



Scottish Environment Protection Agency (SEPA)

External Audit Plan for the financial year ending 31 March 2020

SEPA Audit Committee

Final Audit Plan – 26 March 2020

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Our audit at a glance



Planning materiality is set at **£1.65 million**, being approximately 2% of gross expenditure based on 2019/20 revised (March 2019) budget. 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. Our materiality reflects our professional judgement of the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. We will apply a lower materiality threshold on review of the Remuneration and Staff report to ensure that remuneration has been disclosed within appropriate bandings (being **£2,500**). We will revisit our materiality throughout our audit including updating to reflect the unaudited financial statements.



Performance materiality is set at **75%** of overall materiality. This is consistent with the prior year reflecting our audit knowledge and understanding with the only material adjustments to the accounts in the prior year being isolated to the defined benefit pension scheme.



Significant audit risks are: management override of controls; risk of fraud in revenue recognition as set out in International Standards on Auditing (ISAs UK); the risk of fraud in expenditure recognition as set out in Financial Reporting Council's (FRC) Practice Note 10; defined benefit pension scheme liabilities; and, the valuation of property plant and equipment.

An audit
underpinned by
quality



Our audit is undertaken in accordance with the Audit Scotland Code of Audit Practice and reflects the wider scope nature of public audit. Through our audit planning we have identified wider scope risks reflecting SEPA's **financial sustainability** and **value for money arrangements**. In particular, we will consider SEPA's plans to address medium term financial pressures, including working with strategic partners and developing a workforce model that supports the delivery of corporate priorities with resources available to the organisation. In accordance with Audit Scotland's planning guidance, during 2019/20 we will have particular audit focus around the risk of fraud and corruption in SEPA's procurement arrangements.



The Scottish Environment Protection Agency (SEPA) face significant financial challenges over the next five years with management forecasting a budget gap of £12.7 million (over 13% of current operating expenditure) by 2023/24. With between 65-70% of operating costs being staff costs.

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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

External Audit plan

The External Audit Plan summarises our responsibilities in accordance with ISAs and the Code:

- Respective responsibilities;
- Our audit process and timeline
- Materiality
- Our risk based audit approach to the audit of the financial statement
- Our wider scope responsibilities including those in relation to the four wider audit dimensions prescribed in the code: Financial management; financial sustainability; governance and transparency; and, value for money.

Continuous improvement and 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:

Continuous learning and development: We have discussed with Management opportunities to develop our audit approach to ensure we deliver an efficient and effective audit approach. This will include meetings with senior members of the finance team to discuss the financial statements and the supporting information we will require during our audit.

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. **Constructive challenge and feedback:** We aim to provide constructive challenge by identifying areas of improvement and by recommending and encouraging good practice.

Audit appointment

The Auditor General for Scotland is an independent Crown appointment, made on the recommendation of the Scottish Parliament. The Auditor General is independent and not subject to control of any member of the Scottish Government or the Parliament. The Auditor General is responsible for securing the audit of the Scottish Government and most public bodies, and reporting on their financial health and performance.

Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out their statutory functions, including monitoring the performance of auditors through a quality control process.

The Auditor General has appointed Grant Thornton UK LLP as external auditor of SEPA for the five year period 2016/17 to 2020/21.

Our team

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The audit will be supported by a team of qualified and part qualified accountants from our public sector audit team. Where required we will use other audit experts, including Public Sector technical accounting team to support our audit.

Respective responsibilities

As set out in the Code of Audit Practice 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 and 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 Value for Money
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 ISA compliant 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 in accordance with Audit Scotland's Code of Audit Practice and applicable guidance
- Contributing to Audit Scotland Performance Reports
- Providing regular updates to Audit Scotland to share awareness of current issues across our audit clients
- Notify Audit Scotland of any cases of money laundering or fraud
- Contribute to National Fraud Initiative (NFI) report
- Contribute to Audit Scotland technical guidance

