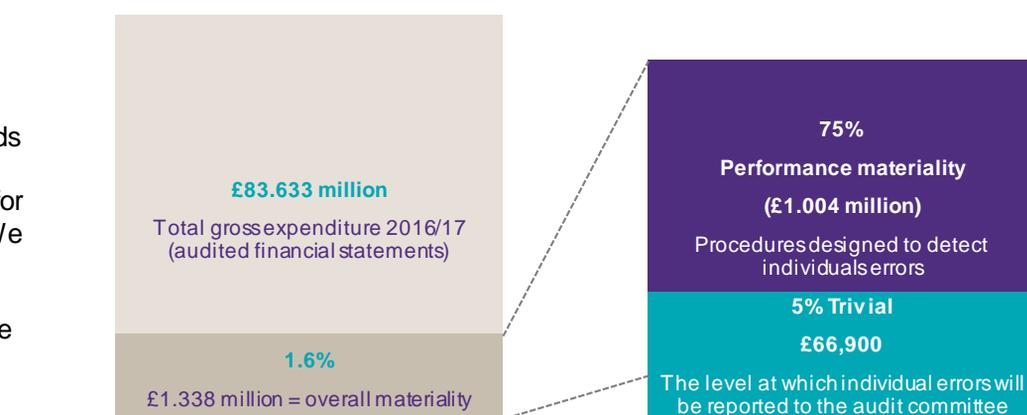


We undertake your audit in accordance with International Standards in Auditing (UK) (ISAs) and the Audit Scotland Code of Audit Practice (May 2016). On an annual basis we are required to give an opinion as to whether the Financial Statements:

- give a true and fair view
- have been properly prepared in accordance with relevant legislation and standards
- the wider information contained in the financial statements e.g. Accountability Report; Directors Report and Governance Statement
- Regularity of expenditure
- audited parts of the remuneration and staff report have been prepared in accordance with the guidance

Materiality

In performing our audit we apply International Standards on Auditing (UK) 320: *Materiality*. Our materiality for 2017/18 is shown below. We will revise this on receipt of the unaudited financial statements for 2017/18 once received.



Overall materiality

We have calculated overall materiality in line with gross expenditure, as is recognised as a common measure in the public sector. This is in line with prior year. As this is our second year of the audit, and taking into account the level of errors and adjustments in prior year, and the context of the SEPA's activities we feel it is appropriate to increase our materiality benchmark to 1.6% (was 1% in 2016/17). Under our audit methodology we typically set materiality within the benchmark range of 0.5% up to 2%.

Performance materiality

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. Based on our audit experience in 2016/17 we have increased this for 2017/18 to 75% (65% in prior year). This does not impact on the financial statement balances we undertake substantive testing on, as all balances are in scope per prior year, but will impact on sample sizes.

Trivial

Under ISA 540 we are required to set an amount below which we consider misstatements would be clearly trivial, and therefore when accumulated we would not expect that they would have a material impact on the financial statements. Misstatements identified below this level would not be reported to the Audit Committee (in their role as those charged with governance).

Misstatements above trivial (corrected and uncorrected) will be reported to the Audit Committee in our Annual Report to those Charged with Governance.

Going concern considerations

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570).

We will review management's assessment of the going concern assumption and evaluate the disclosures in the financial statements.

A risk based audit methodology

Our understanding of SEPA

This is our second year as the external auditors of SEPA appointed under the Audit Scotland framework. In 2016/17 SEPA received £40m from the Scottish Government in the form of Grant-in-aid to fund SEPA activities. Over the last 10 years Grant-in-aid has declined by £5million and this downward trend is forecasted to continue over the medium to longer term. Alongside Grant-in-aid SEPA generate income from its charging schemes and other sources. Total income for 2016/17 was £45.274 million. During 2016/17 SEPA developed a medium term financial strategy which set out various funding scenarios and the impact those would have on SEPA's activities. SEPA continue to focus on reducing inefficiency, and therefore achieving additional cost savings. Essential to SEPA is recovering as close to full cost as possible on the income charging schemes.

