Horizon Scanning

Challenges and opportunities 2023

mazars

Foreword

Our vision is to strengthen the UK's public services, allowing it to be effective in its responsibility for public money and aiding its ability to deliver the services that benefit our communities the most. We're on a mission to play our part in developing strong, resilient and sustainable public services that benefit all, and make the UK a better place to live, work and thrive.

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Our vision is to strengthen the UK's public services, allowing it to be effective in its responsibility for public money and aiding its ability to deliver the services that benefit our communities the most. We're on a mission to play our part in developing strong, resilient and sustainable public services that benefit all, and make the UK a better place to live, work and thrive.

The current environment presents dynamic uncertainty over what the future holds, with only one thing really clear: local authorities must be ready to adapt whilst protecting services for society's most vulnerable. Our Horizon Scanning report not only supports Head's of Internal Audit in developing respective risk based internal audit plans, but also intended to support local authority offices and Members by invoking debate and self-analysis over some of the main issues we expect to feature during 2023 and in doing so, design strategies to sustain effective governance and enable resilient services.

Since our 2022 Horizon Scanning report, the cost-of-living crisis has compounded the demand-led pressures on services, including social care. Inflation and interest rates have rocketed, leading to rising costs of major capital schemes and maintenance of public buildings, concerns on rent affordability, pressures on pay and rising day-to-day expenditure. The audit and assurance landscape in local government is also changing through the increasing number of reports in the public interests, the implementation of the Redmond review recommendations and challenges to external audit.

For many, it's not a matter of whether cost reductions will be required, but how much and how far? The almost inevitable impact is going to require challenging and difficult decisions over cost priorities and service provision as part of the 2023/24 budget setting process. To what extent are public services being asked to deliver the impossible? Hard choices are going to be required – that much has been true for as long as public services have been transitioning out of Covid. Will we see increased innovation and collaboration across the public and social sector to improve outcomes? Or, will we see increased service and organisational failures? Fiscal responsibility is going to be the watchword if we are to see sustainable public services.

Now, more than ever, the principles of good risk management, sound governance and robust internal control must remain central to organisational control to maintain confidence in the ability of authorities to effectively self-govern and reliably demonstrate value to stakeholders.

We hope you find our comments thought provoking and would be delighted to hear your thoughts.

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Note: Our report was written in December 2022.

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With high inflation, government spending cuts, and a looming threat of recession, as well as the significant impact of the Covid-19 pandemic, local authorities are going to find it harder than ever to balance the books.

Introduction

For those scanning the horizon for future threats to local authorities and local authority budgets, the current economic climate looms large. It also makes all the other challenges local authorities face that much more severe.

We are entering what is expected to be an even more difficult period than local authorities have become used to facing, combined with the looming threat of recession, central government austerity, high inflation and very high energy prices. All of which are already producing a cost-of-living crisis, which over time will, to a greater or lesser extent, affect just about everyone.

The consequence for local authorities is all too clear: increased budgetary pressures, at a time when the rising cost of living is likely to further increase demand for their most important services, which already have excessive demand.

Financial settlement

While no new spending review was announced in September 2022, the Government have confirmed the 2023/24 financial settlement, averaging a 3% increase on the current year. Although increased funding is welcomed, this is still below the current inflation and CPI figures and may leave local authorities with shortfalls to find.

One area in which expenditure is set to increase heavily is pay. Prior to the surge in inflation, most local authorities had budgeted for an increase in staff pay of around 2%. But in recent negotiations, the latest offer was for a rise of above £1,900 for everyone on the National Joint Council pay scale. For those on the lowest bands, this would represent a rise of over 10%. In the absence of further government funding, this is money that councils will have to find.

The rising cost of borrowing

Another factor making life more difficult for local authorities is the rise in interest rates. The Bank of England, in its efforts to control soaring inflation, has pushed the base rate up to 3.5%, its highest level for well over a decade. And there are expected to be further rate rises on the way.

Economic challenges – including the cost-of-living crisis

Mazars Chief Economist, George Lagarias (November 2022)

The UK economy is experiencing a fast slowdown in growth. Internal and external demand conditions are anaemic. Inflation is currently running at nearly 10% while employment conditions remain very tight. Despite the dismal growth conditions, the Bank of England remains steadfast in its rate hiking cycle, with as many as six 0.25% more rate hikes projected by investors over the next five months. A consensus of economists believes that 2023 will feature a recession for the country. Inflation could prove more protracted in the UK than in other countries, as tight employment conditions and skilled labour shortages may push wages higher. Brexit, meanwhile, remains largely unresolved and looms large over major policy decisions.

In this environment, and following a sharp reaction to Liz Truss's business and consumer-friendly budget, Rishi Sunak and new Chancellor Jeremy Hunt were forced to perform a U-turn to placate markets, promising 'difficult decisions'. While, at the time of writing, the measures have yet to be specified, it is reasonable to expect more 'austerity' in the form of higher taxes and spending cuts. The rise in inflation, possible further raises in taxes and higher mortgage rates (the effect of which is kicking in slowly), are all pressuring consumers. Local governments will likely be severely impacted. On the one hand, local authorities will be faced with significantly higher costs. On the other, the ability or willingness of their residents to pay higher bills will become increasingly, and noticeably diminished. Meanwhile, services might struggle to retain key staff, as the jobs market is very tight. While we believe that market pressures to maintain austerity will eventually ebb and policy will become eventually more accommodative, UK inflation and higher rates could persist well until the end of 2023. From an economic perspective, we expect the next year to be one of the most difficult in recent memory.

Introduction

This will make borrowing more expensive for everyone. For local authorities it will have a double effect: not only will it make it harder to finance often desperately needed capital investments, but it will also make short-term borrowing, often used to bridge short gaps in finances, much more expensive.

Difficult decisions at a difficult time

Across many of the areas covered in this report difficult decisions will need to be made: Should encouraging growth and investment from capital projects take precedence over improving vital infrastructure and maintaining services? What discretionary services can be cut back to ensure that statutory services continue to be delivered?

And these decisions are made all the more challenging because they are coming at a time of increased political uncertainty, at both a national and local level. We have seen the changing of political control at traditionally stable local authorities over recent years, and such changes may become more frequent across the country.

The picture painted here may appear bleak. But full awareness of the issues can help local authorities make difficult decisions early, which is critical both to execution and governance. We hope that this report helps local authorities to plot a path through these difficult times and to find a way to balance the books while continuing to deliver their vital work in their communities.

> In the absence of further government funding, this is money that councils will have to find.

Introduction

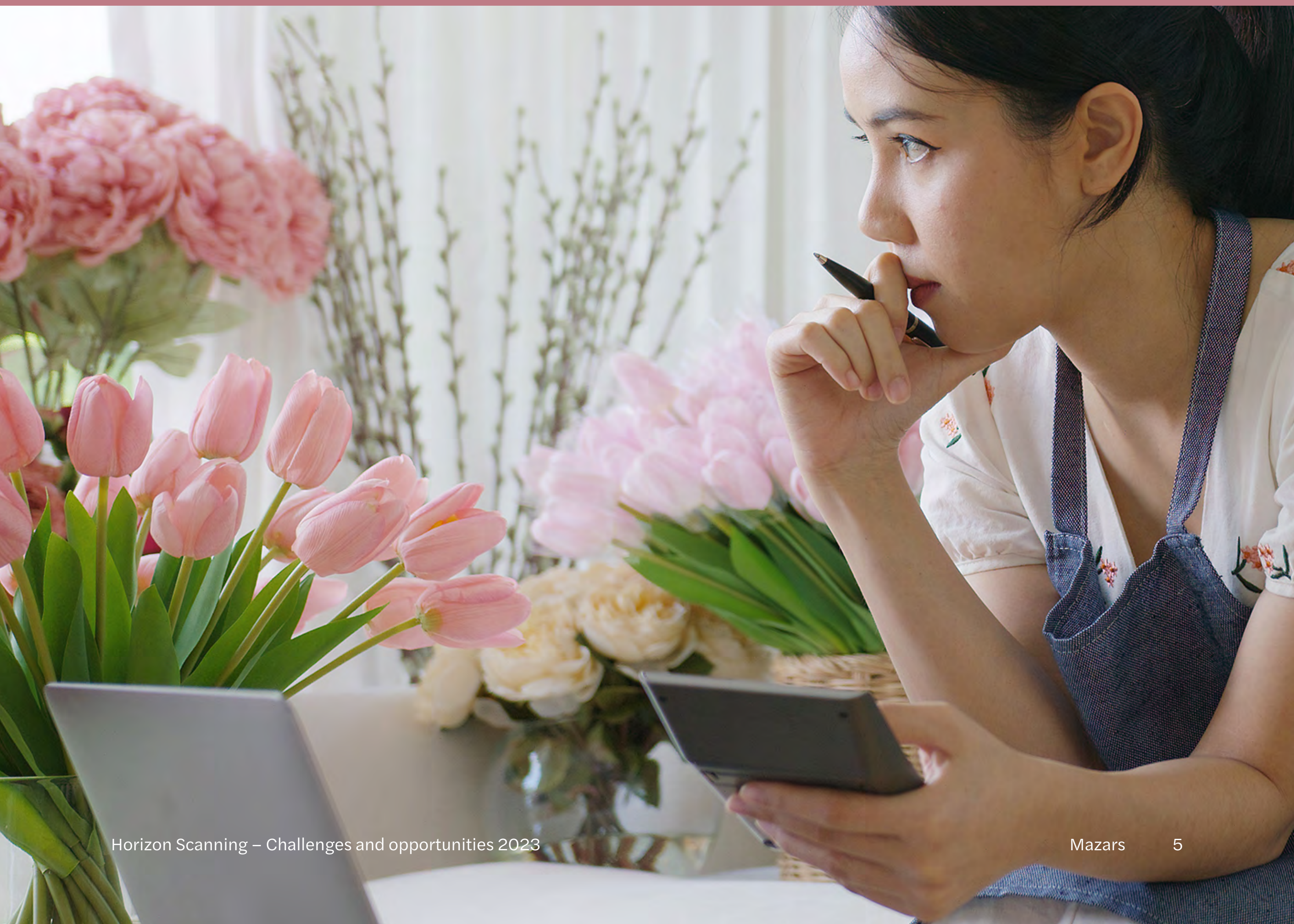
The main challenges facing local authorities in light of the cost-of-living crisis, include:

Cost of Living >>>	With most people experiencing financial pressure, spending habits are changing. High energy costs and increasing food prices have impacted on levels of disposable income. With wage (and potentially benefit) increases failing to keep pace with inflation, more people will be facing hardship.
Added budget pressures >>>	With inflation soaring, the cost of goods, services and resources are becoming more expensive. Local authorities are not immune to the increasing cost of energy supply, although the government announcements on energy caps are welcome, many local authorities are still facing higher costs. Local authorities typically budget for modest salary increases year on year, are now seeing their unexpected increases in salaries that need to be funded.
Cost of borrowing >>>	Interest rates have increased to 3.5% for the first time in over ten years meaning that the cost of borrowing for capital projects has increased significantly.
Contractors and suppliers >>>	The cost-of-living crisis has resulted in business failures. Although government support has been announced, some businesses will continue to struggle, with a greater risk of supplier failure. Supply failures anywhere in the supply chain will have a knock-on effect.
Service delivery >>>	Likely budget reductions and savings plans are going to impact the ability of local authority services to maintain levels of delivery (which have already been under increased pressure for some time), particularly at a time of increased demand. Decisions may need to be taken around the provision of discretionary services historically provided by local authorities.