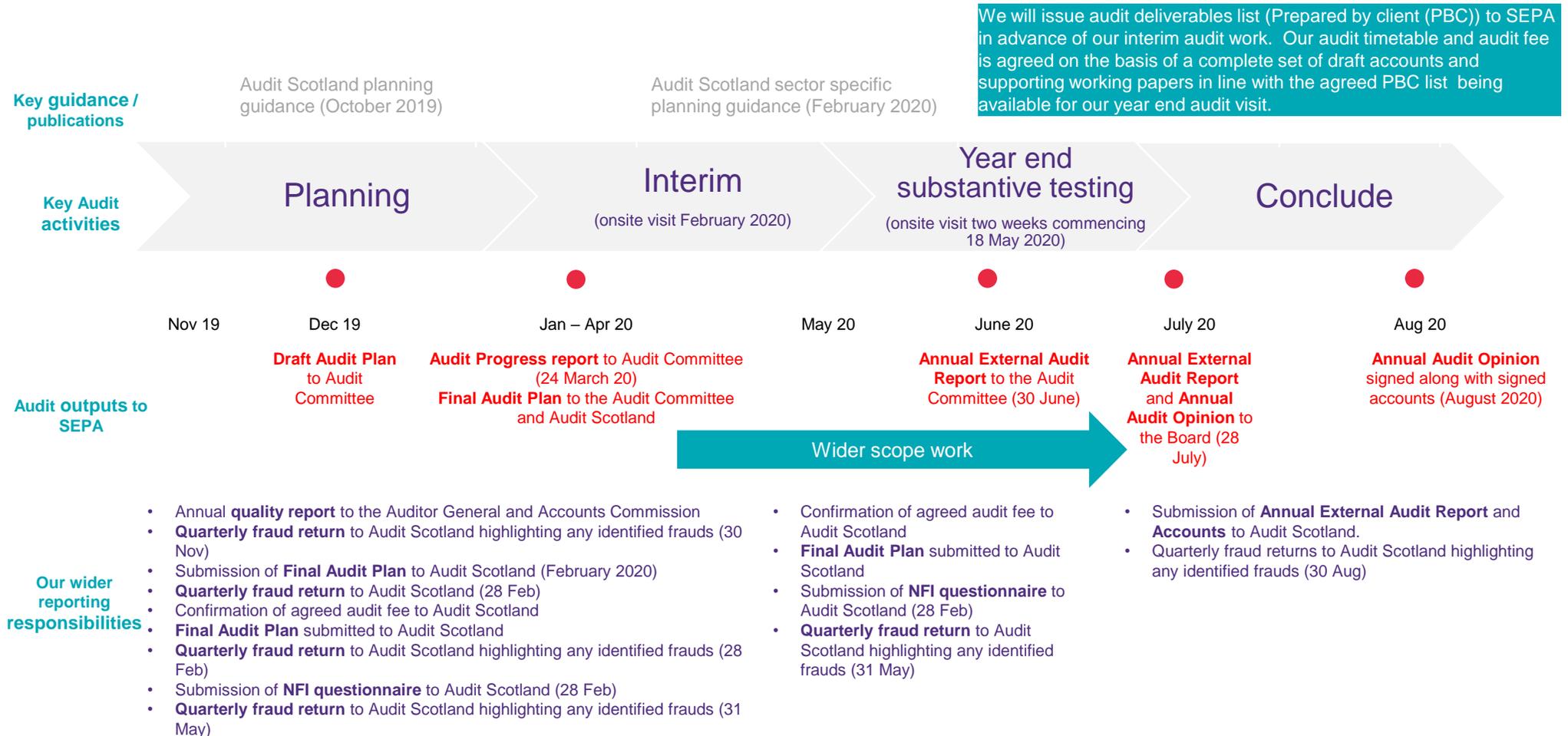
How do we do this in practice



- 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
- Providing quarterly fraud updates to Audit Scotland and information on any money laundering
- Providing relevant data to Audit Scotland relating to SEPA to contribute to shared risk assessment and national performance reports
- Consider and report on audited bodies participation in NFI
- Support Audit Scotland through engaging in technical guidance publications

Audit process and timeline

Our planned audit timeline is detailed below. In accordance with the Code of Audit Practice and audit Scotland Planning Guidance, we are required to undertake and report on a range of areas. The diagram below summarises our planned audit timetable for 2019/20, and output both to SEPA and Audit Scotland.



Throughout the audit process there will be continuous communication and engagement. We will also continue to engage with Audit Scotland to ensure they are aware of any current or emerging issues at SEPA

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 SEPA materiality to be **£1.65 million**, which equates to approximately **2%** of your budgeted total expenditure for the year (based on final revised budget in March 2019).

