

Scottish Environment Protection Agency

Annual Audit Plan 2022/23



 AUDIT SCOTLAND

Prepared for Scottish Environment Protection Agency

31 March 2023

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Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2022/23 external audit of the Scottish Environment Protection Agency (SEPA). The main elements of our work include:

- evaluation of the key controls within the main accounting systems
- an audit of the annual report and accounts, and provision of an Independent Auditor's Report
- an audit opinion on regularity and other statutory information published within the annual report and accounts including the Performance Report, the Governance Statement and the Remuneration and Staff Report
- consideration of arrangements in relation to wider scope areas: financial management; financial sustainability; vision, leadership, and governance; and use of resources to improve outcomes
- consideration of Best Value arrangements

Audit Appointment

2. We are pleased to be appointed as the external auditor of SEPA for the period 2022/23 to 2026/27 inclusive. You can find a brief biography of your audit team at [Appendix 1](#).

3. In the first year of the audit appointment, we invest significant time gaining an understanding of your business and identifying and assessing the risks of material misstatement to the financial statements. While we use our initial assessment of risk to inform our planned audit approach, we keep our assessment of risks under review as the audit progresses. We will inform you of any significant changes in assessed risks and any resulting changes in our planned audit work.

4. The audit team will actively engage with you over the course of the audit to ensure our audit work continues to be focused on risk.

Adding value

5. We aim to add value to SEPA through our external audit work by being constructive and forward looking, by attending meetings of the Audit and Risk Committee and by recommending and encouraging good practice. In so doing, we will help SEPA promote improved standards of governance, better management and decision making and more effective use of resources.

Respective responsibilities of the auditor and SEPA

6. The [Code of Audit Practice 2021](#) sets out in detail the respective responsibilities of the auditor and SEPA. Key responsibilities are summarised below.

Auditor responsibilities

7. Our responsibilities as independent auditors are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice](#) (including [supplementary guidance](#)) and guided by the Financial Reporting Council's Ethical Standard.

8. Auditors in the public sector give an independent opinion on the financial statements and other information within the annual report and accounts. We also review and report on the wider scope arrangements in place at SEPA. In doing this, we aim to support improvement and accountability.

SEPA responsibilities

9. SEPA is responsible for maintaining accounting records and preparing financial statements that give a true and fair view.

10. SEPA has the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable it to deliver its objectives.

Financial statements audit planning

Introduction

11. The annual report and accounts are an essential part of demonstrating SEPA's stewardship of resources and its performance in the use of those resources.

12. We focus our work on the areas of highest risk. As part of our planning process, we prepare a risk assessment highlighting the audit risks relating to each of the main financial systems relevant to the production of the financial statements.

Materiality

13. The concept of materiality is applied by auditors in planning and performing the audit, and in evaluating the effect of any uncorrected misstatements on the financial statements. We are required to plan our audit to obtain reasonable assurance that the financial statements are free from material misstatement. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.

Materiality levels for the 2022/23 audit

14. We assess materiality at different levels as described in [Exhibit 1](#). The materiality values for SEPA are set out in [Exhibit 1](#).

Exhibit 1 2022/23 Materiality levels for SEPA

| Materiality | Amount |
|---|--------------|
| Planning materiality – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. Materiality has been set based on our assessment of the needs of the users of the financial statements and the nature of SEPA's operations. For the year ended 31 March 2023 we have set our materiality at 2% of total operating expenditure based on the audited financial statements for 2021/22. | £2 million |
| Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this could indicate that further audit procedures should be considered. Using our professional judgement, we have assessed performance materiality at 75% of planning materiality. | £1.5 million |

Reporting threshold (i.e., clearly trivial) – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount. £100 thousand

Source: Audit Scotland

Significant risks of material misstatement to the financial statements

15. Our risk assessment draws on our cumulative knowledge of SEPA, its major transaction streams, key systems of internal control and risk management processes. It is informed by our discussions with management, meetings with internal audit, attendance at committees and a review of supporting information.

16. Audit risk assessment is an iterative and dynamic process. Our assessment of risks set out in this plan may change as more information and evidence becomes available during the progress of the audit. Where such changes occur, we will advise management and where relevant, report them to those charged with governance.

17. Based on our risk assessment process, we identified the following significant risks of material misstatement to the financial statements. These are risks which have the greatest impact on our planned audit procedures. [Exhibit 2](#) summarises the nature of the risk, the sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurance over the risk.