Full awareness of the issues can help local authorities make difficult decisions early.

Economic challenges – including the cost-of-living crisis

After showing resilience and adaptability over the last two years responding to the Covid-19 pandemic, local authorities are already facing a period of high demand. They are now in the midst of another national crisis, the cost-of-living. Increasing costs through high inflation and soaring energy bills have meant that local authorities are facing unexpected challenges, to already stretched capacity.



Economic challenges – including the cost-of-living crisis

The cost-of-living crisis

The cost-of-living crisis has been very well documented and the subsequent areas in this chapter will delve into some of the causes and impacts of the cost-of-living crisis. Whilst the headline Energy Crisis and rising inflation and interest rates will affect all organisations, there are some risks that may materialise that are unique to local authorities. One thing that we do know is that the cost-of-living crisis will affect everyone in some way and this will have a severe impact on local authority services.

Key revenue streams, such as Council Tax and Business Rates, may be affected as the level of non-payment may rise given the pressures families and businesses are under. We know that a combination of the Covid-19 pandemic and the cost-of-living crisis has caused a large number of businesses to fail. Although, recent government announcements of an energy freeze for six months were welcome, experts have predicted that this will not be enough. Council Tax increases, whilst necessary, may be politically unpalatable for many local authorities given the wider economic issues facing households, potentially increasing the demands for Council Tax support.

On top of this, the demand for services is likely to increase, from an already high level that many local authorities are struggling to meet the demand of. Local authorities need to pay particular attention to levels of homelessness and discretionary schemes (such as discretionary housing payments, Council Tax reduction schemes, etc.). Additional funding that may be needed to support residents, but the subsequent cost of processing will also increase. If there is a significant increase in applications for support, current staffing levels may not be able to handle this increase. Alternative solutions will be needed, whether that is achieved through digitalisation or automation, local authorities will need to be innovative and agile in their approach. For example, the partnerships with the local voluntary sector, which were strengthened through the joint working during the Covid-19 pandemic, are likely to increase as the demand for support increases.

Budgetary pressures

The budgetary pressure on local authorities seems relentless. We have seen several high-profile failures and S114 notices being issued recently and the tough times are set to continue for a number of years.

Local authorities should be preparing for a period of austerity, even if this is in all but name. While funding levels for local authorities remain higher than previous years, the recent announcement of the 2023/24 financial settlement increased local authority funding by an average of 3%, this is still well below current levels of inflation experienced over the last six months. This leaves S151 officers across the country struggling to balance the books and reserves are dwindling, with the latest predictions being that many local authorities will have depleted their reserves by 2025/26 if additional funding is not provided.

Recent pay increases add more pressure; many authorities had budgeted for a modest 2% increase in salary costs but the recently agreed pay award of £1,925 to all points on the scale was a significant increase, in excess of 10% at the lower grades. While the pay award is good for employees, it is placing additional pressures on already stretched budgets and may result in savings needing to be achieved in other areas or potential vacancy freezes (where they do not already exist). This is all with a backdrop of increasing industrial action and unrest with above inflation pay requests becoming common place. Staff, and therefore services and communities, will be affected by disruption with rail and bus travel as well as the recent disturbances to the postal network, as well as the threat of local government industrial action.

Recent reports have indicated that London Boroughs are facing budget deficits of up to £700m by 2023/24 unless the current level of funding is increased. These budgetary pressures are going to be felt across the country with other reports estimating that funding gap will reach approximately £4.8bn by 2026/27. Local authorities need to act to ensure that this gap doesn't widen. Addressing this budget gap is going to require tough decisions to be taken

> Local authorities need to pay particular attention to levels of homelessness and discretionary schemes.

Economic challenges – including the cost-of-living crisis

> There should be a greater need for assurance as the likelihood of a breakdown in control is increased during periods of excessive workload or reduction in capacity.

around service delivery and savings plans, not only in relation to non-statutory services but also the way statutory services are delivered. It is estimated at approximately 60 local authorities earmarked or unallocated reserves, have been forecasted to be used within the next year.

The budget plans, size of reserves and achievement of planned savings for the next years will be key and, Directors of Finance will be looking for assurances in this regard. The achievability of savings plans and the timing of these savings will come under increased scrutiny. Back office functions are typically areas that local authorities look to drive savings from and this may also include internal audit service. Careful consideration will be required when balancing the need to reduced budgets of internal audit services with the assurance needs of the local authority. Arguably, where pressures are being experienced, there should be a greater need for assurance as the likelihood of a breakdown in control is increased during periods of excessive workload or reduction in capacity.

Economic challenges – including the cost-of-living crisis

Cost of borrowing

Inflation over the last six months has reached unprecedented highs of 10% with economists' and the Bank of England's expectations that this will increase to a peak of over 11% before falling. In response the Bank of England has raised interest rates to 3.5%, the highest in well over 10 years and are expected to continue to rise over the next year to try to control inflation.

This has led to significant increases in the cost of borrowing with many local authorities having to make decisions over their capital programmes. Councillors, S151 officers and Chief Executives will face difficult decisions around where to prioritise their capital spending over the next few years. The reality is that there will not be enough funding to achieve all their capital programme objectives. Politically, this will be a sensitive area but one that will require local authorities to be more risk aware and challenge the value of capital expenditure.

The volatility in the market has made long term planning more challenging for local authorities. As interest rates have climbed, it has, and will, continue to impact the agility of local authorities to react to short term borrowing needs. It is not as 'easy' to borrow money when the ongoing financial commitments to service debt have increased significantly.

Contractors and suppliers

Local authorities rely on contractors (both large and small organisations) to either deliver or support the delivery of a number of key services. The challenging economic outlook and the difficulties businesses had during the Covid-19 pandemic, leave many businesses struggling to survive. Government support for rising energy bills is limited to a relatively short period of time so will begin to start impacting businesses as we approach April 2023.

As the risk of supplier failure increases, local authorities should be preparing themselves for such circumstances and ensuring that regular and robust contract management activities are happening.

With increasing costs affecting the whole economy, contractors may look to terminate or renegotiate costs. This will have an impact on the level of service provided or have an impact on planned budgets. In addition, with inflation and the Consumer Price Index (CPI) being at a high level, the planned uplifts in contractual costs may be significantly higher than budgeted.

Local authority services

Given the economic outlook and the issues that local authorities are facing already discussed in this chapter, local authorities will be forced to review the services that they offer to the community that are non-statutory. Services are likely to come under ever increasing strain as the level of demand increases, particularly for those services that offer support (for example, discretionary housing payments, Council Tax support, school uniform support grants).

With the risk of austerity increased and a lack of review of funding levels, local authorities are going to face tough decisions around the viability of discretionary services. Local authorities will need to make substantial savings to ensure the quality of statutory services remain high and meets demand. Local authorities are familiar with the challenges of service delivery in tough economic times with many organisations restructuring or revising services and the delivery mechanisms during the last period of austerity. However, despite this relatively recent experience, this time is expected to be harder as local authorities are already finding it difficult to meet the current levels of demand or, retain the experience within services to deliver change programmes.

Many local authorities, over recent years, have used commercial ventures to supplement their income to support service delivery – with differing levels of success. There have been some high profile failures, such as local authority owned energy companies or investments in windfarms, with common themes around governance, decision making and skills being primary causes of these failures. Learning lessons from these examples is crucial to undertaking commercial ventures within the local government sector.

> Local authorities to be more risk aware and challenge the value of capital expenditure.

Economic challenges – including the cost-of-living crisis

Summary

Internal audit planning will need to take account of the challenges that are facing all local authorities in respect of the economic pressures. The financial pressures caused by entering a new phase austerity-like pressures could result in diminishing of controls in key areas or, a change in risk profile. Local authorities will need respond rapidly to the challenges that they are facing to already stretched services, and internal audit should be set up to support the organisation through these changes.

Internal audit should be positioned and in place to provide assurance to leaders that governance, risk and controls are performing adequately in difficult times and, giving the best chance to manage the impact of these challenges.

Internal audit will not be immune from the wider challenges faced by local authorities, as internal audit professionals, we must find new and innovative ways to provide assurance to organisations. The development of assurance maps and embedding of data analytics within the audit methodology will allow internal audit services to deliver more assurance with less resources to a wider range of services. Risk based plans should be challenged to ensure that audit plans are focussing on the real risks facing local authorities rather than the cyclical work often favoured in plans.

Key risks for focus internal audit activity on over the next year:

- Capacity within services do not be enough to meet demand, which causes those in need failing to receive the services they need.
- Discretionary schemes are not sufficient to support those that require assistance which causes increased demand for other local authority services.
- Funding has not kept pace with inflation which causes local authorities being unable to set a balanced budget affecting delivery of key services.
- Council reserves are being depleted which causes a lack of financial resilience and impact on the local authorities ability to set a balance budget.
- Savings plans are unrealistic causing loss of key staff or reduction in service to unacceptable levels.
- Capital programmes are unachievable as the appropriate level of financing is unavailable causing difficult decisions around which areas to prioritise.
- Supplier failure or increasing contractual costs have a detrimental effect on local authority finances or service delivery.

Considerations for the Internal Audit plan

The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes), should be considered for inclusion in the Annual Internal Audit Plan:

- Medium term financial planning and strategy;
- Saving plans;
- Budget monitoring;
- Supplier or contractor (financial) resilience;
- Business continuity;
- Income collection;
- Capital programme and projects;
- Investment strategy;
- Business case management and approval;
- Governance and decision making;
- Capacity and demand management; and
- Contract management.

The workforce crisis

The Head of Workforce at the Local Government Association (LGA) declared that local government has a 'recruitment crisis'. The IIA 2023 Risk in Focus report included 'Talent Management' as the second biggest risk organisations are facing. The national press has numerous articles discussing the early 2021 'Great Resignation' that shows no sign of stopping. There has been increasing industrial action across multiple sectors linked to the cost of living, fair reward and working conditions.

The main challenges facing local authorities in light of the cost-of-living crisis, include:

- **Recruitment:** Local authorities are in a difficult position to recruit (and retain) talent. Typically, local authorities salaries are at the lower end of public sector pay, and constrained with years of financial funding pressure. Also, skill requirements are changing as technology becomes more advanced in local authorities.
- **Retention:** With increasing inflation, pressures on living expenses and demand for expertise, local authorities face a battle to retain staff. Local authorities usually attract staff that have a desire to help local communities and do the job well but with the increasing financial and capacity pressures facing service, this is becoming harder and harder to achieve.
- **The Great Resignation:** According to Office of National Statistics, resignations accounted for 50% of reasons people left their jobs for the June to September 2022 quarter. A general increase has been seen from the beginning of 2021 to date. While these statistics are across all industries, there is a very clear trend that local authorities must be cognisant of and respond to accordingly.
- **Interims:** Given the difficulties attracting talent to key positions, local authorities are using interim contracts for key roles. The use of interims is necessary to allow the local authority to operate effectively, however the impact on long term strategic goals and cost must be considered.
- **Workforce demographics:** The most recent data from the LGA identifies that over 70% of local authority officers are over the age of 40 and less than 5% are under 25. Given the age demographics, coupled with the Great Resignation, local authorities are on course to potentially lose a wealth of knowledge over the coming years, with a small pool of officers to developing knowledge.