Performance materiality

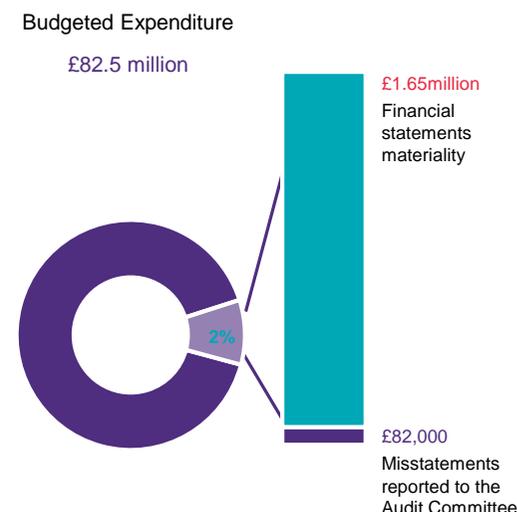
Performance materiality represents the amount set for the financial statements as a whole to reduce the probability that the aggregate of uncorrected and undetected misstatements exceed materiality. Based on our audit experience we have retained this for 2019/20 at **75%**, being **£1.23 million**. Performance materiality determines those accounts which testing will be undertaken on and the level of sample testing performed where applicable. Performance materiality is set at 75% of overall materiality. This is consistent with the prior year reflecting our audit knowledge and understanding with no material adjustments in the prior year.

Our materiality reflects our professional judgement of the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. We will apply a lower materiality threshold on review of the Remuneration and Staff report to ensure that remuneration has been disclosure within appropriate bandings (being **£2,500**).

We will update our materiality based on the unaudited 2019/20 financial statements. During the course of our audit engagement, we will continue to assess the appropriateness of our 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 by auditing standards to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. We have determined this threshold to be **£82,000**, being 5% of overall planning materiality.



A risk based audit methodology

A core part of audit planning is understanding SEPA and the wider public sector. This is our fourth year as the external auditors of the organisation appointed under the Audit Scotland framework. Through our audit planning procedures we consider a range of factors to assess the risk of material misstatement to the financial statements. 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. Our risk assessment includes the following;

Consideration of critical accounting estimates including valuation of property, plant and equipment and the recognition of defined benefit pension scheme liabilities

Assessment of inherent risk factors including changes in the organisation's activities and environment

Understanding of entity level controls and the control environment, including IT controls.

Financial and operational performance during the year, including pressures in delivering outcomes while operating within available financial resources

Identified Significant audit risks

- Risk of fraud in Revenue recognition
- Risk of fraud in expenditure recognition
- Management override of controls
- Defined benefit pension scheme liabilities
- Valuation of property, plant and equipment

We continue to assess the risk of material misstatement and our response to these risks throughout our audit. Within our Annual Audit Report we will report to you the conclusions from our audit procedures over these risks, including any further risks identified or changes to our planned audit response.

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Risk of fraud in revenue recognition	Income from Contracts (at the year end) (Occurrence, Completeness) Receivables (Existence, Completeness)	<p>As set out in ISA 240 there is a presumed risk that revenue may be by misstated due to improper recognition of revenue. In 2018/19, SEPA received £38 million in grant-in-aid resource funding from the Scottish Government. While material, we consider this funding to be well forecast and directly agreed to Scottish Government funding letter and draw down. We therefore consider the opportunity and incentive to manipulate this revenue stream as low and rebut the presumed risk around revenue recognition over revenue resource allocation. Similarly, SEPA recognised £5.5 million of grant income (Other income) during 2018/19 which we agree to the underlying grant agreement and cash receipt. This reduces the opportunity for manipulation and the inherent risk of material misstatement in revenue recognition. We therefore consider the risk of fraud in revenue recognition to be present in material revenue streams recognised within contract income, being charging scheme fees and charges and grant income. In 2018/19 SEPA generated £46 million of income from these revenue streams.</p> <p>As financial performance targets are primarily set for year end outturn position, including financial performance against the Scottish Government grant, we therefore consider the risk is prominent around year end revenue transactions and receivable balances. In the context of medium term financial pressures facing the organisation, there is an incentive for both over and understatement of revenue either to support the delivery of in year performance targets or to support next years. Consequently, at our planning stage we attach the risk to both occurrence and completeness of revenue. We will continue to assess this throughout the year.</p>
Audit Response		
<ul style="list-style-type: none"> • Walkthroughs of the controls and procedures over charging scheme fees and charges and grant income. • Perform substantive testing (at an elevated risk level) over income recognised in the final two months of the year and post year end transactions where there is an increased risk of fraudulent recognition of revenue. We will ensure that these are correctly accounted for in the financial statements. • Evaluation of the existence of receivables balances held at 31 March 2020 through agreeing balances held to invoices and/or other supporting records. • Perform income cut-off procedures and substantive testing over pre and post year end balances, over non Scottish government funding income streams. • A focus on recoverability of balances through agreeing a sample of debtor balances (at an elevated risk level) and agreeing to post year end cash receipt. 		