Total staff costs for 2016/17 were £56 million, representing a large proportion of SEPA's total expenditure.

SEPA have in place a clear corporate strategy, supported by an annual operating plan, and an underlying performance management and risk framework across key metrics.

Overview of our audit risks identified at planning and our proposed approach

	Risk of fraud in revenue	Risk of fraud in expenditure	Management override of controls	Valuation of specialised assets
The Risk	As set out in ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. £45.274 million is generated from income from charging schemes and other sources of income (not grant-in-aid related). We consider the risk to be prevalent around the year end and therefore focus our testing on cut-off of income.	Operating expenditure is understated or not treated in the correct period (risk of fraud in expenditure). As set out in Practice note 10 (revised) which applies to public sector entities. We consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of expenditure.	As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities	SEPA hold £22.993 million of assets (PPE). Of these assets a number are specialised in nature e.g. gauging stations; and vessels. There is a risk that the valuation either under or overstates the asset values reflected in the accounts. There is also a potential risk around impairment.
Our planned response	<ul style="list-style-type: none"> Walkthroughs of the controls and procedures around material income streams and validation of key controls where appropriate Consider income cut off procedures and substantive testing over pre and post year end balances A focus on recoverability of balances 	<ul style="list-style-type: none"> Perform cut off at year end on pre and post year end transactions and recording Walkthrough of the key expenditure controls in place Regularity – Expenditure incurred in accordance with the type/nature of SEPA as an organisation 	<ul style="list-style-type: none"> A focus on understanding how/where management override of controls may occur Review of the controls over journal entries Understanding key areas of judgement within the Financial statements and the basis for these judgements and the application of accounting policies Reviewing unusual and/or significant transactions 	<ul style="list-style-type: none"> We will review the valuations undertaken in year by the independent valuer including the basis of the valuation We will review management's assessment of impairment risk We will review the classification of PPE to ensure this is appropriate, depreciated in line with SEPA policies and complies with the FRM.

Specific areas of focus

During the course of our audit we may apply a lower level of materiality to specific balances or transactions in the financial statements. This reflects areas where there is a greater degree of interest or sensitivity on the amounts reported in the financial statements. Examples include the audit sections of the Remuneration and Staff Reports where due to the nature of the amounts reported we will apply a lower level of materiality.

Wider scope – what this means for the 2017/18 external audit

Financial sustainability

SEPA have developed a medium term financial plan which reflects on a number of circumstances, including at which point Grant-in-aid funding reductions would have a direct impact on SEPA activities and SEPA would have to in effect stop providing a certain service. As well as focusing on how SEPA can operate as efficiently as possible, SEPA are also focused on ensuring they maximise income through the respective charging schemes, and recover the costs of these schemes. Lastly, SEPA do receive sources of EU funding which may be subject to risk depending on Brexit discussions.

Our Response: We will continue to discuss financial sustainability with SEPA Management. We will review the financial plans in place, including the scenarios set out, the governance of the plans and regular reporting on future financial scenarios.

Financial management

No specific financial management risks have been identified for 2017/18.

However, we will continue to consider SEPA's financial management arrangements informed through the work of internal audit and the high level financial framework of policies and procedures in place. This will include: Financial Standing Instructions, Scheme of Delegation; and Fraud policies and training.



Best value

Governance and transparency

No specific governance and transparency risks have been identified for 2017/18.

We will continue to consider through discussions with management and review of minutes SEPA's overarching governance arrangements and how SEPA ensure that they are transparent and open to SEPA's stakeholders including members of the public.

Value for money

SEPA has a number of overarching strategies including the Corporate Plan, the annual operating plan and the People Strategy. These are focused on delivering key performance measures which report on the outcomes of SEPA as an organisation, including the impact of SEPA as a regulator.

Our Response: We will consider SEPA's performance management framework and how they capture and measure performance and outcomes. We will also consider progress against the key strategic corporate plans and how this is being reported and monitored.