Exhibit 2

2022/23 Significant risks of material misstatement to the financial statements

| Significant risk of material misstatement | Sources of assurance | Planned audit response |
|---|---|---|
| <p>1. Risk of material misstatement due to fraud caused by management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability</p> | <p>Owing to the nature of this risk, assurances from management are not applicable in this instance</p> | <ul style="list-style-type: none"> • Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements • Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud • Evaluate significant transactions outside the normal course of business. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. |

| Significant risk of material misstatement | Sources of assurance | Planned audit response |
|--|---|--|
| to override controls that otherwise appear to be operating effectively. | | <ul style="list-style-type: none"> • Focussed testing of accounting accruals and prepayments. |
| <p>2. Estimation in the valuation of land, buildings, and gauging stations.</p> <p>There is a significant degree of subjectivity in the valuation of land and buildings. Valuations are based on specialist and management assumptions and changes in these can result in material changes to valuations.</p> <p>SEPA holds specialist property assets (gauging stations) for which there is no market evidence in respect of existing use, and these are valued using depreciated replacement cost. The previous valuation has been indexed annually to reflect inflationary increases to the replacement cost: 2022/23 is a full valuation year for these assets.</p> | <ul style="list-style-type: none"> • Use of professional valuers to carry out full and desktop valuations. • Preventative property maintenance program • Capital and revenue budgets set aside for repairs and maintenance. • Condition surveys carried out on gauging stations • Annual impairment review | <ul style="list-style-type: none"> • Review the information provided to the external valuer to assess for completeness. • Evaluate the competence, capabilities, and objectivity of the professional valuer. • Obtain an understanding of management's involvement in the valuation process to assess if appropriate oversight has occurred. • Critically assess the adequacy of disclosures regarding the assumptions in relation to the valuation of land and buildings. |

Source: Audit Scotland

18. As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statement*, there is a presumed risk of fraud over the recognition of revenue. There is a risk that revenue may be misstated resulting in a material misstatement in the financial statements.

19. We have rebutted this risk as funding received from the Scottish Government and other grant providers is clearly communicated and can be readily agreed to third party confirmations. For SEPA's other income streams, we have concluded there is limited opportunity or incentive to manipulate the recognition of income in the financial statements. For example, charging schemes income is based on publicly available information.

20. In line with Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom*, as most public-sector bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk relating to revenue recognition.

21. We have rebutted this risk as the main expenditure streams of SEPA can be readily forecast based on a predictable pattern of spend and mainly comprise a high volume of relatively low value items. We also consider there to be limited incentive and opportunity for the manipulation of expenditure recognition in the financial statements.

22. We have not, therefore, incorporated specific work into our audit plan in these areas over and above our standard audit procedures.

Other area of audit focus

23. As part of our assessment of audit risks, we have identified another area where we consider there are also risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we do not consider this to represent a significant risk. We will keep this area under review as our audit progresses.

24. The area of specific audit focus is:

- Valuation of the pension liability due to the material value and significant assumptions used in the calculation of the liability. We will use the work of PwC as our auditor's expert in assessing the reasonableness and methodology used and assumptions made by the pension fund actuary in arriving at the pension valuation as at 31/03/2023. We will also assess the oversight exercised by management over the valuation.

Wider Scope and Best Value

Introduction

25. The [Code of Audit Practice](#) sets out the four areas that frame the wider scope of public sector audit. The Code of Audit Practice requires auditors to consider the adequacy of the arrangements in place for the wider scope areas in audited bodies.

26. In summary, the four wider scope areas cover the following:

- **Financial management** - means having sound budgetary processes. We will consider the arrangements to secure sound financial management including the strength of the financial management culture, accountability, and arrangements to prevent and detect fraud, error and other irregularities, bribery, and corruption.
- **Financial sustainability** - means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs. We will consider the extent to which audited bodies have shown regard to financial sustainability and are planning ahead effectively. We look at planning for the medium term (two to five years) and longer term (longer than five years). The audit will include consideration of the use of the going concern basis of accounting as part of the annual audit. We will also comment on financial sustainability in the longer term.
- **Vision, leadership, and governance** - audited bodies must have a clear vision and strategy and work together with partners and communities to improve outcomes. set priorities for improvement. We will consider the arrangements in place to deliver the vision, strategy and priorities adopted by SEPA. We will also consider the effectiveness of the governance arrangements to support delivery.
- **Use of resources to improve outcomes** - audited bodies must make best use of their resources to meet stated outcomes and improvement objectives. We will consider how SEPA demonstrates economy, efficiency, and effectiveness through the use of financial and other resources.

Wider scope risks

27. We have identified a wider scope audit risk in the area set out in [Exhibit 3](#). This exhibit sets out the risk, sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurances over the risk.