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Risk of fraud in Expenditure recognition	Other Expenditure (at the year end) (Completeness, Existence) Payables (Completeness, Existence)	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. Similarly, capital costs including depreciation are well forecast and based on underlying assets value and reconciled to SEPA's fixed asset register therefore presenting less opportunity for misstatement. We therefore focus on other operating expenditure (2018/19: £23 million). As financial performance targets are measured on year end outturn, including Scottish Government resource levels, we consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of other operating expenditure . In the context of medium term financial pressures facing the organisation, there is an incentive for both over and understatement of revenue either to support the delivery of in year performance targets or to support next years. Consequently, at our planning stage we attach the risk to both occurrence and completeness of expenditure transaction around the year end. We will continue to assess this throughout the year.

Audit Response

- Walkthroughs of the controls and procedures over other operating expenditure
- Perform substantive testing (at an elevated risk level) expenditure recognised pre and post year end to identify if there is any potential understatement or overstatement and ensuring correctly recognised in the accounts.
- Testing post year end bank statements and review of minutes and legal fees/correspondence, including legal account codes, to identify any potential unrecorded liabilities.
- Reviewing accruals and deferred income around the year end to consider if there is any indication of understatement of balances held through consideration of accounting estimates

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Management override of controls	Journals Accounting Estimates	<p>As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override SEPA's controls for specific transactions.</p> <p>We consider those key judgements that are most susceptible to significant audit risk of management override are those over income and expenditure recognition transactions around the year end. These are areas where management has the potential to influence the financial statement through estimate and judgement.</p>

Audit Response

Accounting estimates:

In assessing the risk of management override, consider those key accounting estimates and judgements that could impact on the organisations financial results and where there is an inherently increased risk of fraudulent misstatement or where management bias could result in a material misstatement. In response to the significant audit risk we will:

- consider the design of controls in place over key accounting estimates and judgements; and
- Review accounting estimates for management bias / indication of fraud that could result in material misstatement. This will include review of estimates as at 31 March 2020 and retrospective review of those estimates as at 31 March 2019.

Journals testing:

We will use our data analytics tool *Idea* to support our evaluation of journal transactions during the year. In response to the significant risk we will:

- Assess the design of controls in place over journal entries, including how these are prepared, authorised and processed onto the financial ledger;
- Will risk assess the journals population to identify large or unusual journal entries, such as those that are not incurred in the normal course of business, or those entries that may be indicative of fraud or error that could result in material misstatement. We will test these journals to ensure they are appropriate and that suitably recorded in the financial ledger and the financial statements;
- We will review controls in place to mitigate the risk of management override of controls including restricted access to posting / authorising manual journals to only appropriate users as well as segregation of duties; and
- We will perform targeted testing of transactions at the financial year end, including those to support the accounts preparation process, reviewing those journals are large or otherwise appear unusual to understand the rationale for the transaction.

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Valuation of property plant and equipment	PPE – Valuation (Land and buildings)	<p>In accordance with the HM Treasury Financial Reporting Manual (FRoM), subsequent to initial recognition, SEPA is required to hold property, plant and equipment at current value. The exact valuation basis depends on the nature and use of the assets. For assets with short term useful economic lives such as computer Equipment, fixtures, fittings and vehicles, depreciated historical cost is considered a suitable proxy for current value and therefore lower inherent risk of material misstatement in carrying value. However for Land and buildings, these require regular revaluation to ensure that carrying value within the financial statements reflects the current value of the asset. As at 31 March 2019, SEPA held land and buildings of £6.3 million and gauging stations of £16.6 million. Given the value of these assets held by the SEPA and the level of complexity and judgement in the estimation of valuations, there is an inherent risk of material misstatement in the carry value within land and buildings and gauging stations.</p>

Audit Response

Management expert

We will consider the independence and objectivity of the appointed valuer and consider their competence and experience as a suitable management expert.

We confirm the completeness of underlying information provided by SEPA to the valuer, including instructions provided to ensure that these are in line with the requirements of the FRoM and IAS 16: *Property, plant and equipment*.

We will review the valuation report provided by the valuer and reconcile to the underlying accounting entries made by SEPA.

Valuation

We will consider the suitability of the valuation methodology to ensure consistent with the FRoM and IAS 16.