Recruitment

While there are many positions being actively recruited for at a large number of local authorities, many are also retaining vacancies as part of budget saving activities. With both of these factors considered, local authorities are, in some areas, severely under resourced. The exit from the EU and immigration may also be a factor as the labour pool has shrunk. Although this impacts all industries, competition is now much fiercer for all roles which is likely to have negatively affected local authority recruitment.

The LGA reported that 74% of local authorities in England were reporting difficulties in recruiting the right calibre of staff and retaining staff. The nature of public services is changing as digitalisation becomes normal, contracted services increase and complex financial systems exist meaning that the skills local authorities are looking to recruit for are highly sought after and competition is high. In many instances, local authorities are competing with each other and the private sector for the best talent in the market.

While expectations around skills remain high, local authority pay tends to be at the lower end of the public sector, as well as generally being behind the private sector in terms of wages, adding to the challenges of competing for the best workers.

Salary is likely to be important to many people searching for new jobs, so local authorities may already be at a disadvantage. But, typically local authorities continue to use the same recruitment techniques they have done for years. One of the main challenges will be attracting people to want to work in local authorities. This means that traditional recruitment activities may not be sufficient to attract the right candidates to apply. Local authorities must respond to the new generation of job hunters and find ways to appeal to the right talent – there is a talent war and local authorities are at risk of being left behind.

In addition, recruitment costs money. Budgets are going to tighten, if they haven't already, and this may cause recruitment activities to default to the least expensive. But, that could be detrimental to reaching the best candidates.

Local authorities are competing with each other and the private sector for the best talent in the market.

Case study:

Adult social care workforce

In October 2022, it has been estimated that there are 165,000 positions that employers were actively seeking to recruit somebody to in the Social Care sector. Forecasts by Skills for Care, estimate that by 2035 an additional 480,000 posts will be required if there is proportional growth of posts in line with demographic changes in the community (people over 65).

Retention

Local authorities are competing for the same talent pool, so retention is key to maintain continuity of service, particularly in hard to recruit areas. The challenge is how they can retain high performing or high potential staff.

We have seen that many authorities offer monetary incentives to retain staff, such as 'market forces' or supplementary payments effective for a set period of time. But with the increased budgetary pressures local authorities are facing, the ability to offer additional money may become more and more limited or restricted as savings are sought.

As remote working boomed during the Covid-19 pandemic and continued as workplaces return to 'normal', this has provided alternative opportunities to retain staff by offering home working or hybrid working as an option. This allows greater flexibility and work life balance and widens the geographical area that staff can be located.

Retention in local authorities is often made difficult by the rigidity of the staffing structures. Often talented employees are looking for the next step in their career and this can be stifled by being unable to offer additional opportunities or promotions. This means that local authorities must look at alternative ways to offer staff progression.

Performance management is key to retaining a high performing workforce, as well as potentially unblocking progression pathways if staff are underperforming. The absence of effective performance management can be a factor in employees morale and this could affect the likelihood of employees staying at the local authority.

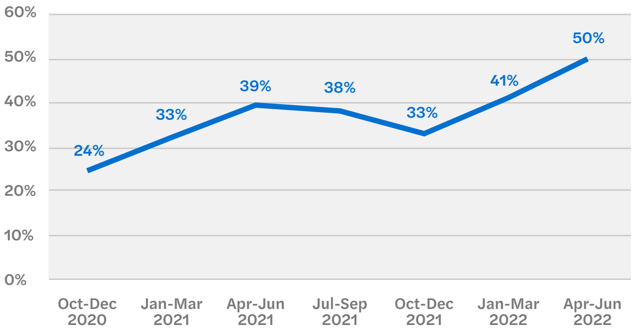
With many organisations recognising the difficulty of recruiting and retaining experienced staff, the 'grow your own' strategy has been adopted, of building affinity and connection to the authority from the outset. Often there is a lack of formal succession planning in place at local authorities, meaning where senior officers depart there is a loss of corporate knowledge, including around the control environment, which could be effectively mitigated through active succession planning.

The Great Resignation

While not only affecting local authorities, the UK (as well as globally) has seen an increase in resignations, dubbed 'the Great Resignation'.

The following graph shows the trend in resignations as a proportion of all job moves since October 2020 to June 2022 (data from the Office of National Statistics):

Resignations as %age of total job moves



In the latest quarter, half of all job moves resulted from resignation. which has been on the rise for the last 18 months. Although the reasons behind these figures are a little unknown. this uptick in resignations could be attributed to the Covid-19 pandemic causing workers to consider their jobs and career choices.

As discussed earlier in this article, retaining staff is already a challenge for local authorities and the economic pressures facing local authorities and their staff are only going to increase. So, local authorities and their managers should be preparing for a potential continuation of the Great Resignation.

Temporary appointments

Local authorities often used temporary solutions to fill vacancies, particularly at senior levels, through the appointment of 'interim' or agency staff. We have noticed a steady increase in the use of interims across our local authority clients.

While interim appointments serve many purposes, for example bringing a specific skillset to a project or covering short term skills shortages, there are occasions where interims are in post for longer periods of time (e.g. over 12 months). All temporary staff, agency and interim, have a greater financial cost to the authority as well as the additional costs that may be incurred through the recruitment of interim staff.

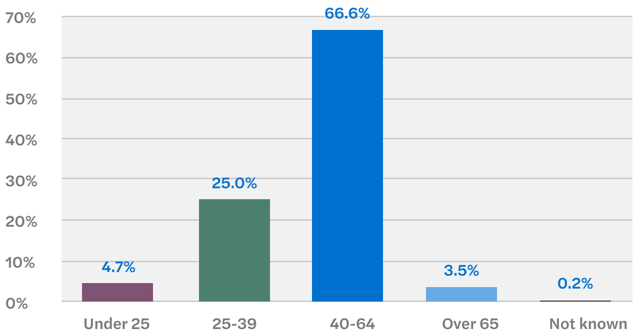
Local authorities will have to balance the risk of increased costs (with decreasing budgets) and the need to have a position filled. Often interim positions are at senior positions within the local authorities that we work with and therefore would create difficulties in service delivery or decision making if these positions remained vacant.

Big, strategic decisions about future service delivery are coming for local authorities as we enter a new period of austerity. These decisions are likely to consider the short, medium and longer term. Therefore, in some circumstances, interim staff may be involved in these decisions making or shaping the services for the future and local authorities must ensure that these decisions are aligned to overarching objectives.

Workforce demographics

The following data form the LGA (latest data from 2019/20) paints a very clear picture in relation to the age demographics at local authorities across the country:

Age profile of local government employees



There is less than 5% of the workforce under 25 and over 70% of the workforce is over 40 years old. This may indicate that local authorities may encounter issues regarding succession planning unless the age profile shifts.

With the difficult decisions facing local authorities, particularly around staffing and structures, there is potentially a high number of experienced officers that may seek early retirement or redundancy. Local authorities will need to manage the risk of experience, corporate knowledge and expertise leaving the organisation.

The workforce crisis

Summary

Many controls in local authorities are implemented by staff action and risks are often managed though human intervention. With difficulties attracting staff into key positions or retaining high performing staff, controls and risks may come under strain to continue to be operated and managed in the same way.

Internal audit will face challenges of engaging with teams should workforce levels be significantly affected. Both service areas and internal audit may need to reflect on operations to ensure the delivery of key services.

There is also the glaring issue of the challenges faced by internal audit teams and attracting, recruiting and retaining staff. There is a shortage of internal auditors and there is so much competition for talent in the local authority market that many internal audit services are now short of their required staff level to deliver their plans. Once again, internal audit services will need to focus on and invest in innovative approaches to providing assurance.

Below are some of the key workforce related risks that should be considered when discussing internal audit plans with senior officers:

- Local authorities may be unable to attract the right calibre of candidates which may cause difficulties in achieving their strategic objectives.
- Vacancies may remain unfilled for a long period of time causing service delivery to reduced.
- Local authorities may be unable to attract the right skills needed which may cause transformation programmes or innovation of services to fail to keep pace with the changing environment.
- Key staff may not be retained which may cause knowledge or experience gaps in vital service areas or decision making.
- Poor performing staff may be retained to ensure a minimum staffing level is achieved and services can continue to be delivered.
- Staff morale may be reduced as experienced or knowledgeable staff leave the organisation which may cause reduction in service levels.
- Local authorities do not understand the reasons for staff departures causing an inability to learn lessons or change working environments based on feedback.
- Increased financial pressure through short term appointments causing added difficulties in setting balanced budgets.
- Interim appointments may not have the long-term interests of the local authority at the heart of decision making which may cause poor decisions to be made.

Considerations for the Internal Audit plan

The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes) should be considered for inclusion in the Annual Internal Audit Plan:

- Workforce planning;
- Recruitment strategies;
- Retention strategies;
- Succession planning;
- Performance management;
- Leavers – lessons learned;
- Temporary / agency staff; and
- Business case management for interim appointments.

Political uncertainty

2022 has seen the UK's political landscape move fast. Political uncertainty affects economic policy, which in turn impacts growth and leads to intense pressure on public finances. We have seen many changes in central government over the last six months and local authorities are also facing a changing political landscape.

Political uncertainty

Legislation and bills

Many of the Bills set out in the Queen's Speech in May 2022 have been delayed due to the personnel changes in central government departments, which adds to the uncertainty of future policies affecting local authorities.

The fair funding review that was first promised in 2016 has been put off again with confirmation that there will be no review in the current spending review period. This means that the calculations used to allocate local government funding are based on local authority spending needs from 2013-14, despite the population sizes across England changing – in some cases significantly – since then.

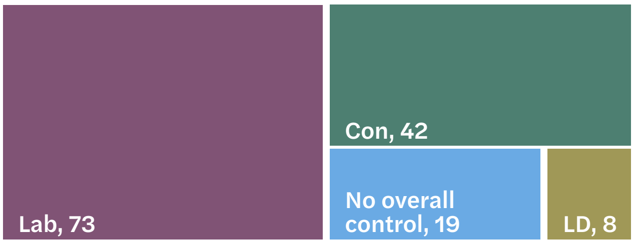
Both the Institute for Fiscal Studies and the LGA have recently commented on how *"public service funding cuts are putting the Government's Levelling Up agenda in danger"*.

They go on to say that *"levelling up will only be turned into a reality if councils have the powers and funding they need to address regional inequality, tackle concentrations of deprivation and make towns and communities across England attractive places to live, work and visit"*.

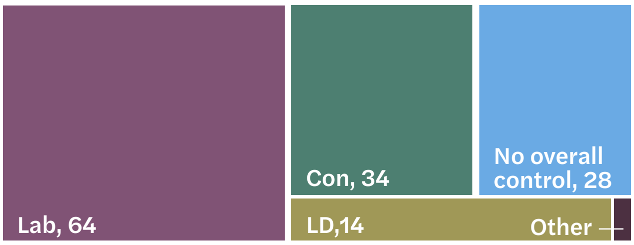
Overall control

In the most recent local elections in May 2022, a number of historically stable Council's saw a change in overall control. The results of local elections from 2018 to 2022 show a changing political picture at a local level, the following graph shows how the controlling party at local authorities has changed in four years:

2018



2022



Changes bring uncertainty and our experience has shown us that when local authorities change control, there are changes in objectives, priorities and plans as well as sometimes in the risk appetite of the organisation. While these changes have happened over four years, it is important to consider the impact of local elections where Members are elected in thirds, meaning there are elections three years out of four and the uncertainty that this can cause.

