Scottish Environment Protection Agency (SEPA)

External Audit Plan for the financial year ending 31 March 2019
Audit Committee 11 December 2018

Final Plan

Joanne Brown
Engagement Leader

John Boyd
Senior Manager
Our audit at a glance

Performance materiality is set at 65% and trivial is 5% of materiality. This has been reduced from prior year (2017/18: 75%) reflecting audit adjustments in prior year relating to revaluations. Given the complexity of the valuations and subsequent increased risk of misstatement, we reduce our threshold in the current year.

Materiality is set at £1.4 million, being approximately 1.6% of gross expenditure based on 2017/18 audited information. This is based on our assessment of what misstatement either individually or in aggregate could be significant as to be misleading to the users of financial statements.

Significant audit risks are: management override of controls; the risk of fraud in revenue as set out in International Standards on Auditing (ISAs UK); risk of fraud in expenditure as set out in practice Note 10; and, valuation of property, plant and equipment.

An audit underpinned by quality and adding value to you

During 2018/19, as set out in the Audit Scotland planning guidance we will consider wider factors that may potentially impact on SEPA including: EU Withdrawal, changing landscape for public financial management, dependency on key suppliers and openness and transparency. We will consider these where relevant throughout our audit work.

For 2018/19, new accounting standards will apply for revenue and financial instruments. We will consider SEPA’s evaluation of the new standards and the recognition of any adjustments required to the financial statements from their adoption.

Our audit is undertaken in accordance with the Audit Scotland 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.
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**Overarching principles of our audit**

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

Our overall objective is a effective, 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
- Delivering a quality audit through our experienced public sector audit team, use of data analytics to focus our audit and understanding of the organisation
- clear and upfront communications, with regular communication during the year
- reporting with focused actions which will support you in improving your controls/operations

**Adding value**

Our aim is to add value to SEPA through our external audit work. This will be delivered through delivering a high quality audit. Specifically for SEPA we will also undertake the following arrangements:

- **Robust and effective audit methodology**: Our ISA compliant audit methodology is tailored to focus audit resource on significant risk areas and key estimates and judgements.
- **Investing in our people**: Our resourcing model is designed to ensure you have a skilled, experienced and knowledgeable audit team.
- **Investing in technology**: We continue to invest in data analysis and audit software to deliver more efficient ISA compliant audit processes.

We will share relevant Audit Scotland and Grant Thornton publications with Senior Management and the Audit Committee, identifying particular areas for consideration. We will pro-actively work with management during the year to discuss any new or emerging matters, such as the new accounting standards.

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**Audit timeline**

- **Planning and risk assessment**
  - Audit committee: December 2018
  - Interim audit: January 2019
  - Year end audit: May/June 2019

- **Audit Plan**
  - Audit committee: June 2019
  - Board: July 2019
  - Annual Audit Report
  - Audit opinion

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**Key audit deliverables**

- **2018/19 Deliverables as set out in the Audit Scotland planning guidance (October 2018)**
  - Confirmation of agreed fee by end of February 2019
  - Annual quality report to the Auditor General and Accounts Commission (January 2019)
  - Current issues return for Central Government to Audit Scotland (21 January 2019 and 19 July 2019)
  - Submission of fraud cases to Audit Scotland on a quarterly basis
  - National Fraud Initiative - completed Auditor questionnaire (30 June 2019)
  - Submission of annual audit report and audited accounts

- **Planned Audit Scotland publications which may be relevant to SEPA**
  - Digital progress in central government and health (reporting early 2019/20)
  - Modern Apprenticeships

- **External Audit deliverables for 2018/19 – Audit Committee**
  - External Audit Plan (this document)
  - Annual Report to those Charged with Governance (June 2019) and Audit Opinion
  - Management letter of representation (July 2019)
Materiality

We undertake your audit in accordance with International Standards on 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
- audited parts of the remuneration and staff report have been prepared in accordance with the guidance
- regularity of expenditure and income
- the wider information contained in the financial statements e.g. Accountability Report; Directors Report and Governance Statement is consistent with our audit knowledge and the financial statements

**Basis for materiality**
We determine financial statement materiality based on a proportion of the total operating expenditure. This approach is consistent with our prior year materiality determination. We have determined materiality to be £1.4million (PY £1.388million), which equates to approximately 1.6% of your prior year total operating expenditure for the year. This is based on our judgement of our consideration of material to the user of the account based on understanding of SEPA. We will update our materiality based on the unaudited 2018/19 financial statements. During the course of our audit engagement, we will continue to assess the appropriateness of our materiality.