We will review the appropriateness of the assumptions adopted by the valuer, including where relevant, reference to third party information (indices etc)

We will assess the valuation across land and buildings and gauging stations and compare actual valuation movements against expectation (based on average revaluation movements) to identify and large or unusual movements. We will assess the reasonableness of these through discussion with Management and the Valuer to gain assurance over valuations applied.

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Defined benefit pension scheme	Defined benefit pension scheme (valuation)	<p>SEPA participates in the Falkirk Pension Fund, a local government pension scheme. The scheme is a defined benefit pension scheme and in accordance with IAS 19: <i>Employee Benefits</i>, SEPA is required to recognise its share of the scheme assets and liabilities on the statement of financial position. As at 31 March 2019 SEPA had pension fund liabilities of £13.7 million.</p> <p>Hymans Robertson UK LLP provide an annual IAS 19 actuarial valuation of SEPA's net liabilities in the pension scheme. There are a number of assumptions contained within the valuation, including: discount rate; future return on scheme assets; mortality rates; and, future salary projections. Given the material value of the scheme liabilities and the level of estimation in the valuation, there is an inherent risk that the defined benefit pension scheme could be materially misstated within the financial statements.</p>
Audit Response		
<ul style="list-style-type: none"> • Walkthroughs of the controls and procedures over the valuation of pension scheme liabilities, including information and instructions provided to the pension fund and actuary; • Understanding the arrangements in place at the SEPA for reviewing the assumptions adopted by the actuary and suitability of these for the authority; • We will consider the suitability and reasonableness of the underlying assumptions adopted by the actuary in arriving at the defined benefit pension scheme liability, including ensuring underlying data used is appropriate in informing the valuation; • Audit Scotland have established a protocol between the auditors of Scottish local government pension schemes and auditors of participating bodies to provide assurances over the arrangements in place over pension information managed by the pension fund. Due to the timing of SEPAs financial statements audit being in advance of work over the pension fund, we will need to rely upon alternative audit procedures to gain assurances over information managed separately from SEPA. We do this through directly liaising with Falkirk Council, as administrators of the Falkirk Pension Fund; and • Reviewing the underlying data supporting the valuation to ensure these are consistent with the SEPA's underlying records. 		

Other audit areas

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, alongside our assessment based on substantive testing and audit procedures.

Working with Internal Audit

The Auditing Standards Board's version of ISA (UK) 610 “Using the work of internal auditors” prohibits the use of internal audit to provide “direct assistance” to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

During 2019/20, we engage with Internal Audit to confirm any awareness of fraud or suspected fraud. Where Internal Audit have identified specific material deficiencies in the control environment that would create a risk of material misstatement to the financial statements, we will consider adjusting our testing so that the audit risk is covered by our work.

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 including controls to mitigate Management override of controls.
- Perform walkthrough procedures on key controls around identified risk areas including operating income, payroll expenditure, other expenditure, journal entries, IAS 19 pension accounting and property, plant and equipment valuations.

Coronavirus

The full extent and impact of the outbreak of novel coronavirus (COVID-19) remains uncertain. As a firm we are actively monitoring the outbreak and taking proactive steps to protect the health and wellbeing of our clients, employees and communities. We are following the latest guidance from Public Health England and Scotland and have taken precautionary measures including restricting non-essential travel and steps to limit potential exposure.

We have reached out to our audit clients, including SEPA, to understand arrangements in place to enable us to deliver the audit in the event that travel restrictions remain in place over the planned period of the audit. Currently, we assume that the audit will need to be delivered remotely. We have established arrangements, including remote working of our staff and testing approaches, taking into account regulatory guidance, in order to deliver our audit work. We will continue to liaise with health authorities, Audit Scotland and our clients about the situation.

For SEPA, the impact of the Coronavirus on the primary financial statements remains uncertain. External markets are likely to see a reduction in the market value of investment assets held as part of the defined benefit pension scheme. In addition, the volatility in markets impact on the carrying value of property, plant and equipment. There may also be further impacts on recoverability of income, particularly amounts due around the year end, reflecting wider economic downturn. We will continue to monitor the impact of the coronavirus and of government measures to manage the outbreak. Where required we will continue to reassess our audit plan accordingly.

International Financial Reporting Standards 16: Leases (IFRS 16)

IFRS 16 was effective for accounting periods beginning on or after 1 January 2019 and is due to be adopted for bodies reporting under the FReM for financial years beginning on or after 1 January 2020. The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and replaces the previous standard IAS 17. IFRS 16 introduces a single lessee accounting model aimed at providing a fairer representation of a lessee's assets and liabilities and disclosures around these. Under IFRS 16, the lessee recognises assets and liabilities with a term of more than 12 months, unless the underlying asset is of low value. In practice, this is likely to result in lease or lease type arrangements associated assets and liabilities being recognised in the financial statements of the lessee, where these may have previously been treated as operating leases where there was no asset or liability recognised and only an annual lease charge through expenditure.