Trust and confidence

With political uncertainty comes a lack of public trust and confidence in decision making at a local level – particularly where relationships between officers and Members appear tense. Local authorities need to ensure that decision making is more transparent, involves a wide range of stakeholders, and holds to account those responsible for implementation.

Summary

Internal audit planning will need to take account of the above uncertainty / changes, while also considering that cutting costs can also lead to removal of controls and the organisation needs to be more inventive, which needs to be taken into account when conducting audits.

Considerations for the Internal Audit plan

The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes) should be considered for inclusion in the Annual Internal Audit Plan:

- Financial Planning / Medium Term Financial Strategy;
- Budget Monitoring;
- Governance and accountability audits;
- Procurement;
- Effectiveness of the Scrutiny functions; and
- Effectiveness of the Audit Committee.

Social housing

The outlook for social housing providers going into 2023 is one of continued challenges and headwinds on an ever-broadening front. Risks that the Regulator of Social Housing (RSH) has been alerting the sector to in prior years are now beginning to crystallise. Elected Members and Committees have a wide range of risks which they need assurance over. Fundamental risks facing providers centre on stock decency and the safety of residents, service delivery and accountability to residents and, the real reputational risks for organisations which flow from what can be basic operational failures.

Internal Audit teams have a key role in supporting their organisations in proactively going to look for problems now and helping to surface them so they can be addressed.

The recent coroner's inquest on the tragic death of Awaab Ishak, serves as a sobering reminder of what those failures can result in. The coroner concluded in November 2022 and found that Awaab's death was caused by environmental mould exposure in his home. The coroner's inquest judgement, the RSH's Regulatory Notice to the social landlord involved and, The Housing Ombudsman's publications on damp and mould should all be 'must reads' for local authority internal audit teams. These should be used as a tool for organisational learning, should help determine priorities for internal audit and act as a catalyst to truly use internal audit as a key business improvement tool to surface issues and help put them right.

Focussing on fundamental purpose

It is no surprise that the Chair of the RSH used a recent speech to the social housing sector to urge landlords to focus on their fundamental purposes: The provision of safe, well-maintained homes for residents and providing more social homes for those in need of them. In short, a focus on getting the basics right. Social landlords need to heed the lessons from Awaab Ishak's death and redouble their efforts to:

- Listen to their tenants' concerns and take appropriate action;
- Understand and take account of tenants' diverse needs;
- Have an up to date and detailed understanding of the condition of tenants' homes; and
- Remove unnecessary barriers that tenants may have in accessing services and being heard.

Internal Audit has an important role to play in providing your organisation's elected Members and leadership with assurance that these risks are being effectively managed. It is important to ensure that the focus and scope of internal audit work around areas such as complaints, resident engagement, the delivery of the responsive repairs service, stock investment, stock data, stock quality, disrepair and damp and mould continues to evolve, to ensure your organisation is learning the lessons from across the sector.

Outlook for tenants

The current economic environment is placing unprecedented strains on all households' finances and, these challenges will be amplified for many living in social housing on modest or fixed incomes. Helping ensure that residents can sustain their tenancy through the current cost of living and energy price crisis is an crucial responsibility. It is important that support measures for residents are targeted, and effective. Internal audit teams have a role to play in providing assurance to the Audit Committee that those interventions are helping your organisations fulfil its fundamental purpose.

Standards of existing stock

The RSH's Home Standard sets clear outcomes for what is expected of all social housing providers, including local authorities with retained housing stock or where their stock is managed by an Arms-Length Management Organisation (ALMO). The so called 'big six' areas of tenant safety: gas and fuel (including oil and solid fuel) servicing, electrical safety, fire risk assessment, asbestos management, legionella and water safety and lifts and lifting equipment safety, are all major areas of tenant safety. Areas where Members need assurance that the homes their residents live in are safe places.

For social landlords this means going beyond bare minimum legal compliance which might be expected in the private sector. The RSH has made clear its expectation on the aspirations it expects of the sector. Internal Audit teams have a role in providing robust, in-depth assurance over the timely delivery of all of these safety programmes. Key areas of focus for each should include:

- The completeness of the programme – are all properties who should feature in that workstream included within it? How do you know? How good is the data underlying the programme from which it is driven?

- The basic delivery of the programme – are all assessments or checks up to date? Is the programme on track? Does the Audit and Housing Committees have clear visibility of the state of progress of each programme?
- Are actions arising from servicing, assessments and checks completed in a timely manner? If they are overdue is there a plan to address this, and does the Audit and Housing Committees know?
- Where a contractor undertakes the work on your behalf, does the dataset they use reconcile with your data? Are you content that all key datasets concerning tenant safety triangulate and there are no gaps?

Our experience from the sector and the learning widely shared by the RSH suggest that poor data quality is often at the root of tenant safety failures, self-referrals to the RSH and breaches of the Home Standard. Internal Audit teams have a unique opportunity to help drive up the quality of their organisations' data in these and other key risk areas.

Tenant safety needs continue to evolve, with recent new regulatory requirements for social housing providers being released. These include the Smoke and Carbon Monoxide Alarm (Amendment) Regulations 2022, where providers will need assurance that they are now meeting these requirements.

There are also a range of other requirements around building safety which many providers will have already been readying themselves for, so that they are as prepared as possible once the legislation is enacted. Internal Audit can help assess how ready they are, including for the requirements of the Building Safety Act 2022 and the Fire Safety Act 2021. And, areas where change can be expected following consultations recent for example Electrical Safety and the Decent Homes Standard.

Consumer regulation and readiness for change

In addition to all of the above requirements, major change is coming. The RSH's Consumer Standards will be regulated across social housing providers, including local authorities. It is vital that local authority registered providers are taking action now to be ready for these changes, and Internal Audit teams can play a key role in helping their organisations be ready for them. The changes flow from the Social Housing White Paper and reflect the desire of government to see more proactive regulation and protection of tenants after the Grenfell Tower fire.

The RSH has already published its Tenant Satisfaction Measures which, all Registered Providers will be expected to be collecting data on from April 2023. These include measures on tenant safety compliance across the main six areas of landlord health and safety. As well as new qualitative measures of satisfaction such as tenant's experience of the safety and quality of their home, and the quality of the repairs service. As with any performance measure, it is important there is robust data underlying these figures - whilst it will be provided to the RSH – your organisation will be accountable for the quality and integrity of that data.

The Social Housing (Regulation) Bill is expected to receive Royal Ascent in the spring of 2023 and will expand the remit and powers of the RSH, and following this, the RSH intends to carry out public consultation on the draft new consumer standards in 2023. The RSH has been telling the sector, now for some time, to 'act now' to be ready for this new regime of proactive regulation. It is important that each and every Registered Provider is doing so. Internal Audit teams have a key role in supporting their organisations in proactively going to look for problems now and helping to surface them so they can be addressed.

Some key questions for local authority internal audit teams to consider include:

- How is your organisation getting ready for proactive consumer regulation?
- How will your Audit Committee get assurance over your organisation's compliance with the consumer standards?
- Does your organisation operate within an environment where issues can be brought to light and then put right?
- How do you know problems observed in other providers don't exist within your organisation?
- How would you know? What would that dashboard look like?
- Is your organisation getting assurance (in contrast to reassurance) over all the points noted above?

Social housing

Considerations for the Internal Audit plan

The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes) should be considered for inclusion in the Annual Internal Audit Plan:

- Gas safety;
- Fire risk assessment;
- Lift safety;
- Legionella;
- Electrical safety;
- Asbestos management;
- Carbon monoxide and smoke detectors;
- Data integrity of the health and safety areas;
- Data governance;
- Housing disrepair;
- Complaints;
- Damp and Mould; and
- Tenant engagement.

Technology, digital and cyber

Local authorities are embracing digitalisation to generate efficiencies, and this generates different risks than local authorities may be used to managing. As part of digitalisation, more and more local authorities are investing in technology and software that is cloud based. Cyber security is always high on many local authorities risk registers and continues to be an area of focus particularly given the well-publicised attacks on local authorities. Technology risks are always evolving and investment is required to provide protection and this is likely to be become more challenging with the financial pressures local authorities are now facing.

Digital transformation execution

Digital transformation reflects the strategic - people, process and technology - implementation activity that aims to change the core activities of an organisation to meet evolving business and stakeholder needs, usually with an "online" technology focus.

Local authorities are continuing their focus on digital transformation activity, with trends in technology and innovation identified as having the biggest impact on organisations in the coming years. The Mazars C-suite barometer indicates that "82% of leaders plan to increase their spend in maintaining and evolving IT systems", despite impending cost pressures, with investment in IT seen as integral to delivering on the organisational strategy.

However, with greater focus on return on investment (RoI) as a result of government spending plans, there is even more emphasis on applying the appropriate governance to transformation activity. Research from the UK Public Accounts Committee shows that despite annual spending of £20 billion per year on IT projects, many are failing.

We see the following as key considerations to enable a successful digital transformation that delivers defined benefits:

a) **Strategy alignment:** The vision, strategy and goals of the organisation need to be established and communicated, incorporating how technology adoption will compliment this. A three-to-five-year direction is typically required to enable effective long-term technology planning.

b) **Executive level technology capability:** Executive leadership needs sufficient technology capability at their disposal to execute a successful digital strategy. Heads of IT and technology require a "seat at the table" in key decision-making forums

> 82% of leaders plan to increase their spend in maintaining and evolving IT systems", despite impending cost pressures.

c) **Organisation architecture:** The organisational structure needs to compliment the defined strategy, with functions aligned to deliver the digital target operating model. This includes digitally enabled business functions of the future (e.g. online customer services), as well as IT functions.

d) **Key processes:** Defining the as-is and to-be business process is fundamental in ensuring that technology is deployed successfully to enable the core activities of the organisation, both now and in the future.

e) **Programme management:** It is of critical importance that transformation activity is effectively managed end-to-end, ensuring that technology is deployed in line with objectives and requirements, with an established delivery framework, and successfully adopted by end users.

f) **Technology strategy and architecture:** A clear technology strategy should be defined, including a target architecture, underpinned by standards and governance. The strategy should incorporate the technology that will be deployed, how core operations will be established, procurement strategy, capability, skills and training requirements, data considerations and adoption and scaling opportunities.

g) **Technology roadmap:** A technology roadmap, identifying the key components, timelines and interdependencies is required to identify the planned cadence of delivery and any barriers to execution.

h) **Define business value:** Define key measures for success, and track performance. This should include a balanced scorecard of measures, including financial (such as Total Cost of Ownership, Cost to Serve, Cost to Implement) and non-financial (System Adoption, System Availability, Security Posture). Organisation value should be tracked and monitored throughout the lifetime of the transformation.

