

Appendix 1

Corporate Governance & Audit Committee note – 27 September 2024

1. Executive Summary

The findings of the internal audit into the district heating schemes published in June 2024, has accelerated the work we are doing to resolve the historic issues relating to our district heating schemes and has highlighted some important priority areas that we are addressing with urgency.

We have responded proactively to the audit findings by forming an internal project group, creating an action plan to address each area of concern, and maintaining oversight at a senior level of the progress being made.

2. Background

This audit followed a previous internal audit review of the district heating schemes which was undertaken in October 2019 which highlighted several weaknesses: The scheme not achieving break-even, the need to prepare to renew the contract for support services and the management of the vulnerability criteria. These have not been addressed due to there being no inhouse technical capabilities to develop and manage an energy strategy that would inform the decisions around heat networks in Kirklees.

In accordance with the 2023/24 Internal Audit Plan, a review of the processes around District Heating Schemes across the Homes and Neighbourhoods housing stock was undertaken in March/April 2024, followed by a report published in June 2024.

The scope of the audit was to review and evaluate the systems and procedures in place to ascertain whether they are sufficiently robust in relation to overall arrangements for District Heating Schemes. Audit testing identified that the processes surrounding the District Heating Schemes have significantly broken down in relation to some key controls.

District heating, also known as a heat network, is a system that uses a singular central heat source to distribute hot water through a network of insulated pipes to multiple individual dwellings. The structure is usually used to fulfil heating and hot water requirements in apartment complexes.

The current provider provides the end-to-end heat management service. This contract expired in January 2023. Therefore, Kirklees is currently out of contact, however an exemption to continue to use the current provider until 31st December 2024 was granted by the Strategic Director of Homes and Neighbourhoods and the Head of Procurement.

The current Contract requires consideration for a further 12-month extension, due to the requirement of an Energy Strategy that will include our heat networks. Linking in the boiler improvement programme, reaching our net zero targets across Homes and Neighbourhoods and understand the impact of the current district heating renewal programme. To achieve this, we need to procure a technical specialist to

write the specifications for the metering and billing contract and the completion of the procurement for a new supplier of heat meters and a contract with a billing provider.

The contract for the PV dashboard has also expired and the above procurement will include the provision of a new provider.

Kirklees residents that use district heating have a pre-payment meter provided by the current provider who also collect the income from the meters. For the 2023/24 financial year, the expenditure was approximately £787K against income of approximately £191k. This represents a shortfall of £596k (in 2022/23 the shortfall was approximately £1m) this is currently being subsidised from the HRA.

The situation arose by the original unit costs for gas not been reviewed since the commencement of contract with the current provider in 2013. The increase in energy bills due to rising wholesale energy prices, was never applied to reflect the cost of the energy supplied to residents. Like other landlords we are affected by these higher costs and cannot avoid passing them on to our residents. However, this was not applied due to the absence of a contract Manager and key personnel changes. We recognise the significant loss in income and cannot charge our residents retrospectively for this. Currently the HRA is subsidising the shortfall in district heating payments and the actual cost of energy usage is not being recovered.

Going forward we will apply an increase in charge to our residents and a report is being prepared for Portfolio Holder approval for the end of September 2024.

To charge our residents correctly, Assets are:

- Reviewing what we are paying against what the residents are paying to determine what the price should be.

And as part of the longer-term strategy:

- Completing a boiler replacement programme to ensure system efficiency.
- Procuring a new meter for pre-payment
- Procuring a new billing provider to review the contract we have in place to evidence value for money.

Correct meter readings and a boiler replacement scheme is required to ensure system efficiency and finance can reconcile our income against expenditure. The boiler replacement scheme is underway and to date we have replaced 9 boilers and the further 3 will be completed by April 2025. The remaining 13 boilers do not currently need to be replaced, based on the boiler's lifecycle.

3. Property details

Kirklees has 25 individual heat networks that supply heat to 1,042 homes (as of 22nd August 2024). Approximately of which 10% are leaseholders. The mix of tenures pose their own challenges and risk. The properties span a wide geography across the Kirklees footprint and are split across electoral wards of which 486 are the various Dewsbury wards and 177 are in the Newsome ward.

4. Audit findings

A summary of the audit findings is in the table below:

<u>Follow Up Audit</u>	<u>Opinion</u>	<u>Outstanding Recommendations</u>		
Homes and Neighbourhoods	Overall, Limited Assurance	Fundamental	Significant	Merits Attention
District Heating Schemes	Breakdown: <ul style="list-style-type: none"> • Documented procedures – Limited Assurance • Support contract – No Assurance • Income collection/expenditure – Limited Assurance 	3	10	1

5. Audit response

A project Group has subsequently been established to:

- To ensure the audit report and all recommended actions are addressed.
- Oversee a compliant procurement, prioritising the needs of end users and ensuring value for money.
- Ensure key stakeholders are consulted as the new meters will be used in the future in other dwellings including independent living schemes.
- Produce a realistic and achievable timeline for procurement of a new contractor for meters and billing.
- To have a robust contract for meters and billing in Kirklees.
- Establishing arrangements to recover the full costs. (of energy and system management)

The project group met on 6th June 2024 and agreed the action plan. The group met again in September, with future meetings scheduled monthly.