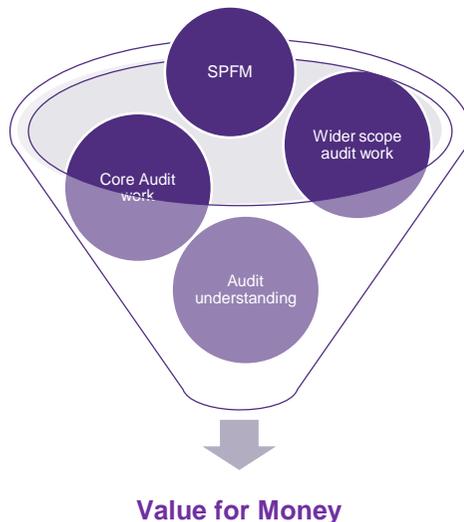
During 2019/20 we will review the progress made by SEPA in evaluating the potential implications on adoption of the new accounting standard. This will be reflected in the 2020/21 financial statements.

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:

- Scottish Public finance Manual (SPFM) nine characteristics of Value for Money
- Our core audit work and audit knowledge
- Audit Scotland planning guidance

We consider each of these areas through our audit planning process. We summarise our planning consideration over the wider scope areas below, including where we have identified a significant wider scope risk, our planned audit response. We have also identified areas that we will continue to consider throughout our audit to allow us to conclude on the wider scope areas in our Annual Audit Report.

Wider scope audit dimensions

Financial sustainability

SEPA face significant financial challenges over the short to medium term. Management's financial projections forecast that by 2023/24, there will be a budget gap (shortfall between forecast operating costs and available revenue) of £12.7 million.

SEPA recognise that it is critical that resources are prioritised on delivering the organisations key strategic outcomes. With limited capacity to bridge the funding gap through additional revenue support, a key area of focus for SEPA is in managing cost pressures. With between 65-70% of operating expenditure is staff costs, it is critical that SEPA develop robust workforce plans to ensure staffing resources are used efficiently and effectively as possible to deliver corporate objectives in a financially sustainable operating model.

SEPA recognise that to ensure long term financial sustainability it needs an efficient and affective workforce, designed and focused on delivering corporate priorities. Therefore, a clear and concise workforce plan and strategy are required to support the delivery of a an operating model that both supports the delivery of strategic goals, but does so in a financially sustainable way. During 2018/19, due to the volume of work between the restructuring of portfolios and devising sector plans, the preparation of workforce plans have been put on hold. It is important that these are taken forward as a matter of urgency.

Significant wider scope risk identified: Like many public bodies, SEPA face financial challenges through rising pressures on payroll costs, as well as inflationary increases on other operating expenditure. With forecasts levels of Scottish Government and other income sources not offsetting these, SEPA faces an estimated budget gap of £12.7 million. It is critical that SEPA has an operating model that is financially sustainable while supporting the delivery of key strategic priorities. Critical to this will be robust workforce plans to maximise the use of available human resource.

Audit
response

Response to significant wider scope risk

We will review the financial plans in place, including the scenarios set out, and how these align resources to the delivery of SEPA's corporate priorities. We will assess the progress made by SEPA in developing financially sustainable operating plans that continue to support the delivery of these priorities. We will consider the progress made by SEPA in developing comprehensive workforce plans that aim to maximise the use of human resource in line with financial plans. In addition we will consider the extent to which SEPA evaluate the potential impact on service performance either through pursuing additional revenue generating activities or through delivering operational efficiencies.

Other wider scope procedures

In relation to broader financial sustainability we will continue to develop our understanding of SEPA's financial planning arrangements including workforce plans and how these developed both supporting and recognising the financial and operational challenges facing the organisation.

Wider scope audit dimensions

Financial management

Based on our cumulative audit experience over the last three years, we have found that SEPA has reasonable financial management arrangements. Financial performance is monitored by management and report to the Board on a quarterly basis. Financial performance reports were clear and concise, focusing on key areas of financial performance. During 2018/19, SEPA reported and underspend of £259,000 against the Scottish Government's Departmental Expenditure Limit (DEL). While an overspend of £6.1 million was reported against Annually Managed Expenditure budgets, this was primarily due to IAS 19 pension charges being higher than forecast. SEPA's cost base is predominantly payroll costs, with these contributing to between 65-70% of total operating expenditure. Effective oversight of pay and non pay costs forms an important part of budget monitoring arrangements across SEPA.