The UK Public Accounts Committee commented that "government faces significant long-term barriers to successful digital change that will take much time, effort, and money to overcome." Alignment of technology implementation to the organisation strategy, with senior management sponsorship, is key to ensuring transformation delivers in line with requirements, given the added scrutiny expected requiremenover technology spend.

Public cloud adoption

There has been exponential growth in the consumption of public cloud technology in the last decade, with research by Gartner highlighting the global spend on public cloud services is to be upwards of $590bn by the end of 2023, controlled by the big three cloud vendors; Microsoft, Amazon Web Services and Google Cloud.

Local authorities are continuing to adopt the public cloud infrastructure, platforms and applications, as perceived concerns over risk around data privacy, security and resilience has been addressed by cloud providers. Adoption of public cloud technology offers organisations several benefits, including:

Elastic scalability >>>	Organisations can scale up and scale down technology capabilities, as required, based on demand.
Enhanced security >>>	Opportunity to leverage security tools and technologies that can, if appropriately configured, significantly enhance the security posture.
Added resilience >>>	Cloud services can enable highly available service delivery.
Rapid deployment >>>	Technology can be deployed with greater velocity, significantly reducing the "time-to-value" in implementing.
Outsourcing of capability >>>	Activities such as server, database, configuration and network management may be transferred to trusted vendors.
Remote connectivity >>>	Technology can be consumed anytime, anywhere.
Deployment of emerging technology >>>	Emerging technologies such as AI, Data Lake and Low Code App Development platforms are built "Cloud Native" – that is they are born in the cloud.

While the above are considered advantages of public cloud technology, there is a risk that organisations in the sector do not adequately assess the associated risks particularly with regard to their choice of platform and configuration. For example, while public cloud provides opportunities for greater resilience, it does depend on the organisation selecting the right architecture; insufficient provision of available capability can result in the organisation encountering more outages than under their previous "on premise" structure. The same is true in areas such as security and controls, where inappropriate configuration and tooling can result i n the introduction of risk, rather than reduction.

Technology, digital and cyber

Cyber security: Is your safety net strong enough?

Cyber threats are all around us. Every day brings new hacks, new data leaks, new embarrassment – and new costs, both financial and commercial. Nobody is spared. The attacks target organisations large and small, as well as individuals. How can organisations protect themselves?

Cyber security is now a major preoccupation among business leaders. Effective cyber defence has become a delicate balancing act for many local authorities, and the important thing is to build a strong safety net that can cushion any eventual fall.

Our research reveals...

Organisation leaders everywhere are bracing for cyberattacks but remain confident they can withstand them.

More than half of leaders surveyed in our annual C-suite barometer see an increase in cyber threats over the past year, and 35% expect a significant data breach in their own company in the coming year. Nonetheless, most companies seem confident of their ability to cope with attacks: globally, 68% of business leaders see their company's data as being "completely protected".

Financial losses are the biggest perceived risk.

More than half of the business leaders we surveyed put financial losses at the top of the list of the biggest data protection risks.

Effective cyber defence rests on five pillars: identification, prevention, detection, response and recovery.

Each has an important technological component, but equally each has a critical human component. Business continuity plans need to have been painstakingly elaborated and extensively tested so they can be adopted seamlessly by the entire organisation.

Shifting mindsets to prepare for the worst is the best defence.

Cyber security is a fast-evolving field, with attackers now heavily armed (including with AI) and often two steps ahead of the organisations in their sights. Accepting that data breaches will happen and having robust plans for handling them provides the best assurance that the response will be swift, recovery effective and the costs limited.

Technology, digital and cyber

Cyber threats are here to stay – and they will get worse. The best protected organisations will be those that strengthen their cyber safety net.

Ransomware is one of the biggest cyber threats to the UK. Ransomware attacks can come with huge financial and reputational costs beyond the ransom itself, with many stopping critical business operations for days or even weeks at a time. These threats have intensified under current international affairs, with the National Cyber Security Centre (NCSC) raising the national threat level for cyber-attacks.

Ransomware threats take many forms. The most common ransomware variants often "double-dip", charging a ransom to decrypt data and then publishing that data on the dark web for other cybercriminals to use. Paying the ransom is never a guarantee the encrypted data will be restored, as many of these criminals operate in bad faith.

Local authorities are a key target and has suffered from multiple high-profile attacks. NCSC research has shown that four in ten businesses (39%) and a quarter of charities (26%) reported having cyber security breaches or attacks in 2021, with many more potential breaches going undetected. Research from IT security Barracuda highlighted that 12% of all publicised ransomware attacks in the last 12 months were against local authorities.

> Every day brings new hacks, new data leaks, new embarrassment – and new costs, both financial and commercial. Nobody is spared.

The outcomes of successful ransomware attacks on local authorities are wide-ranging. The largest causes for concern are the encryption and theft of citizens' sensitive financial data, compromised supply chains, and the disruption of emergency services. According to the 2022 National Cyber Security Strategy, 23% of organisations still do not see cyber security as a high priority, believing they are "too small" to be targeted or that they don't hold any valuable information. All information is valuable to cybercriminals who may seek to disrupt the UK's critical services and operations. As such, it is crucial for local authorities to follow cyber-security best practices and improve prevention, detection, and response to ransomware attacks.

UK GDPR Certification

In addition to adherence to the principles of the UK GDPR, organisations are now encouraged to demonstrate that their processing of personal data is compliant, via criteria approved by the Information Commissioners Office (ICO), by achieving independent and objective compliance certification.

Organisations can choose which data processing activities are certified, and certification will relate to specific personal data processing operations that take place in a product, process or service offered by a controller or processor. Those processing operations will be assessed against the certification criteria by an ICO accredited certification body.

Certification provides a framework for organisations to follow, thereby helping ensure compliance and offering assurance that specific standards are being met; for example in a processor to controller relationship.

The UK GDPR is complex. Non-conformity carries important legal and financial risks, which are hidden costs until an organisation is fined (up to 4% of its income). Getting certified means that independent and objective specialists have taken a close look at an organisation's processes, so they can be sure that they are compliant.

The certificates also demonstrate commitment to protect personal data and to be a trustworthy provider for citizens, as well as a reliable data processor for key partners. It also reduces legal and financial risks by demonstrating compliance with legislation and ensuring controls are in place, which and can save substantial costs.

Certification will become a key step for organisations with significant data processing to demonstrate their compliance with external stakeholders, and we expect organisations within local government to explore and adopt the benefits of obtaining accreditation.

Summary

Internal audit planning should consider relevant IT and technology risks. Many local authorities are reliant on their IT teams to help shape and direct internal audit's focus so an initial audit needs assessment can be helpful to support internal audit functions to really understand where assurance is needed with respect to their IT functions. The use of audit needs assessment is an effective way to engage with IT teams to identify where the risks and weaknesses exist. This may be a useful exercise to undertake, particularly as many local authorities buy-in specialist advice or support to help deliver the IT work included in internal audit plans.

With developing technologies and increasing innovation in local authorities, investment needs to keep pace with the expectations and requirements. This may be challenging within the economic boundaries that local authorities are facing so consideration of these impacts will be required when conducting internal audit planning.

Considerations for the Internal Audit plan

The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes) should be considered for inclusion in the Annual Internal Audit Plan:

- Delivery of Digital Transformation Execution (including strategy and programme strategy);
- Cloud technology configuration;
- Cyber security – identification, prevention and detection;
- Cyber security – response and recovery;
- Cyber security – ransomware;
- Cyber security – awareness and training;
- Cyber security – scenario based testing;
- Data privacy; and
- Data processing.

Many local authorities have declared a climate emergency in recent years, but it remains to be seen if the investment to respond to the climate emergency can keep pace with the speed need to respond effectively. Deregulation is leading to the relaxation of planning rules and regulations and this may have a significant impact on the sustainability of developments, including the newly announced 'investment zones' where land is made available for development.

Environmental, social and governance

In recent years, there has been a refreshed focus on the accountability of local authorities to the public and the environment. The Air Quality regulation helped to show the connection between local authority activity, people and the planet and this is true across all local authority activities. The momentum of sustainability has only increased, driving the demand for greater transparency and accountability from stakeholders, which has contributed to the popularity of ESG (environmental, social and governance).

Regardless of the size of the organisation, adopting ESG practices can help improve performance and increase market visibility. In this chapter, we'll discuss some of the best practices for implementing ESG into your organisation.

What is best practice for integrating ESG into an organisation?

There are no one-size-fits-all answers to this question, as the best practices for an organisation trying to integrate effective ESG principles will vary depending on the specific organisation and its unique circumstances.

Firstly, it may be helpful to start with undertaking a review of the organisation's strategy and approach to implementing ESG practices, as it is important to clearly understand the "why" behind incorporating these practices into your organisation. ESG is about identifying your greatest opportunities, risks and impacts and focusing on them through a social and environmental lens.

There should also be a focus on continuous improvement. The integration of ESG should not be considered a one-time event, it should be a continuous effort to improve the organisation, and regular reviews of your strategy and implementation should take place. Furthermore, it is also important to have a clear understanding of the "who" and "what" is responsible for implementing any ESG initiatives into your organisation.

According to the Harvard Law School Forum on Corporate Governance, the current demand for ESG leadership talent is 'unsurpassed and unrelenting'. This is due to how ESG has changed in recent years from being a merely functional requirement to a 'commercial imperative', with investors, employees and customers demanding that organisations show strong ESG principles.

Top-down leadership can be a powerful method of integrating ESG principles into an organisation. Leaders can set the tone and expectations for how ESG should be integrated into an organisation – for example by setting goals and targets for reducing environmental impact, increasing social responsibility, and improving the corporate governance framework in place.

Leaders can also contribute to an organisation's ESG strategy and ensure that ESG forms a core value of the organisation. This in turn will send a clear message that ESG is a priority for the organisation, not only to the public, but also for employees. ESG requires companies to operate in a more transparent and socially responsible manner, and in implementing ESG initiatives, it is important to empower employees to be engaged and participate. Leaders can help with this by using their influence to provide resources, support and training to employees and departments. Ultimately, employees will be the ones carrying out ESG initiatives and therefore it is key to get their engagement and buy-in.

Finally, and linking into how goals and targets should be set, ESG successes should be communicated and celebrated both internally and externally. A wide variety of stakeholders including investors and the public are watching, and as an organisation you have the chance to set a positive example. Celebrating successes also helps with the engagement of your employees and reminds them that they are contributing to the success of the organisation.

Climate change

Climate change has arrived at our doorstep. In the summer of 2022, the UK experienced record high temperatures and drought-like conditions. Climate change is no longer a future problem, it is here now, and we must increase our resilience to deal with the challenges.

The government has set a target of net zero carbon emissions in the UK by 2050 and many local authorities will have to transform their operating model in order to meet the target. While many view this as expensive, exacerbated by inflation, the risks of not making these changes could be far greater. Sixty-one climate risks were identified in the technical report for the government produced by the Climate Change Committee. Risks were ranked by expected impact and given an urgency score. It was viewed that 34 of these risks required firmer government action over the next five years and of these eight were viewed to have a ‘very high’ impact by the 2050s.

As local authorities look to future proof their operations, emerging threats from climate change is a logical place to start. Projections show that unless additional action is taken, a 2^{o}C rise in temperature by 2100 could increase flooding damages across non-residential properties by 27% by 2050 and 40% by 2080. This places additional strain on supply chains and warehouse storage as well as the threat of causing severe disruption for the workforce. It also raises concerns relating to building safety and would place additional emphasis on local authorities to ensure that electrical and structural work was at the required standard.