An action plan has been agreed and work has started against the actions, to rectify the issues identified within the audit report. [Internal Audit District Heating Action Plan - updated 6 September 24.docx](#)

Progress to date:

- Consideration of potential price increases for 24/25, due to increase in wholesale price that was never applied.
- Provide an accurate income/expenditure position for 24/25
- Boiler replacement programme is underway.

- Process in place to capture the meter readings: Programme put in place to obtain monthly metering readings for finance to reconcile against invoices from gas supplier.
- All District heating expenditure and income is now accounted for directly within the HRA
- Consideration for funding through the Energy Bill Relief Scheme to address the historical shortfall was given. However, this funding has been withdrawn.

6. Governance

Following the commitment within the Council’s response to the Regulator for Social Housing to establish focused governance and programme management on building safety and asset management, additional governance has been introduced.

The newly established District Heating Board is part of the new governance briefly comprises of Action Groups for each of the building safety and asset management service areas, a Service Manager Operational Group (SMOG) and an Asset Management Steering Group (AMBSSG). See appendix 1

We acknowledge that issues have accumulated over the years due to the responsibility of the district heating falling under different remits and service areas, due to the interdependencies, complexities of the schemes and staff changes. To ensure accountability and monitor progress going forward, the following senior KHN staff will take responsibility for the delivery of the action plan:

- Strategic lead: Head of Assets and Strategy
- Managerial responsibility: Service Manager, Strategy and Performance
- Project Management responsibility: Planning and Performance Officer
- Day-to-day responsibility: Sustainability Team Leader

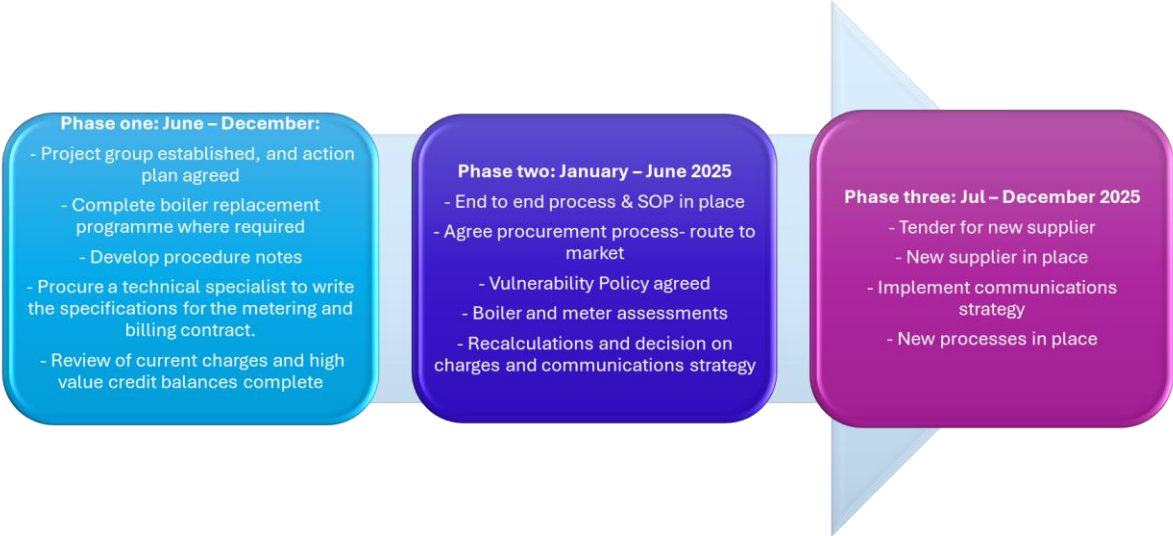
7. Risk evaluation

Risk	RAG	Mitigation	RAG
Contract extension lapses and heating is cut off to all households on the district heating network	High	Securing a new contract for the management of the network is of the highest priority. We are currently exploring the options to ensure that the specification and the procurement of the contract is completed in a timely manner and will resolve some of the current issues.	
Potential negative impact on Council’s reputation of increasing charges	High	Robust planning and a comprehensive communications strategy, addressing all stakeholders and designed alongside the implementation plan, to mitigate the financial impact of the price increases on residents.	
Financial impact on the Council of not passing on charges to residents	High	The scheme should break even, and it is currently running at a loss. The decision to adjust the charges moving forward and bring them in line with the expenditure is being actioned through members of the project group.	

Resource and capacity to meet the demands of the action plan	High	The project group has been formed to address the actions and take ownership.	
Staff changes impacting the delivery of the action plan	Medium	Once the procedures and new contract and ways of working are in place, future handovers should be more thorough and achieve continuity of service.	

8. Project timeline

The project group have agreed the action plan and project timescales as outlined below.



Appendix 1 – Governance Reporting Structure