To support operating costs, SEPA generates funding through three main streams: grant-in-aid funding; fees and charging schemes; and other income including grant funding. SEPA has gradually moved towards generating the majority of revenue from fees and charges and other income sources and less around Scottish Government Grant in aid funding and this trend is expected to continue in 2020.

Audit
response

We have not identified any significant wider scope risks through our audit planning. We will continue to review SEPA's financial management arrangements including the extent to which there is effective scrutiny over both operational spend as well as monitoring of income generated to ensure this was in line with budgets.

As the organisation continues to focus on delivering operational efficiencies to manage rising pay and inflationary cost pressures, we will consider the extent to which the delivery of these efficiencies are scrutinised to ensure management have an understanding of the operational impact of these savings.

Wider scope audit dimensions

Governance and transparency

SEPA has a relatively stable governance structure with the Board and its committees well established. The Board meets regularly during the year and from attendance at Audit Committee and from our audit knowledge we have no underlying concerns around the level of scrutiny, debate and challenge.

During 2019/20, the Chair of the Audit Committee is due to stand down and it will be important that SEPA ensure there are handover arrangements in place to ensure continued effective governance and scrutiny.

SEPA's Corporate Plan 2017-2022, articulates the Board's strategic outcomes. The strategy aims to align the organisations regularity role, including compliance and regulation as well as flood risk management. It recognises that the organisation must both support business and partners as well as managing and addressing areas of non-compliance with regulation.

Furthermore, SEPA aims to support and promote businesses move "*beyond compliance*", providing low carbon, low materials. Low water and low waste operating model. For flood management, SEPA continue to play a key role in flood risk management through flood forecasting and warning as well as promoting preventative action to protect vulnerable people and communities at risk of flooding.

Critical to the delivery of SEPA's corporate priorities is working with key strategic partners. SEPA has been developing sector plans with key partners across regulated sectors. Through these plans SEPA develop an understanding of the ambitions of the sector and find ways to facilitate growth in ways that provides for effective environmental protection and improvement. SEPA aim to utilise the plans to address area of non-compliance with environmental legislation, looking at practical solutions addressing sector wide issues faced.

Audit response

We have not identified any specific significant wider scope audit risks in relation to the SEPA's governance and transparency. To support our wider scope audit, we will continue to consider through discussions with management and review of minutes the adequacy and effectiveness of overarching governance arrangements.

We will consider the extent to which SEPA have oversight of the sector plans and utilises these to work with partners to address environmental compliance issues.

Wider scope audit dimensions

Value for money

SEPA has an established performance management framework and there is ongoing monitoring and scrutiny across management and the organisation. SEPA continues to face challenges in meeting its performance targets. During 2018/19 SEPA reported failing to deliver 5 out of the 15 corporate targets. Areas where corporate objectives have not been delivered include increasing the length of river or loch shore where physical condition; finalising sector plans; making waste sector less attractive to criminals; increasing, in targeted sectors, the percentage of permits which have obligations that are clearer; and develop new sustainable growth agreements. SEPA recognises the importance of working with partners to support the delivery of corporate objectives.

Significant risk identified: *With forecast budget pressures over the next five years, it is increasingly important that SEPA ensure they maximise the use of resources to support the delivery of corporate objectives. Working with key strategic partners will be critical to this as well as ensuring that performance targets and measures align to corporate objectives.*

Audit
response

Response to significant wider scope risk: We will assess the extent to which SEPA works with key strategic partners to enhance performance improvement and deliver corporate objectives. A key part of this will be ensuring that performance measures are clearly aligned to corporate priorities and SEPA's statutory requirements to ensure performance monitoring is aligned to the delivery of these. We will consider the extent to which there is consideration of how resources can be best utilised in supporting the delivery of these and how SEPA ensure they can monitor the organisation's performance in targeting outcomes, particularly in areas reliant on strategic partners.

Other wider scope procedures:

We will consider the extent to which SEPA can demonstrate that they deliver value for money through the delivery of services, using resources efficiently and effectively to deliver outcomes. We will consider the progress made by SEPA in working with strategic partners to support the delivery of corporate outcomes.