The global rise in temperature has highlighted that many organisations in the UK may not be equipped to deal with extreme heat, with estimates that heat related deaths could be set to triple by 2050. Employee wellbeing becomes a key factor in extreme temperature situations and the increased pressure placed on healthcare services as a result. Ensuring that buildings and other assets are equipped to withstand extreme temperatures will help to protect the wellbeing of all stakeholders including employees. Local authorities will be under increasing pressure to maintain vital infrastructure including transport networks and water supply. Extreme heat has many knock-on impacts, and the UK is not currently well-equipped to deal with them.

Organisations should strongly consider minimising the vulnerability of their supply chains to help minimise the disruptions that can be caused by these events. This includes UK suppliers and also requires an understanding of the climate risks faced by any international suppliers.

The recent war in the Ukraine has highlighted the volatility of energy prices and the resulting government intervention has shown how many people and businesses are not prepared for such drastic changes to the status quo. Effective business continuity planning, and crisis management is vital for local authorities to ensure that they remain agile and prepared for climate and energy related events. The risks of increased cost in terms of energy and transport need to be accounted for as well as the potential of less disposable income being available for those who live within social housing.

Local authorities should focus on progressive, rather than reactionary, policies that allow them to react quickly and do not leave them on the back foot, continuing to remain abreast of key climate related factors to their activities. This will assist them in their continued development and prevent black swan events from having such a devastating effect on their business. A recent government White Paper has pointed to several key areas to help the local authorities achieve net zero goals through new energy solutions and the development of new innovations such as effective retrofitting and the use of new energy efficient ‘smart’ buildings.

Although we are in turbulent and uncertain times, effective organisational resilience and a focus on future proofing businesses we allow the public and social sector to combat climate challenges and emerge from the other side stronger and more prepared to face new challenges.

Net Zero

A year on from the UK Government’s publication of the Net Zero Strategy, the Climate Change Committee have warned that the UK is only on track to cut 40% of the emissions required to hit net zero. While there has been promising progress made in efforts to cut emissions, there are still urgent policy gaps in energy efficiency and a need to make existing homes more energy efficient.

The current energy and cost of living crisis has highlighted the need for effective climate action. However, while Climate Emergency UK estimate that a third of all emissions are within the influence of local authorities, they have indicated there are significant barriers to achieving the net zero targets.

It is clear the targets create new risks and challenges for local authorities as they are faced with the task of realising these goals within existing resource constraints.

While local authorities can be pivotal in delivering net-zero locally and efficiently, a strong understanding of the path to net-zero is needed to lead the way in achieving the government's targets by 2050. A key limitation, is a lack of in-house expertise on how to deliver comprehensive plans, this was highlighted by the Public Accounts Committee in March 2022. The report concluded that the government has not sufficiently supported or engaged with local authorities on the net-zero transition and that the government should mandate net-zero transition plans while providing free tools and guidance for them to do so.

This need for clear policy and guidance is highlighted by the growing cost of energy bills. While the LGA claims retrofitting homes could reduce energy bills by nearly £700 million, local authorities are tasked with the challenge of juggling the multiple objectives of both retrofitting and new low-carbon housing. As the Environmental Audit Committee (EAC) highlighted in their recent report, there is a lack of coherent policy for local authorities to navigate social housing suggesting there may even be an incentive for demolition over retrofit.

The drive for net-zero also provides increased financial pressure for local authorities. According to Room 151's survey of section 151 officers, published in September 2022, only 6.6% of local authorities said they were fully funded to meet net-zero pledges. As the cost-of-living crisis develops, local authorities will witness increased pressure, as growing demand may mean local authorities have to make difficult decisions on the scope of services they can provide.

However, this also presents an opportunity as local authorities are already taking the lead in construction. The EAC's report highlighted local authorities are mandating Whole-life Carbon (WLC) assessments on their own accord; showing the policy is achievable and demonstrating an effective way for the government to dramatically reduce carbon in construction. It also provides an encouraging indication of the progress the public sector is already making against the EAC's recommendation that the government mandate WLCs by December 2023. It is evident that with clear guidance and expertise, local authorities can lead by example and play an integral part in realising the UK's net-zero targets.

Deregulation

Conflicting priorities – new and emerging risks arising from deregulation

The recent announcement of deregulation in the planning and construction industry aims to rapidly increase development and create more housing throughout the UK (HM Treasury, 2022). However, these will not come without sacrifices. Through deregulation, planning rules and regulations will become more relaxed, leading to quicker, but likely poorer, development (Fern et al., 2020). This could allow for a host of new and emerging environmental, social and governance risks to arise. The government is currently in discussion with 38 local authorities to create 'investment zones' in the UK. These zones will make more land available for the development of commercial buildings and housing, and will offer various tax incentives for businesses to encourage relocate and recruit (Department for Levelling up, Housing & Communities, 2022).

There is a risk that developers may take advantage of the relaxed planning and construction rules and use this as an excuse to bypass existing (and important) environmental guidelines. Through increasing development activities, we could see a reduction in natural space for many local authorities. Urban areas and developments will leak into natural land, negatively affecting both landscape and habitats. Loss of habitat is extremely damaging for local wildlife and biodiversity and will eventually impact the stability of local ecosystems, explaining why the RSPB have labelled the Government's plans as "an attack on nature" (RSPB, 2022). On top of this, Laville and Horton (2022) discovered that investment zones can be created on green belt land, in national parks, and areas of outstanding beauty, further emphasising the damage that could be done. The process of construction itself is also a threat to the environment. Impacts during construction include pollution from construction sites such as sewage and waste, as well as dust and noise pollution from building and transporting materials (Willmott Dixon, 2010). By introducing this pollution, alongside the other environmental impacts of construction to protected natural areas could have dire consequences for crucial local ecosystems and would directly contradict environmental commitments made by local authorities.

As well as harmful environmental impacts, social impacts will also arise due to deregulation. By offering tax cuts in these zones, commercial enterprises will be incentivised to relocate and employ more people. However, relocating companies pose the threat of overshadowing and taking business from smaller, established, local businesses. This could affect both employment in the areas and the livelihoods of small business owners as well as a much lower likelihood of profits being reinvested in the local area. In addition to this, deregulation in the construction industry has previously led to poorer quality housing due to bypassing planning regulations (Clifford et al., 2018). This housing may be more affordable and more readily available; however, it could end up costing buyers and landlords more in the form of repairs and alterations. This would affect both residential and commercial premises; Nazaire (2019) expressed concern and provided examples that if construction is rushed and not quality checked, there could be health and safety risks to workers and future occupants. In addition, claims have been made that deregulation makes it difficult to amend problematic building regulations which are already in place (Lowe, 2022), such as regulations around fire safety which could add to the potential health and safety risks.

Local communities will also be affected by deregulation. They will be met with more people and employers moving into their towns and potentially overcrowding them, as well as losing their visual landscape which is extremely important to many individuals. If developments go ahead without the say of local communities, they may lose trust in their local authority and be reluctant to comply.

These risks can be managed, however, by having ESG (environment, social & governance) as a central strategic framework and incorporating it into decision making. ESG ensures that relevant non-financial risks are prioritised in decision-making, which helps to avoid conflicting priorities between environmental and social aims and other activities. For the proposed deregulation, environmental impacts can be mitigated by ensuring that all current environmental regulations, checks, and impact assessments are followed and carried out despite any relaxations that will occur. Contractors and developers should be encouraged to put environmental impacts at the forefront of their decisions, and if any proposed development is found to have a materially negative impact on protected species or area of land, development should be considered in an alternative area. For social considerations, housing and working conditions should be assessed to confirm that they are up to the correct standard before houses are put on the market or work is commenced. Developers should not be incentivised to rush work and compromise on quality due to the issues this will cause further down the line. Communities should also be consulted during any development proposals to ensure that they feel included in the decision-making process, their voices are heard, and their opinions are meaningfully considered.

Despite the many potential negative impacts that come with the announced deregulation and planning zones, incorporating an ESG strategy into decision making can work to mitigate and minimise these risks. By considering the ESG issues that come with development and construction, local authorities can work to ensure that existing requirements are adhered to, and the environment and local communities are not negatively impacted.

Considerations for the Internal Audit plan

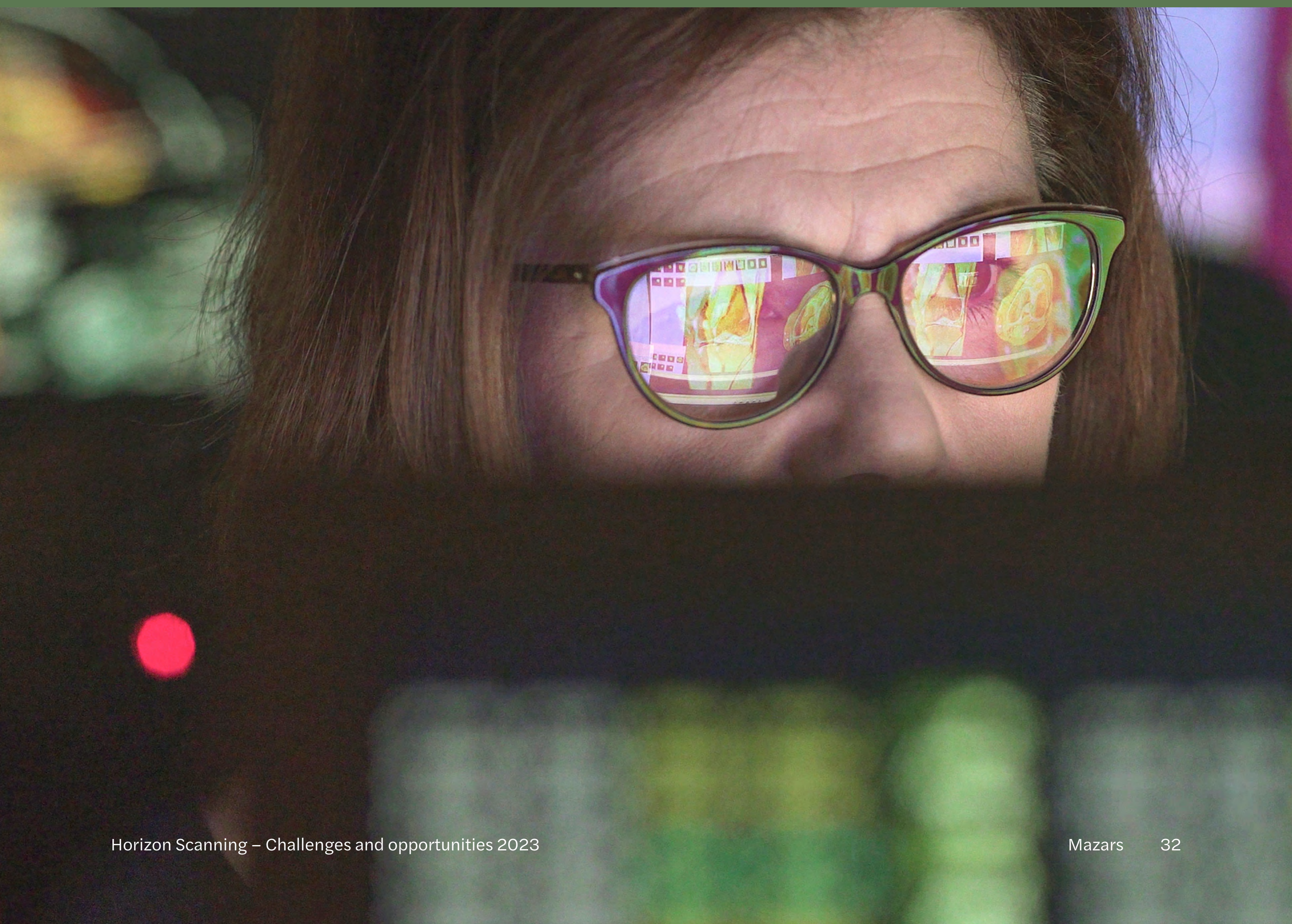
The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes) should be considered for inclusion in the Annual Internal Audit Plan:

- Climate change planning;
- Climate change strategy ;
- Net-zero transitions and pathways;
- Supplier due diligence; and
- Social value.