**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 2017/18 we have reduced this for 2018/19 to 65% (prior year 75%). Performance materiality determines those accounts which testing will be undertaken on and the level of sample testing performed where applicable.

**Prior Year Expenditure**
£86.264m

**Materiality**
£1.4m
- Financial statements materiality

£0.069m
- Prior year total operating expenditure
- Materiality

**Reporting to those charged with governance**
Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) ‘Communication with those charged with governance’, we are required to report corrected and uncorrected omissions or misstatements other than those which are ‘clearly trivial’ to those charged with governance. We have determined this threshold to be £69,000. (PY: £67,000).
A risk based audit methodology

A part of audit planning is understanding your organisation and the industry it operates. This is our third year as the external auditors of SEPA appointed under the Audit Scotland framework. In 2017/18 SEPA received £34 million 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 £8.8 million 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. During 2017/18 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 2017/18 were £60.8 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. SEPA plays a dual role in as both regulator as well as support and advisor to businesses and other organisations. Managing this dual role continues to play a key role in the delivery of corporate objectives.

Significant risks

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

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

<table>
<thead>
<tr>
<th>Risk area</th>
<th>Description of risk</th>
<th>Planned response</th>
</tr>
</thead>
</table>
| Risk of fraud in revenue recognition                | As set out in ISA 240 there is a presumed risk that revenue may by mistated due to improper recognition of revenue. In 2017/18 SEPA received grant in aid funding from the Scottish Government of £34 million. We consider this transaction stream to be well forecast and agreeable to third party confirmation and therefore rebut the rebut the presumed risk of improper recognition. SEPA’s main revenue comes from charging schemes. During 2017/18 SEPA generated revenue of £38.9 million from these streams. In addition, SEPA generated approximately £6.2 million from other operating activities. SEPA’s financial performance is measured through its outturn position at year end. We consider the risk to be prevalent around the year end where there is greatest incentive and opportunity for manipulation and therefore focus our testing on existence of debtor balances at the year end and cut-off. | • Walkthroughs of the controls and procedures around material income streams and validation of key controls where appropriate  
• Considering management’s assessment of the impact of IFRS 15 on revenue streams and ensuring that revenue has been recognised in accordance with the new standard.  
• Evaluation of the existence of debtor balances held at 31 March 2019  
• Using our data analytics tools to provide assurance that income recognised is in line with expectation  
• Consider income cut off procedures and substantive testing over pre and post year end balances, over non grant in aid revenue streams  
• A focus on recoverability of balances |
| Fraud in expenditure recognition as set out in Practice Note 10. | 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. As payroll expenditure is well forecast and agreeable to underlying payroll systems there is less opportunity for the risk of misstatement in this expenditure stream. We therefore focus on non-pay expenditure. We consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of non-pay expenditure. | • Perform cut off at year end on pre and post year end transactions and recording  
• Reviewing the completeness of creditors (and expenditure) recognised.  
• Analytical procedures to gain assurance that expenditure is recognised in line with expectation  
• Walkthrough of the key expenditure controls in place |
### Overview of our significant audit risks identified at planning and our proposed approach

<table>
<thead>
<tr>
<th>Risk area</th>
<th>Description of risk</th>
<th>Planned response</th>
</tr>
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</table>
| 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 | • A focus on understanding how/where management override of controls may occur  
• Review of the controls over journal entries using our IDEA journal analyser tool to focus on higher risk journals  
• Understanding key areas of judgement and accounting estimates within the financial statements and the basis for these judgements and the application of accounting policies. This include assumptions around IAS 19 defined benefit obligations.  
• Reviewing unusual and/or significant transactions that are out with the normal course of business for the entity to understand the rationale for these transactions |
| Valuation of specialist Property, plant and equipment | SEPA hold £34.8 million of assets (PPE). Of these assets a number are specialised in nature e.g. gauging stations; and vessels. Given the specialist nature of the assets valued and volume of individual assets, 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. | • We will review the approach to the valuation of PPE to ensure this is consistent with IAS 16 as interpreted by the FReM.  
• 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 FReM. |

### 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, confirming these are appropriate through our substantive testing.

### Working with Internal Audit

We will aim to not duplicate the work of your internal auditors. We will consider the internal audit plan for 2018/19 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 consider internal audit work throughout the year and maintain and ongoing, open, dialogue with internal audit.