Exhibit 3 2022/23 wider scope risk

| Description of risk | Sources of assurance | Planned audit response |
|---|--|---|
| <p>1. Financial sustainability</p> <p>Whilst it is recognised that SEPA generates contract income via various charging schemes, there is a risk that SEPA may not be able to achieve its planned outcomes should insufficient grant-in-aid income be available.</p> <p>There are financial uncertainties and pressures SEPA will need to manage to remain financially sustainable.</p> | <ul style="list-style-type: none"> • 5-year financial modelling undertaken and presented to Board 2022/23 Budget Paper. For 2023/24 onward, in line with public sector review, One SEPA Modernisation currently reviewing deliverables and the outcomes will be mapped to financial resources. • Regular Liaison meetings with SG on corporate plan and funding. • Monthly financial reports to CLT. • Quarterly financial reports to Audit and Risk Committee and Board. • Regular SG returns and Comprehensive Spending Review (CSR). | <ul style="list-style-type: none"> • Review of relevant financial plans and strategies to assess the reasonableness of the assumptions contained within. • Ongoing monitoring of Board and committee papers and minutes and attendance at committees. |

Source: Audit Scotland

28. Our planned work on our wider scope responsibilities is risk based and proportionate and in addition to local risks we consider challenges which are impacting the public sector as a whole. In 2022/23 we will consider tackling climate change and responding to cyber security threats.

Climate Change

29. Tackling climate change is one of the greatest global challenges. The Scottish Parliament has set a legally binding target of becoming net zero by 2045 and has interim targets including a 75% reduction in greenhouse gas emissions by 2030. The public sector in Scotland has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change.

30. The Auditor General and Accounts Commission are developing a programme of work on climate change. In 2022/23, we will gather information on SEPA's arrangements for responding to climate change covering areas such as the development of climate change strategies and the monitoring and reporting of progress against targets for reducing emissions.

Cyber Security

31. There continues to be a significant risk of cyber-attacks to public bodies, and it is important that they have appropriate cyber security arrangements in place. A number of recent incidents, including the 2020 cyber-attack on SEPA, have demonstrated the significant impact that a cyber-attack can have on both the finances and operation of an organisation. In 2022/23, we will consider SEPA's arrangements for managing and mitigating cyber security risks. This will include the lessons learned as a result of the 2020 cyber-attack.

Duty of Best Value

32. [Ministerial Guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) explain that accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. We will be carrying out a high-level review to confirm that such arrangements are in place within SEPA.

Reporting arrangements, timetable, and audit fee

Reporting arrangements

33. Audit reporting is the visible output for the annual audit. All Annual Audit Plans and the outputs, as detailed in [Exhibit 4](#), and any other outputs on matters of public interest will be published on our website: www.audit-scotland.gov.uk.

34. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officers to confirm factual accuracy.

35. We will provide an independent auditor's report to SEPA, the Scottish Parliament and the Auditor General for Scotland. We will provide SEPA and the Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

36. [Exhibit 4](#) outlines the target dates for our audit outputs. We aim to issue the independent auditor's report by the 10 December 2023 which is later than the target date of 31 October 2023. Factors which have impacted on this include the delay in starting 2022/23 audit work, resourcing and scheduling of our audits and quality requirements.

Exhibit 4 2022/23 Audit outputs

| Audit Output | Target date | Audit and Risk Committee Date |
|------------------------------|-------------|-------------------------------|
| Annual Audit Plan | 31/03/2023 | 21/03/2023 |
| Independent Auditor's Report | 31/10/2023 | 12/12/2023 |
| Annual Audit Report | 31/10/2023 | 12/12/2023 |

Source: Audit Scotland

Timetable



37. To support an efficient audit, it is critical that the timetable for producing the annual report and accounts for audit is achieved. We have included a proposed timetable for the audit at [Exhibit 5](#) that has been discussed with management.

38. Covid-19 has had a considerable impact on the conduct and timeliness of the audit. We recognise that it is in the best interests of public accountability to get the reporting of audited accounts back to pre-pandemic timelines. We are identifying ways to work more efficiently to expedite the 2022/23 audits whilst at the same time maintaining high standards of quality.

39. We intend to take a hybrid approach to the 2022/23 audit with a blend of onsite and remote working. We will continue to work closely with management to identify the most efficient approach as appropriate and will keep timeframes and logistics for the completion of the audit under review. Progress will be discussed with management and finance officers over the course of the audit.