Given the relative infancy of sustainability activity in local authorities and the complexities, greater value could be added to the organisation by planning consultancy activities in this area using specialist resources. This could also be in the form of upskilling the existing team to deliver work in the area in future years.

Fraud

Fraud costs local authorities a significant amount of money each year, and given the financial challenges being faced, money that local authorities can ill afford to lose. Undertaking key anti-fraud activities, such as the National Fraud Initiative, are key to help mitigate fraud risks. However, the changing nature of fraud means the risks facing local authorities are also changing.



Fraud

An update on fraud and the Covid-19 pandemic

Local authorities have been responsible for distributing a range of central government funded grants to local companies during the Covid-19 pandemic. It is estimated that fraud relating to the grants distributed by local authorities is approximately £1bn.

Local authorities were responsible for 4.5 million individual payments worth approximately £22.6 billion to businesses impacted by the pandemic.

The cost of fraud is therefore estimated to be just under 4.5% of all payments made.

Back in March 2020, the Chancellor unveiled the Covid-19 financial support package which was worth £330 billion, with the primary objective to get money quickly into the hands of struggling businesses and frightened people.

As speed was the prime objective it meant that pre and post-payment assurance systems for all grant schemes were not published until June 2020, more than two months after the first grants were issued.

It became quickly apparent during the pandemic that fraudsters quickly adapted their techniques to exploit the Covid-19 environment and abused the isolation and the public's growing dependence on the internet. This is supported by self-identified fraud against individuals increasing by 41% in both 2020 and 2021.

These figures support the considerations raised in our February 2022 Horizon Scanning report where we identified that government initiatives were likely to be targeted.

As a result, local authorities have been required to remodel services, cut staff and consider new innovative ways of delivering their services. All the while, the local government finance system has been in crisis and all local authorities have been trying to find savings in order to deliver essential services.

How COVID grant-making drove local authorities fraud vulnerabilities | ICAEW

Running-on-Empty-WEB-July2022.pdf (netdna-ssl.com)

The introduction of the Public Sector Fraud Authority ("PSFA")

In August 2022 the PSFA was launched and has been described as "a new team at the heart of the government" with their aim being "to hunt down fraud committed against the public purse, with a £180 million target set for the first 12 months".

The PSFA will have mandatory processes for ministerial departments and public bodies that include:

- Initial Fraud Impact Assessments;
- Submission of quarterly performance data on levels of fraud and error and progress against action plans and metrics;
- The use of, and assurance against the Counter Fraud Functional Standard; and
- Agreement of annual action plans and metrics on fraud management.

As it stands the PSFA will be focused on ministerial departments and public bodies and therefore does not include the wider public sector, i.e. Local Government.

Whilst there is no requirement at the moment to complete the mandatory processes outlined above, Local authorities should be mindful of the benefits of implementing counter fraud functions, and being in line with best practice.

The PSFA have said they will share practices and make available standards to the wider public sector.

3042-PSFA-Mandate-V4-final.pdf (publishing.service.gov.uk)

Existing fraud risks that have not disappeared

Pre-existing risks that are still prevalent:

- Housing Fraud;
- Council Tax Fraud;
- Business Rate Fraud;
- Procurement Fraud;
- Blue Badge Fraud;
- Social Care Fraud;
- Insurance Fraud; and
- Insider / Internal Fraud.

Spotlight on working more than one job now Covid has made flexible working the norm and is it illegal?

We have seen an increase in the number of dismissals of employees in local authorities regarding working more than one job due to the new agile ways of working the Covid-19 pandemic has introduced.

The question is, is it illegal to work more than one job?

The answer is no. There is no law to state that someone is unable to work more than one job at a time, however considerations will need to be made in relation to the individuals' contract of employment with their initial employer as it may have strict clauses within it that do not allow for secondary employment. Some contracts will forbid it entirely and others will require that permission is sought to undertake any secondary employment.

If an employee fails to get permission or is actively dishonest about their secondary employment if asked about it, then this is likely to result in a conduct issue which would need to be dealt with as a disciplinary. However, this would depend on what their contract states regarding secondary employment.

It should be noted that each situation for each employer/employee would differ based on circumstances. This does however highlight the importance for employers to ensure that they have clear wording in employment contracts and policies should this situation arise. Employers should also be aware of their responsibilities in ensuring that the employee does not work more than 48 per week under the Working Time Regulations 1998 and to ensure that the employees working hours do not pose a risk to themselves or others.

[Employees working a second job: what you need to know – Quick reads – Gateley (gateleyplc.com)]

Considerations for the Internal Audit plan

There is still the risk that local authorities may not have had the opportunity to reflect the changes to their processes that were adopted or changed as a result of the pandemic within their written policies and procedures.

While there are no specific considerations for the Internal Audit Plan, we would recommend that local authorities are mindful of building any change to controls and processes into their updates to written policies and procedures and these updates/changes are considered as part of any Internal Audit that is due to be undertaken on the corresponding areas.

In addition to this, we would encourage all local authorities to consider the implementation of a Counter Fraud and Anti-Bribery Health Check as part of their yearly plans. This health check should be aligned with the government Functional Standard – GovS 013: Counter Fraud. The health check is designed to assess the current governance arrangements in place as well as identifying vulnerabilities and possible improvements and how they can be implemented.

By ensuring that they have a robust Counter Fraud and Anti-Bribery function in place is a big step in preventing fraud and bribery from occurring, as well as preparing authorities in responding appropriately should they be a victim or if they are required to undertake any mandatory processes similar to those being rolled out by the PSFA.

The government's recent u-turn on the repeal of the off-payroll workers legislation, has brought employment status for tax very much back on the risk agenda for local authorities.

Tax

In Chancellor Jeremy Hunt's fiscal statement on 17 October 2022 he confirmed that the off-payroll workers (OPW) legislation (IR35 reforms) will continue for the indefinite future. This was following an announcement by the former Chancellor Kwasi Kwarteng on 23 September 2022 to repeal this legislation from 6 April 2023. Therefore, the OPW legislation is here to stay.

The OPW legislation was brought into force for local authorities in 2017 as a result of a failure by all public and social sector bodies (including local authorities) to correctly determine the employment tax status of workers engaged via intermediaries, leading to an underpayment of PAYE and NIC to the exchequer.

These failures are still occurring even though organisations are using HMRC's employment status for tax assessment tool, Check Employment Status for Tax (CEST). CEST relies on users interpreting the questions correctly. If any questions are answered incorrectly, the wrong outcome could be produced and HMRC will not accept any outcome from CEST that is not deemed accurate. These incorrect assessments are leading to large bills for additional tax and NIC. For example, the DWP was charged with an £87.5m tax liability in 2021. The liabilities would be payable by local authorities if HMRC find that the OPW legislation has not been correctly complied with.

As well as the ongoing challenge of ensuring that the employment tax status of workers is correctly determined, there was an additional requirement introduced in April 2021, when the rules were extended to the private sector. From 6 April 2021 local authorities are now required to:

- Provide a Status Determination Statement (SDS) to all workers providing services to you via an intermediary (typically a personal service company). The SDS sets out whether the engagement is inside or outside IR35, and how this decision has been arrived at.
- Have an appeals process in place to enable workers to appeal to you directly regards the decision arrived at on the SDS, and then critically review the grounds of the appeal and make a decision on whether this is accepted or not.

The area of employment status for tax is complex

In the absence of specific legislation, it is necessary to consider the criteria for each type of role. The key factors which are considered in such cases include:

- Whether the individual is required to provide personal service during the engagement or can send a substitute.
- The level of control exercised over the worker by the engager.
- The level of financial risk by the worker during the engagement.
- Whether there is sufficient mutuality of obligation within the engagement to constitute employment.

Salary Sacrifice and National Minimum Wage

With the current cost of living driving pay rate expectation higher, many local authorities are seeking alternative ways to increase their remuneration packages by enhancing their reward packages on offer to recruit and retain employees.

Salary sacrifice schemes, such as car/electric vehicles, pension contributions, cycle to work, gym memberships, tech packages, are becoming increasingly popular within local authorities. Not only do they provide tax and NIC efficiencies (for employees and local authorities), but they can make luxury items more affordable to employees on lower pay scales. These schemes, however, do come with a health warning when it comes to checking employee eligibility to ensure that national minimum wage (NMW) obligations are still being maintained. We have seen instances where the necessary due diligence checks have not been fully considered by local authorities in relation to the impact on pay for national minimum wage (NMW) purposes, which in turn has resulted in NMW underpayments being enforced by HMRC across six years for all impacted employees, along with a penalty charge and reputational damage from naming in the media.

Careful consideration is therefore recommended for local authorities as follows when offering participation in a salary sacrifice scheme:

- The aggregate of all salary sacrifice reductions to pay should not reduce a workers rate of pay below the appropriate NMW pay rate for their age band.
- Pay elements (and deductions) have been correctly identified to determine that the amount of pay to be sacrificed is being reduced appropriately.
- Worker category for NMW purposes has been established to ensure absence pay and time worked is factored into the compliance check accurately.
- Statutory payments are not being reduced below an individual's entitlement.
- The sacrificed pay is not being "flipped" in and out of gross pay whenever pay may fall below the NMW rate payable.
- The contractual liability to a worker for any termination payment taken on leaving employment and the impact to NMW pay.

Local authorities need to ensure that they seek professional advice around implementing a salary sacrifice scheme or the interaction of on-going schemes, in relation to National Minimum Wage or from a PAYE/NIC perspective.

Considerations for the Internal Audit plan

The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes) should be considered for inclusion in the Annual Internal Audit Plan:

- IR35
- Salary sacrifice schemes
- National minimum wage

Due to the deteriorating macroeconomic environment including interest rate increases, local authorities are expected to experience continued financial pressures. Ongoing change and innovation will be required to help reduce expenditure and produce further efficiencies through the effective use of available resources.

Projects and programmes

Local authority changes are often in response to environmental conditions. In a shifting social and economic environment, these factors can have consequences for local authorities which may require changes within those organisations to improve service delivery whilst addressing the needs of citizens.