### Internal control environment

Throughout our audit planning and fieldwork we will continue to develop our understanding of the overall control environment (design) as related to the financial statements. In particular we will:

• Consider procedures and controls around related parties, journal entries and other key entity level controls.

• Perform procedures around IT general controls.

• Perform walkthrough procedures on key controls around identified risk areas including revenue, expenditure and the recognition and valuation of property, plant and equipment

• We will liaise with the Pension Fund auditor to support our assessment of the controls in place over the completeness and accuracy of the defined benefit pension fund valuation.
Wider scope audit

Our responsibilities under Audit Scotland’s Code of Audit Practice extend beyond the audit of the financial statements.

The Code sets out four dimensions that frame wider scope audit work into identifiable areas. Alongside Value for Money, the audit dimensions set a common framework for our audit work and we review and conclude on the four dimensions and that there are organisational arrangements in place to secure Value for Money.

Wider scope approach

Our wider scope audit work is a risk based approach. It is built upon our understanding of the organisation and consideration of:

- Four audit dimensions defined within the Audit Scotland Code of Audit Practice
- Scottish Public finance Manual (SPFM) nine characteristics of Value for Money
- Our core audit work and audit knowledge

We consider each of these areas through our audit planning process.

Audit Scotland Audit Planning guidance

Audit Scotland Audit Planning guidance outlines key areas for consideration. Relevant to the organisation we will consider the following:

- EU Withdrawal,
- changing landscape for public financial management,
- dependency on key suppliers and
- openness and transparency.

Details included in the appendix 6. We consider these areas during our audit planning and throughout our wider scope audit work.
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 recovery the costs of these schemes.

Over the medium term, SEPA continue to face financial challenges.

Management have considered a number of scenarios, particularly around grant-in-aid funding levels as well as rising operational costs.

Management have considered a number of scenarios, particularly around grant-in-aid funding levels as well as rising operational costs. Management forecast a funding gap of £6.9 million by 2022/23 and are working through savings options to address these.

Our response

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. We will assess the extent to which savings are identified and delivered while ensuring that the organisation maintains the skills and experience within its workforce to deliver its corporate objectives.

Financial management

SEPA have well established financial management and governance arrangements in place. This includes effectively designed systems of internal financial control. Historically, financial plans have been informed through relevant information and reasonable assumptions. Financial performance is monitored both at and operational and strategic level and reporting is clear and concise.

No specific financial management significant risks have been identified for 2018/19. 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.
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.

Governance and transparency

SEPA has in place well established systems of governance including clear roles and responsibilities and systems of internal control. The organisation continues to develop and enhance its financial and non-financial performance reports, including those available to the public.

No specific governance and transparency risks have been identified for 2018/19. 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.

The delivery of Corporate objectives will require SEPA to work closely and strategically with key partners. Failure to engage and work with key partners across both public and provide sectors could result in significant challenges in delivering effective regulation and flood prevention activities.

No specific governance and transparency risks have been identified for 2018/19. 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 including how the organisation engages and works with key partners.
Appendices

Key audit deliverables and our team
Fees and independence
Fraud arrangements
Respective responsibilities
Technical updates
Specific considerations as set out in the Audit Scotland planning guidance
Communication of audit matters with those charged with governance
# Key audit deliverables and our team

## Our team

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joanne Brown</td>
<td>Director</td>
<td>T: 0141 223 0848 E: <a href="mailto:joanne.e.brown@uk.gt.com">joanne.e.brown@uk.gt.com</a></td>
</tr>
<tr>
<td>John Boyd</td>
<td>Senior Manager</td>
<td>T: 07795283846 E: <a href="mailto:john.p.boyd@uk.gt.com">john.p.boyd@uk.gt.com</a></td>
</tr>
</tbody>
</table>

In addition we will use our pensions team (assumptions) and our Accounting technical team as required.