Exhibit 5

Proposed annual report and accounts timetable

|  Key stage |  Provisional Date |
|--|--|
| Latest submission date for the receipt of the unaudited annual report and accounts with complete working papers package. | 23 October 2023 |
| Latest date for final clearance meeting with the Director of Finance (or equivalent) | 17 November 2023 |
| Issue of draft Letter of Representation and proposed Independent Auditor's Report | 28 November 2023 |
| Agreement of audited and unsigned annual report and accounts | 12 December 2023 |
| Issue of Annual Audit Report to those charged with governance. | 12 December 2023 |
| Signed Independent Auditor's Report | 12 December 2023 |

Source: Audit Scotland

Audit fee

40. In determining the audit fee, we have taken account of the risk exposure of the SEPA and the planned management assurances in place. The proposed audit fee for 2022/23 is £72,630 as set out in [Exhibit 6](#).

41. Our fees have increased in 2022/23 and this is a reflection of the current audit market and the rising costs in delivering high quality audit work. There are

increased regulatory expectations and risks placed on audit and its quality, as well as a widening in the scope of work audit must cover.

Exhibit 6

Audit fees (including VAT)

| Fee component | Fees (£) |
|--------------------------------------|----------|
| External auditor remuneration | 75,940 |
| Pooled costs | (1,200) |
| Contribution to Audit Scotland costs | 2,160 |
| Sectoral cap adjustment | (4,270) |
| 2022/23 Audit fee | 72,630 |

Source: Audit Scotland

42. In setting the fee for 2022/23 we have assumed that SEPA has effective governance arrangements and will prepare comprehensive and accurate accounts for audit in line with the agreed timetable for the audit. The audit fee assumes there will be no major change in respect of the scope of the audit during the year and where our audit cannot proceed as planned, a supplementary fee may be levied.

Other matters

Internal audit

43. It is the responsibility of the Scottish Environment Protection Agency to establish adequate internal audit arrangements. We will review the internal audit plan and the results of internal audit's work.

44. While we are not planning to place formal reliance on the work of internal audit in 2022/23, we will review internal audit reports and assess the impact of the findings on our financial statements and wider scope audit responsibilities.

Independence and objectivity

45. Auditors appointed by the Auditor General for Scotland or Accounts Commission must comply with the [Code of Audit Practice](#) and relevant supporting guidance. When auditing the financial statements, auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors.

46. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual *'fit and proper'* declaration for all members of staff. The arrangements are overseen by the Executive Director of Innovation and Quality, who serves as Audit Scotland's Ethics Partner.

47. The appointed auditor for SEPA is Liz Maconachie, Senior Audit Manager. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of SEPA.

Audit Quality

48. Quality is at the core of public audit in Scotland and is the foundation for building consistency and confidence across all audit work. High quality audits provide assurance, add value, and can support public bodies to achieve their objectives.

49. Until 2021/22, the applicable audit quality standard was International Standard on Quality Control 1 (ISQC (UK) 1). This set out an audit practice's responsibilities for its system of quality control for audits.

50. ISQC(UK) 1 has been replaced by two new audit quality standards: Internal Standards on Quality Management (ISQM (UK) 1) applicable from 15 December 2022 and (ISQM(UK) 2) effective for the 2023/24 audits. Work is underway at Audit Scotland to meet the requirements of these quality standards.

51. Audit Scotland is committed to delivering high quality audits. The foundation of our quality framework is our Audit Guide, which incorporates the application of

professional auditing, quality and ethical standards and the [Code of Audit Practice](#) (and supplementary guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews. Additionally, the Institute of Chartered Accountants of England and Wales (ICAEW) have been commissioned to carry out external quality reviews.

52. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time, and this may be directed to the engagement lead.

Appendix 1. Your audit team

53. The audit team involved in the audit of SEPA have significant experience in public sector audit.

Liz Maconachie
Senior Audit Manager
Imaconachie@audit-scotland.gov.uk

Liz has over 25 years of public sector audit experience and has delivered external audit services to a range of bodies including local authorities, health boards and central government bodies.

Fiona Owens
Audit Manager
Fowens@audit-scotland.gov.uk

Fiona has over 10 years of public sector audit experience and has delivered external audit services to a range of bodies including local authorities, health boards and central government bodies.

Karla Graham
Senior Auditor
KGraham@audit-scotland.gov.uk

Karla has considerable experience in planning and delivering audits. Karla will manage the team and work alongside the Audit Manager and Senior Audit Manager to deliver the audit.

54. The local audit team is supported by a specialist technical accounting team, all of whom have significant experience of public bodies and work with accounting regulatory bodies.

Scottish Environment Protection Agency

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Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:

www.audit-scotland.gov.uk/accessibility

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