To keep up with the ever-changing landscape, local authorities are implementing significant technology and capital projects to provide and remodel services. That could include hundreds of different projects, ranging in cost from thousands to multi-millions of pounds. Managing a large portfolio of projects, many with multi-year timelines, ever-shifting requirements and complex procurement challenges comes with inherent uncertainties that can affect costs, timelines, and quality of delivery.

The Mckinsey report states that projects that fail to meet planned scope, budget and time do so by a considerable amount on average. For example, budgets being exceeded by 75%, 46% of projects overrun their schedules and generated 39% less value than predicted.

Customer engagement is important to local authorities as it presents an opportunity to understand the needs of citizens and create an ongoing relationship with them. Good customer engagement provides for positive project outcomes such as improved customer and employee satisfaction, improved services and operational efficiency and compliance with legislation/ regulations.

Other ways of maintaining a positive customer journey are through projects actively addressing customer needs, providing options and solutions to the stakeholders, obtaining customer feedback and adapting and scaling up services.

Technology driven change

Technology offers huge opportunities for local authorities, for example the use of data analytics techniques to enable demographic changes to be mapped. This allows for better alignment of the design and provision of services, including being more citizen focused. Digital services, technology change and project management will require significant ongoing investment and further consideration of how public services are provided in a more holistic and technology-enabled way. Risks associated with technology driven change include:

- Lack of skill, depth, and experience of technology across the organisation including those delivering change.
- Lack of a clear, realistic technology roadmap.
- Lost productivity due to system downtime.
- Disruption to the business due to unsuccessful technology deployment and uptake.

A number of changes or projects could be implemented within the technology space to ensure smooth transition, and these include:

- Technology change management including identifying, selecting, and evaluating new technologies, and incorporating effective technologies into the organisation.
- Setting an ambition to increase investment in both workforce and out of work training to the workforce over a period of years.
- Introducing targeted retraining programmes aimed at those facing redundancy due to change.
- Any digitisation implemented across the public sector should be done with due regard to the Public Sector Equalities Duty.
- Ensure clear strategy, effective governance, technology mastery and user adoption.

Digitalisation can transform public services but may be held back by a lack of capabilities and outdated ways of working across the workforce. It is important to equip workers with the skills necessary to deliver and adopt technology driven changes.

Capital projects and programmes

Capital projects include infrastructure construction and maintenance projects on: buildings; roads; and upgrading, expanding, or replacing facilities and equipment. Capital projects should be managed appropriately, for they often require a significant investment and commitment of organisations resources and time.

Risks and challenges faced by capital projects include:

- Inflation risks resulting in higher project costs.
- Regulation changes impacting project costs and time.
- Commercial values risk i.e. worsening market conditions.
- Increase in interest rates and cost of borrowing resulting in higher project costs.
- Supplier risks such as delays in supplies, theft, shortages and operational issues.
- Project interruption caused by funding issues.

The above risks and challenges can be addressed through better visibility and control over projects. For example, through creating a portfolio view of all projects, a path for project delivery and identification of funding and financing sources.

Capital projects place heavy reliance on third party arrangements and as such procurement cost control are necessary to ensure effective procurement and supplier management through tight budget controls.

Capital projects are complex and often encounter changes that have an impact on the project's schedule and overall costs. It is important to ensuring that the controls are in place to determine project impacts, coordinate changes, monitor progress against the approved schedule and budgets and to provide accurate forecasts to the stakeholders.

Common challenges experienced by projects

- Lack of clear business plan and senior support.
- Insufficient or inadequate project resources.
- Complexity of governance requirements impacting on project decision making and approvals.
- Inadequate project controls, policies, procedures and systems.
- Ineffective detection and prevention of cost and schedule overruns, fraud, waste and abuse.
- Non-delivery and /or poor performance by independent contractors and sub-contractors.
- Inadequate stakeholder engagement.
- Unreliable project reporting and project information.
- Poor implementation of supply chain management practices in line with regulatory frameworks and regulations.
- Unreliable and insufficient assurance on project performance (economy, efficiency and effectiveness).
- Increased size and complexity due to changes to the project.

Considerations for the Internal Audit plan

The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes) should be considered for inclusion in the Annual Internal Audit Plan:

- Project management
- Continuous auditing – project health checks at key milestones
- Project planning
- Procurement and contract management
- Project – testing
- Post implementation reviews

Public Finance Initiative

In the past, Public Finance Initiative (PFI) structures were a popular way to fund critical local and national infrastructure. In the current financial climate, a number of public sector bodies are questioning whether the cost of their PFI contracts outweighs the value achieved

Public Finance Initiative

Setting the scene

There are over 700 PFI contracts in the UK involving assets with a capital value of £57bn.

When PFI was rolled out across local government, local authorities were incentivised to consider adopting PFI because, in part, it enabled the public sector to avoid having to fund the up-front capital cost of major public infrastructure whilst obtaining up-front visibility over the cost of operating an asset such as a school or waste facility or street/highway for the long term. In practice, this meant PFI contract terms of between 20 and 30 years was considered the norm.

Every PFI has a separate Special Purpose Vehicle (SPV) – a subsidiary company that helps keep the PFI asset secure and through which the asset is managed on behalf of the local authority. Other organisations may also be involved in a typical PFI contract – such as a bank (or a syndicate of banks) and a construction company. In total there are around 120 separate private sector organisations involved in PFI deals, some owning 100 per cent of the equity, others jointly owning smaller shares. And in most cases, private sector organisations are involved in more than one PFI scheme.

In the same way, it is not unusual for a local authority to have more than one PFI contract on its books. Most will have one or more of: schools, domestic waste management, highways management, street lighting, hospital trusts and so on. These PFI contracts can absorb a disproportionate amount of the available annual budget, in some cases upwards of between 10-15% of a local authority's total annual spend. These are significant sums.

The issues being faced by local authorities with PFI contracts

We have seen a number of issues arising in respect of local authority owned PFI contracts, these include:

- **Lack of flexibility PFI contracts were devised to encourage the private sector (both banks and construction companies) to invest and participate in the building of critical public sector infrastructure.** The primary means this was done was by creating a structure which was long term, stable and gave guaranteed economic returns to its participants. However, the quid pro quo was that PFI contracts had to be watertight in every aspect. Debt interest was hedged for 25 years, inflation rates fixed for the duration, service provision made into immovable objects and payments due from local authorities (usually called Unitary Charges) set in stone. Local authorities are now finding that years later, they cannot amend the services they procured over a decade ago to meet the changing needs of their constituents, are unable to embrace the latest technological developments, to adopt changes to work practices and address budgetary pressures, all of which were unforeseen at the time of entering the PFI.
- **Complexity / Monitoring PFI contracts are complex structures.** The legal documents which underpin a PFI can run into several hundred pages and in most cases, there is more than one legal document governing a single PFI (e.g. Concession Agreements, Direct Agreements, Shareholder Agreements and so on). In many cases, the staff which procured the PFI contracts at the local authority have since moved on, taking critical knowledge of the PFI contract with them. This has left a vacuum of knowledge and expertise within local authorities, leaving them unable to effectively monitor and manage their PFI contracts, to ensure the private sector is being brought to account and for delivering against the key performance metrics enshrined in the PFI contract.
- **Affordability: the debate rages on as to whether PFI contracts do deliver value for money.** The answer will be different for each PFI, but what is clear is that local authorities are contractually tied into long-term financial commitments through their PFI contracts. As noted above, in most cases these PFI contracts cannot be amended easily or service scope reduced to compensate for ever diminishing local authority budgets and increasing costs elsewhere (such as from energy prices). In extreme cases, PFI contracts have become unaffordable for some local authorities and led to difficult conversations between the authority and private sector counterparties, which in some cases has led to expensive and time-consuming legal disputes arising.

What can local authorities do if they are having issues with their PFI contracts?

There is no one size fits all and we have seen a number of PFI situations across the UK where a dispute has or is about to arise between PFI parties. Our experts recommend the following general principles where local authorities are facing challenges with their PFI contracts:

- **Build trust between stakeholders –** remains central to being able to successfully address the issues at hand in a distressed or disputed PFI situation. A broken or fractious relationship between the public and private stakeholders is no basis on which to reach a consensual agreement on the way forward. Independent advisors can help to build and facilitate relationships and dialogue between the parties.
- **Create a stable platform on which to undertake discussions / negotiations –** where either the underlying asset is complex, highly geared or not meeting the required operational standards, there may be critical issues to resolve at the outset. For instance, a key subcontractor to the PFI may either be underperforming or financially unstable. In this situation a "standstill" on the existing performance deductions regime by the local authority and/or lenders consenting to short term debt repayment holidays and/or financial support being provided to the SPV by sponsors, may all be appropriate actions to provide a stable platform on which to conduct the required negotiations.
- **A need to understand the detail whilst being commercial at the same time –** it is important to understand the existing rights and obligations (commercial and legal) each party has under the PFI contract. Once understood, a sensible and commercially focussed way forward can be mapped. In most cases independent finance and legal advisors can add value with this aspect.
- **Carefully manage entrenched positions –** as these are generally an impediment to reaching a mutually acceptable consensual solution, which generally requires concessions to be made on all sides. As noted earlier, avoiding a prolonged and expensive dispute resolution process whilst focussing on strengthening project relationships and following a commercially led solution has been found to be most effective in distressed or dispute situations.

What is next?

Before your contract ends, we recommend planning your exit strategy. The main emphasis should be given to the development of expiry plans, identification of 'gaps' in the processes, systems or areas of contractual ambiguity and resource availability to manage the transition. Local authorities must ensure that future service plans are developed early and integrated with the expiry process.

Considerations for the Internal Audit plan

The following audits (in addition to other audits discussed elsewhere in the document and targeted audits of service undergoing changes) should be considered for inclusion in the Annual Internal Audit Plan:

- Review of PFI
- Annual investment strategy
- Commercialisation
- Investment projects
- Medium term financial planning and strategy
- Saving plans
- Budget monitoring

Business as usual considerations

While this document seeks to highlight the new and emerging areas of risks that Heads of Internal Audit should be considering when preparing and planning their Internal Audit Plans for 2023/24, there are other significant areas that they should continue to gain assurance over.

Business as usual considerations

Continued focus should be placed on the controls operating over all financial systems, including payroll, general ledger, accounts payable and receivable. Particular focus should be given to the impact the cost-of-living crisis has on Council Tax and Business Rates collection as well as other income streams and problem debts.

Adult Social Care and Children's Services remain high risk areas through the services provided to vulnerable service users. Internal audit teams should continue to engage with senior management in their organisation to understand the local risks facing both adult and children services. However, we have identified a changing risk profile in the following areas for both adults and children:

- Demand management;
- Safeguarding;
- Commissioning;
- School funding and compliance;
- Homelessness and temporary accommodation; and
- Domestic violence.

In terms of the wider local authority activities, following a general move to hybrid working we have noticed seen changes in organisational culture including a loss of informal controls and governance arrangements. Local authorities should be cognisant of the impact working arrangements on the control environment across all services.

With the advances of remote working, many local authorities are considering how their buildings are used and the opportunities of commercial arrangements for empty office space. This should be considered for inclusion internal audit plan alongside the governance that support traded or commercial services that the local authority has undertaken.

As always, we are here to help you to navigate this continually changing and challenging environment – please get in touch with the Mazars team if you wish to discuss any of these topics further.

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