## Activity

### October to December 2018
- Meeting with the Head of Finance and finance team to reflect on 2017/18 lessons learned and start planning conversations for 2018/19
- Review of minutes and completion of our internal planning processes

### December 2018
- Presentation of our External Audit 2018/19 plan to the Audit Committee
- Audit and Risk Committee enquiry on fraud and completion of fraud risk questionnaire

### During December and early January
- Review of minutes
- Completion of risk assessment
- Review of internal audit
- Issuing group instructions and instructions to the valuer’s

### February - May 2019
- Substantive testing of balances for the first 9 months of the financial year focused on management accounts reporting
- Walkthroughs of the key controls and validation of controls (to inform year end substantive testing)
- Audit work aligned to the wider scope risks identified in the plan

### May 2019
- Year end fieldwork commences

### May/June 2019
- Audit findings meeting with Senior Management
- Annual Report to those charged with governance (Audit and Risk Committee)
- Sign financial statements opinion
- Submit NFI Checklist to Audit Scotland (June)

### June/July 2019
- Once signed submit the financial statements and our Annual Report to Audit Scotland

### July/August 2019
- Debrief and learning meeting

### July 2019
- Current issues return 2

## Planning and Interim Work

### Final accounts visit
- May 2019
  - Year end fieldwork commences

### Completion and interim work
- May/June 2019
  - Audit findings meeting with Senior Management
  - Annual Report to those charged with governance (Audit and Risk Committee)
  - Sign financial statements opinion
  - Submit NFI Checklist to Audit Scotland (June)

### Debrief
- July/August 2019
  - Debrief and learning meeting

### Key audit deliverables

<table>
<thead>
<tr>
<th>Activity</th>
<th>2018</th>
<th>2019</th>
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<td>Oct</td>
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<td>Dec</td>
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<td>Jan</td>
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<td>May</td>
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<td>Jun</td>
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<td>Jul</td>
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Fees and independence

External Audit Fee

<table>
<thead>
<tr>
<th>Service</th>
<th>Fees £</th>
</tr>
</thead>
<tbody>
<tr>
<td>External Auditor Remuneration</td>
<td>40,410</td>
</tr>
<tr>
<td>Pooled Costs</td>
<td>9,720</td>
</tr>
<tr>
<td>Contribution to Audit Scotland costs</td>
<td>2,420</td>
</tr>
<tr>
<td>Contribution to Performance Audit and Best Value</td>
<td>0</td>
</tr>
<tr>
<td><strong>2018-19 Fee</strong></td>
<td><strong>52,550</strong></td>
</tr>
</tbody>
</table>

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

Fees for other services

<table>
<thead>
<tr>
<th>Service</th>
<th>Fees £</th>
</tr>
</thead>
<tbody>
<tr>
<td>At planning stage we confirm there are no non-audit fees</td>
<td>Nil</td>
</tr>
</tbody>
</table>

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.

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.
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 management 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 a quarterly basis.

Anti-Money Laundering Arrangements

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

<table>
<thead>
<tr>
<th>Area</th>
<th>SEPA Responsibilities</th>
</tr>
</thead>
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| Corporate governance | • 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 | • 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 | • Proper arrangements to ensure financial position is soundly based and responsibility to ensure arrangements secure best value |
| Fraud and error   | • 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.
- 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.
Technical updates

For 2018/19, new accounting standards (International Financial Reporting Standards (IFRS)), will apply covering revenue (IFRS 15) and financial instruments (IFRS 9).

IFRS 9: Financial Instruments

The introduction of IFRS 9 produces a more principles based approach to the accounting of financial instruments, including their classification and measurement. The main features of the new standard are summarised in the table.

<table>
<thead>
<tr>
<th>IFRS 9</th>
<th>Impact</th>
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| Criteria for classification of financial assets | IFRS 9 applies a single classification and measurement approach to all types of financial assets based on:  
- The body’s business model for managing financial assets;  
- The contractual cash flow characteristics of the financial asset.  
This represent a departure from IAS 39’s reliance on the terms of an instrument (traded or not). |
| Measurement categories for financial assets  | The new measurement categories for financial assets are as follows:  
- Financial assets measured at amortised cost  
- Financial assets measured at fair value through other comprehensive income  
- Financial assets measured at fair value through profit or loss |
| Impairment                                  | IFRS 9 contains a forward looking expected loss impairment model and requires the same measurement basis for impairment for all items subject to its impairment requirements.  
The FReM requires the simplified approach allowed under IFRS 9, which removes the need for an entity to consider whether the credit quality of trade receivables, contract assets and lease receivables has deteriorated since initial recognition. |

The FReM requires bodies to recognise any changes in carrying value as at 1 April 2018 arising from the adoption of IFRS 9 within the opening general fund.

IMPACT

The key practical change in IFRS 9 for most public bodies is the introduction of a new approach to recognising impairments of debtors and other financial instruments.

