Autumn budget reflections for CAEs

Organisations and their internal audit functions face a dizzying pace of change and unprecedented uncertainty. The pandemic has destabilised operations and labour, disrupted supply and demand, and undermined previously sound business models to an extent few would have thought possible.

Set against this and a backdrop of escalating social care requirements and the unplanned costs of the ongoing pandemic, Chancellor Rishi Sunak delivered the Autumn Budget in October 2021.

This short reflective piece, from the perspective of a Chief Audit Executive, looks at the key points from the budget and related announcements due to take effect in the Finance Bill 2021-22.

Outlook

When announcing the Spring Budget, the Chancellor said, “it’s going to take this country, and the whole world, a long time to recover from this extraordinary situation,” a sober warning that difficult decisions still lie ahead. Not only for the Cabinet but for business leaders too.

Having borrowed 15.2% of GDP (£319bn) in 2020-21 and a further £183bn this year, it is forecast to fall to £83bn in 2022-23. Such unprecedented peace time borrowing will need to be repaid.

2021 has been a year of tax raising measures impacting both employees and employers, from increased corporation tax, freezing personal allowances and the new Health and Social Care Levy.

The OBR (Office for Budget Responsibility) now forecasts:

- That the early 2022 economy should return to its pre-pandemic size
- That the economy will have grown by 6.5% in 2021 compared to its March forecast of 4%
- That GDP will grow 6% in 2022, 2.1% in 2023, 1.3% in 2024, 1.6% in 2025, and 1.7% in 2026
- That unemployment will peak at 5.2%. The extended furlough scheme attributed for mitigating against the 12% forecast in July 2020

Talent risk

Aside from the number crunching, a key takeaway from the budget for audit leaders is the management of talent risk.

An increase to the national living wage puts pressure on payroll cost but also closes the gap on entry level roles with salaries below £20k. Addressing the talent attraction risk at this level is just as important as maintaining operational excellence and the future pipeline for promotion.

One in twenty (4.7%) of UK workers has resigned from roles during the pandemic according to research by SD Worx. While salary and benefits, including remote working opportunities, were key reasons, many also valued wellbeing such as the work environment.

Tax pressures over the coming years together with high inflation will potentially see salaries drop in real terms for many employees. Retaining talent is often more cost effective than recruitment so this could be an area to think about for the audit plan. Varied reward packages can support employee engagement, such as development programmes, extra day off for birthday, free snacks, electric vehicle schemes, and flexible holiday arrangements. Win-wins are those that also help organisations manage employment costs such as salary sacrifice for pension contributions and share options.

Brexit changed the rules of the game for attracting overseas talent. In the budget, Sunak said that “as we forge the UK’s future as a global scientific and technology superpower, we will ensure the UK continues to be the destination of choice for international talent.”

The Global Talent Network will see government, UK businesses and research institutions collaborate to identify skills needs before sourcing science and tech talent from overseas universities, innovation hubs and research institutions. Launching in the Bay Area in San Francisco and Boston in the US in 2022, alongside Bengaluru in India, the programme will expand to a total of six countries worldwide by 2023. Support will be offered to assist individuals in relocating.

A fast-track version of the Skilled Worker visa as part of the UK’s points-based immigration system will launch in Spring 2022. Eligible organisations for the new Scale-up Visa will need to demonstrate a growth rate of at least 20% over three years (jobs must be highly skilled with a minimum wage of £33k). There is a wide range of work visa categories.

Climate

TCFD reporting is fast becoming a reality. Premium-listed companies must already report for financial years beginning in 2021 on whether or not they have included TCFD-aligned disclosures in their annual reports. The plan is to extend it to standard listed companies for financial years beginning on or after 1

January 2022. Since October, occupational pension schemes have also been required to report. The aim is to strengthen the quality of governance and the level of action by trustees in identifying, assessing and managing climate risk.

Is your organisation ready to report on TCFD?

In the budget, a new ultra-long-haul passenger duty was announced, effective 2023. At the same time domestic air passenger duty was reduced by 50% and there was a continued freeze of fuel duty.