Audit deliverables

As set out in the Code of Audit Practice, as appointed auditors we have a number of wider reporting responsibilities beyond the audit of the financial statements. Below we summarise the key areas of work during our 2019/20 audit, including expected reporting under Audit Scotland's Code of Audit Practice and audit planning guidance (2018/19 Guidance on Planning the Audit)

Requirement	How we will report our findings
Annual accounts Perform an audit of the annual accounts and express and express specified audit opinion on them.	<ul style="list-style-type: none"> • External audit plan • External auditor's opinion on the financial statements • Annual external audit report (to those charged with governance and the Auditor General for Scotland) findings from our audit work of the financial statements
Wider scope audit dimensions Conclude and report on our assessment of the wider scope audit dimensions	<ul style="list-style-type: none"> • Annual external audit report (audit findings report)
National Fraud Initiative Evaluate the Boards participation in the National Fraud initiative	<ul style="list-style-type: none"> • Annual external audit report (audit findings report) • Reporting participation to Audit Scotland including completion of NFI questionnaire
Emerging issues Communication of emerging issues to Audit Scotland and highlight any issues for potential statutory reports	<ul style="list-style-type: none"> • Communicating throughout our audit emerging issues throughout the year
Correspondence queries Carry out preliminary enquiries into any correspondence relevant to the Board that is referred to Audit Scotland.	<ul style="list-style-type: none"> • Providing responses to any correspondence received based on our audit knowledge and understanding and the results of any review as agreed with Audit Scotland
Money laundering and fraud Provide information on cases of money laundering or fraud	<ul style="list-style-type: none"> • Reporting cases to the National Crime Agency of an instances of money laundering at the Board and reporting any identified frauds to Audit Scotland
Technical guidance Contribute to Technical Guidance Notes	<ul style="list-style-type: none"> • Providing responses to Audit Scotland consultations on draft Technical Guidance notes for Auditors.

Audit deliverables

Requirement	How we will report our findings
<p>Audit Scotland area of focus - Procurement</p> <p>In accordance with Audit Scotland's planning guidance, during 2019/20 we will have particular audit focus around the risk of fraud and corruption in SEPA's procurement arrangements. We will evaluate the arrangements at the audited body to mitigate that risk, auditors may wish to consider whether:</p> <ul style="list-style-type: none">• Procurement risk is recognised and managed with key owner;• controls around the procurement process, including segregation of duties, are adequate, followed and enforced• Appropriate policies and procedures in place around procurement including gifts and hospitality• Capacity and capability to undertake procurement activity• internal audit coverage of procurement systems is adequate and proportionate to the risks faced by the body• there are arrangements to encourage and protect whistle-blowers.	<ul style="list-style-type: none">• Our audit work will consider the arrangements for the prevention and detection of fraud and corruption. Specifically, we will consider the extent to which SEPA follows the principles of CIPFA's Code of Practice on Fraud. Our conclusions will be reported in our 2018/19 Annual External Audit Report.

Appendices

Appendices:

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Appendix 1: Fees and independence

External Audit Fee

Service	Fees £
External Auditor Remuneration	44,850
Pooled Costs	9,610
Contribution to Audit Scotland costs	2,290
Contribution to Performance Audit and Best Value	-
2019/20 Fee	56,750

Fees for other services

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

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.

Audit Scotland sets an expected fee for each audit carried out under appointment which assumes that the body has well-functioning controls, an effective internal audit service, and an average risk profile.

Audit Scotland reviews the expected fee each year and adjusts it if necessary based on auditors' experience, new requirements, or significant changes to audited bodies. 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. For 2019/20 we have agreed an audit fee of £56,750, representing a 8% uplift (£3,500) in the auditor remuneration element of the baseline fee. The uplift reflects the additional external audit work required in 2019/20 including the use of external valuations specialist to support our audit testing across the valuation of land and buildings.

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's 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 valuations of assets are supported by an independent specialist

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.

Appendix 2: 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.

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.

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.

Appendix 3: Communication with those charged with governance

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

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.

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	•	
Confirmation of independence and objectivity	•	•
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	•	•
Significant matters in relation to going concern	•	•
Views about the qualitative aspects of SEPA's accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures		•
Significant findings from the audit		•
Significant matters and issues arising during the audit and written representations that have been sought		•
Significant difficulties encountered during the audit		•
Significant deficiencies in internal control identified during the audit		•
Significant matters arising in connection with related parties		•
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		•
Non-compliance with laws and regulations		•
Unadjusted misstatements and material disclosure omissions		•
Expected modifications to the auditor's report, or emphasis of matter		•



The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the entity or all weaknesses in your internal controls.

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