ACTION

SEPA should undertake an assessment of the potential impact IFRS 9 has on financial instruments held to ensure it has sufficient information to ensure compliance with the standard for the year end accounts.
Technical updates

IFRS 15: Revenue from Contracts with Customers

The core principle of IFRS 15 is that a body should recognise revenue for the transfer of goods or services to customers at an amount that reflects the expected price. A body recognises revenue in accordance with that core principle by applying the following five steps:

1. Identify the contract(s) with a customer. The FReM has extended the definition of a contract to include legislation which enables a body to obtain revenue that is not classified as taxation.
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognise revenue when (or as) the entity satisfies a performance obligation.

The impact of the introduction of IFRS 15 will vary across organisations.

The FReM interpretation removes the policy choice to retrospectively restate in accordance with IAS 8. On transition, entities will recognise the difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in reserves.

Impact

The impact of the introduction of IFRS 15 will vary across organisations. For the Authority, careful consideration will need to be given to any contractual arrangement and the potential performance obligations contained within these.

Action

SEPA should undertake an assessment of the potential impact IFRS 15 across its material revenue streams to ensure it has sufficient information to allow with the standard. Early evaluation is advised as this may impact on final outcome reported in the financial statements and budgetary implications.

Audit action

We will continue to work with management to understand the impact of the introduction of IFRS 9 and IFRS 15 on the entity’s financial statements and any potential changes in accounting policy that arise from these. We do not anticipate that IFRS 9 will have a material impact on the entity’s financial statements. However, further assessment is required around the impact of IFRS 15, particularly over contract arrangements. We will provide an early review of the proposed year end accounting treatment, providing relevant technical insight and challenge to provide assurance that the year end financial statements have been prepared in accordance with the FReM and applicable accounting standards.
Specific considerations as set out in the Audit Scotland planning guidance

In accordance with the Audit Scotland Planning Guidance, we consider the following areas of focus as part of our audit work:

- **EU Withdrawal**
  - There are uncertainties surrounding the terms of the UK’s withdrawal from the European Union in March 2019 and these are subject to ongoing negotiation between the UK government and EU. Whatever the outcome of these negotiations there is inevitably implications for devolved government in Scotland and for SEPA

- **Changing landscape for public financial management**
  - Recognising the changing landscape of Scottish public finances, including significant tax-raising powers as well responsibility for 11 social security benefits provides the Scottish Parliament with more policy choices. Subsequently, there is potentially greater volatility and complexity around Scottish budget and greater focus on the use of Scottish funds. This is likely to increase the scrutiny of public sector annual accounts and audit reports.

- **Dependency on key suppliers**
  - The collapse of Carillion and the subsequent impact across the public sector, has brought into focus the risk of key supplier failure and underperformance. We will consider the arrangements in place for identifying key supplier and risks, if any associated with these and how effectively these are being managed.

- **Openness and transparency**
  - There is an increased focus on how public money is used and what is achieved. This includes the extent to which SEPA keeps pace with public expectations and good practices in this area. Including: increased public availability of papers, insight into why any business is conducted in private and development of the form and content of annual reporting.

**Planning consideration**

- The areas of potential risk are: workforce implications; funding; and regulation. We will consider the work done by SEPA with regards assessing the potential risks faced and readiness for EU withdrawal.

- As part of our audit we will consider the extent to which the performance report provides an accessible account of SEPA’s overall performance and impact of its public spending and transparency of reporting.

- We will consider the arrangements in place for identifying key supplier and risks, if any associated with these and how effectively these are being managed.

- We will consider Audit Scotland’s guidance around openness and transparency as we consider SEPA’s governance arrangements during 2018/19.
**Communication of audit matters with those charged with governance**

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<th>Our communication plan</th>
<th>Audit Plan</th>
<th>Audit Findings</th>
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<tr>
<td>Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks</td>
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<tr>
<td>Confirmation of independence and objectivity</td>
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<tr>
<td>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</td>
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<tr>
<td>Significant matters in relation to going concern</td>
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<tr>
<td>Views about the qualitative aspects of SEPA accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures</td>
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<td>Significant findings from the audit</td>
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<td>Significant matters and issues arising during the audit and written representations that have been sought</td>
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<td>Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements</td>
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<td>Non-compliance with laws and regulations</td>
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<td>Unadjusted misstatements and material disclosure omissions</td>
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<td>Expected modifications to the auditor’s report, or emphasis of matter</td>
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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.