Two of these measures appear to conflict with the government’s net-zero target by reducing the cost of domestic flights and not encouraging consumers towards electric vehicles. The government and the board of your organisation tread a difficult line, needing to be mindful of balancing climate commitments and day-to-day actions.

Remedial risk costs

Back in 2018, on the anniversary of the Grenfell Tower tragedy, we urged audit to reflect on operating practices and taken for granted assumptions within their own sectors. A new tax announced in the budget may have gone unnoticed for many of you.

The government’s Building Safety Package aims to bring an end to unsafe cladding, provide reassurance to homeowners and support confidence in the housing market. The new 4% tax, from April 2022, on the largest (profits over £25m) residential property development organisations will help fund it.

It is a reminder that remedial action has a cost. Estimates suggest that rework across all affected housing could cost £15bn. PPI refunds and compensation exceed £36bn and the diesel scandal affecting over 20 manufacturers is estimated to be a similar figure.

What skeletons might be lurking in the closet of your organisation or industry?

Health and Social Care Levy

The pressures of an aging population have been exacerbated by the health pressures of the pandemic. The new Health and Social Care levy begins from 6 April 2022. Collected via National Insurance Contributions it will impact employees, employers and the self-employed.

This new levy will create extra employment costs, significantly so for many businesses. The Chartered IIA has emphasised the importance of financial stability in its report Avoiding the Blind Spot and internal auditors should be mindful of the impact that this could have on cashflow and profitability in the next financial year. Particularly coupled with the increase in national minimum/living wage, high inflation and escalating energy prices.

Reward packages such as salary sacrifice for staff pension contributions can offer efficiencies for both employers and employees. Internal audit’s advisory role could be used to encourage innovative thinking about risk in this area.

Business rates

The current business rate system will be retained, although for 2022-23 there is a freeze on the multiplier and a 50% discount for retail, hospitality and leisure sectors. From 1 April 2023, the frequency of revaluations will move to 3 years and new reliefs will be introduced for investment in property improvements and green technology.

CAEs may need to balance the immediacy of risk mitigation to the commercial benefit of delaying proposed activities to take advantage of this.

Business rate reform is an ongoing debate as the tax on physical property, introduced long before the digital age, creates an uneven playing field for brick vs click retailers. The retail sector currently pays more tax than any other sector in the UK. A consultation into an Online Sales Tax will be launching soon.

Uncertain tax treatment

The next financial year will see large businesses having to notify HMRC when they take an uncertain tax position, with a potential advantage in excess of £5m for a 12-month period, for VAT, corporation tax or income tax. Even where this falls within the scope of external audit, you might want to stay abreast of developments to engage in risk discussions. There are three criteria to consider. Click here for more information.

English Freeports announced

CAEs whose organisation is considering expansion, relocation or partnerships should be aware of this. A Freeport is a special economic zone around an air, rail or seaport. The government aims to create a world leading and highly ambitious Freeport model for England. Organisations operating within these sites benefit from various tax incentives. The first sites are in Humber, Teesside and Thames.

Innovation

Research and development is being boosted as part of the government's strategy for the UK to be a 'science superpower.' R&D tax relief will be extended, effective April 2023, to include data and cloud computing costs. To understand more about R&D accounting click here.

Capital allowance

The temporary £1m Annual Investment Allowance is extended to 31 March 2023. This is designed to encourage investment in plant and machinery for organisations that fall outside of the super deduction rules.

Closing thoughts

The Budget provides the perfect moment to horizon scan for risk, opportunities and threats plus think about those all-important assurance needs that might not be on the audit plan.

"Additional investment in skills, infrastructure and better access to finance will be key drivers for our economic recovery and will provide longer-term benefits and opportunities for businesses across the country.

However, businesses have been battered by 18 months of the pandemic and problems around supply chain costs and disruption, labour shortages, price rises, soaring energy bills and taxes and there will be difficult months ahead".

Shevaun Haviland, Director General, British Chamber of Commerce