Our planned work, like our financial statements work, is risk based and proportionate. We will continue to develop our understanding over the four dimensions and conclude on these in our final report, based on the work we have undertaken during the year.

Appendices

Key audit deliverables and our team

Independence and fees

Fraud arrangements

Respective responsibilities

Communication of audit matters with those charged with governance

Fees and independence

External Audit Fee

Service	Fees £
External Auditor Remuneration	39,490
Pooled Costs	9,610
Contribution to Audit Scotland costs	2,420
Contribution to Performance Audit and Best Value	0
2017-18 Fee	51,520

Fees for other services

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

The audit fee is calculated in accordance with guidance issued by Audit Scotland. In accordance with the Audit Scotland guidance we can increase the fee by up to 10% from the base fee set by Audit Scotland, depending on risk factors identified by us as your external auditors. We cannot reduce the fee from the baseline set out by Audit Scotland. The above proposed fee, set at the base fee, has been agreed with management. The fee is based on the following assumptions:

- supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- the scope of the audit, and SEPA activities will not change significantly from planned
- SEPA will make available management and accounting staff to help us locate information and to provide explanations. We reserve the right to charge an additional fee for any additional work.
- We will only receive (and audit) 3 sets of accounts (1st draft; amended draft and final)
- Specific balances such as pensions and valuations of assets are supported by an independent specialist

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 Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Full details of all fees charged for audit and non-audit services will be included in our Annual Report to those charged with governance at the conclusion of the audit.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

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.

Fraud arrangements

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

As part of our audit work we are responsible for:

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

As auditors we obtain reasonable but not absolute 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..

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 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 arrangements in response to the national fraud initiative exercise.

All suspected frauds and/or irregularities over £5,000 are reported to Audit Scotland by us as your auditors on an annual basis (no later than end of April 2018)

Respective responsibilities

As set out in the Code of Audit Practice (pages 10 to 16) there are a number of key responsibilities you as an organisation are responsible for, and others, as appointed auditors we are responsible for. These are summarised below:

Area	SEPA Responsibilities
Corporate governance	<ul style="list-style-type: none"> Establishing arrangements for proper conduct of its affairs Legality of activities and transactions Monitoring adequacy and effectiveness of arrangements (inc role of those charged with governance)
Financial statements	<ul style="list-style-type: none"> Preparing financial statements which give a true and fair view of their financial position Maintaining accounting records and working papers Putting in place systems of Internal Control Maintaining proper accounting records Preparing and publishing an annual governance statement, management commentary and remuneration report Effective systems of internal control as well as financial, operational and compliance controls – supporting achievement of objectives and secure value for money
Financial position	<ul style="list-style-type: none"> Proper arrangements to ensure financial position is soundly based and responsibility to ensure arrangements secure best value
Fraud and error	<ul style="list-style-type: none"> Establishing appropriate arrangements for prevention and detection of fraud, error, irregularities, bribery and corruption and affairs are properly managed

Our responsibilities



- Undertake statutory duties and comply with professional engagement and ethical standards
- Provide an opinion on financial statements and where appropriate regularity of transactions
- Review and report on, as appropriate, other information eg annual governance statements, management commentary, remuneration reports
- Notify the Auditor General when circumstances indicate a statutory report may be required
- Demonstrate compliance with wider public audit scope

How do we do this in practice



- By reviewing and providing judgements and conclusions on SEPA arrangements including those across the wider scope of audit dimensions.
- Consideration of the effectiveness of performance management arrangements
- Suitability and effectiveness of corporate governance arrangements in year
- Financial position and arrangements for ensuring financial sustainability in the medium to longer term
- Review of other information in line with our knowledge and understanding of SEPA
- Ongoing dialogue and engagement with Audit Scotland during the year

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

Communication of audit matters with those charged with governance

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 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		•

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 above.

This document, The Audit Plan, outlines our audit strategy and plan to deliver the audit, while our Annual Report to those Charged with Governance will be issued prior to approval of the financial statements and will present key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

We will communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to SEPA Management and the Audit Committee.



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