

London Borough of Hammersmith and Fulham  
Final Internal Audit Report  
Service Charges

April 2020



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## 1 Introduction

As part of the internal audit plan for 2019/20, agreed by the Audit and Pensions Committee, we have undertaken an internal audit of Service Charges within the London Borough of Hammersmith and Fulham.

Service charges are levied by Councils to recover the costs incurred in providing services to a building. The way in which the service charge is organised is set out in the leaseholder's lease. The charge normally covers the cost of such matters as general maintenance and repairs, insurance of the building and, where the services are provided, lifts, lighting cleaning of common areas etc.

The Council calculates the service charges as a percentage, as set out in the lease. There are two types of charges made by the Council to leaseholders. These are the annual service charge, which covers services delivered by the Council to a building or estate, and major works bills, which are for significant periodic works done to buildings.

Major works service charges are for necessary repairs, renewals, and in some cases, improvements which cannot be done under the normal day-to-day repairs arrangement due to the amount of work involved. The Council will write to leaseholders before going ahead with any work to tell them what the Council are planning and how much the leaseholder is likely to be charged. At this stage the leaseholder is given an opportunity to comment and ask questions.



The service charge estimated invoices for the year ahead are sent in end of March each year. The actual charges (where the actual costs incurred are adjusted after being calculated) are sent in September after the end of the financial year. A detailed breakdown of how the charges are allocated is included within the invoices.

When major works are needed, residents are issued with Section 20 notices, before the works begin. These are invoiced after completion, with flexible payment terms available.

Major works will not be reviewed as part of this audit. A separate audit of major works will be undertaken.

## 2 Executive Summary

### 2.1 Assurance Opinion

	Nil	Limited	Satisfactory	Substantial
<b>Audit Opinion (Operations)</b>				
<b>Audit Opinion (SAP /Debt Management)</b>				

### 2.2 Recommendations Summary

The following table highlights the number and categories of recommendations made.

Area of Scope	Adequacy	Effectiveness	Recommendations Raised		
			High	Medium	Low
Policies and Procedures			0	0	1
Identification of Leaseholders			0	0	0
Identification and Allocation of Attributable Costs			0	0	0
Estimates and Invoicing			0	0	0
Collection			0	0	0
Debt Management			1	0	0
Total			1	0	1

Please refer to Appendix 1 for the recommendations raised and Appendix 2 for a definition of the audit opinions and recommendation priorities.

### 3 Summary of Findings

In Internal Audit's opinion, **Satisfactory Assurance** can be given to Members, the Chief Executive and other officers that the controls relied upon at the time of the audit were suitably designed, consistently applied and effective in their application.

Controls were found to be effective in the areas of identification of leaseholders, identification and allocation of attributable costs, and invoicing of estimated and actual service charge costs. However significant weaknesses were noted with regards to the identification of outstanding service charges and debt management. These weaknesses were in the main due to the implementation of SAP and is a corporate issue. As such a **Limited Assurance** opinion has been provided for controls relating to debt management.

Management were aware of operational issues with SAP in relation to payments not always posting to customer accounts, aged debt reports not distinguishing between major works and service charges debt, and the dunning service on SAP being deactivated. The situation has since improved with receipt of payment being allocated to the correct account, separation of debts between major works and service charges and plans to reactivate the dunning service.

The key findings and an assessment of controls are summarised below:

#### **Policies and Procedures**

- Policies and procedures are in place for the administration of Service Charges. These are held on SharePoint for all relevant staff to access. It was however noted that the procedures have not been updated since 2016 and refer to the previous financial system, Agresso. Since December 2018, the Council is using a new financial system, SAP. The department is in the process of updating all its procedures to reflect the current system.

#### **Identification of Leaseholders**

- A database of Council leaseholders is held on iWorld, the housing management system. This records the property account number, name of the leaseholder, property address, correspondence address, and the date of sale.
- Legal Services inform the Service Charges Team when a lease has been sold or transferred, and the leaseholder account on iWorld can then be created or amended as appropriate. From a sample of ten lease sales/transfers tested between September 2018 and September 2019, it was confirmed in all cases that the leasehold services team had been notified of the transaction date and the account updated on iWorld within one month of receipt of the notification.

#### **Identification and Allocation of Attributable Costs**

- A spreadsheet is maintained by the Service Charges Team, which records works planned on each building/block, and their corresponding costs.
- The lease for each property details the percentage of the overall building and/or estate service charge that the leaseholder is liable to pay. The annual invoice issued to the leaseholder records the overall service charge for the building and estate, and the percentage that the leaseholder is liable for each element. From a sample of ten leasehold properties selected for testing, it was confirmed that in all cases the service charge had been apportioned correctly in line with the lease agreements.

#### **Estimates and Invoicing**

- Service charge estimates are in the majority of cases an average of the actual cost figures from the previous three years. Management can make adjustments to these figures, i.e. where significant upcoming works are known. A sample of ten leasehold properties was selected for testing, and in all cases, the service charge estimate had been calculated, and invoice sent to the leaseholder in March 2019 prior to the forthcoming financial year.

- Invoices of actual service charge costs are issued to leaseholders in September following the end of the previous financial year. This will show either a credit (which can be credited against the service charge for the next financial year or refunded) or a debit which the leaseholder is required to pay. A sample of ten leasehold properties was selected for testing, and in all cases the service charge invoice had been sent to the leaseholder in September, relating to the actual costs for the previous financial year.
- A reconciliation is undertaken between the number of invoices generated from iWorld and the number of invoices that should be sent as per the spreadsheet records maintained by the Service Charges Team. Any discrepancies are investigated. We confirmed that this reconciliation was undertaken in March 2019 and September 2019 and no discrepancies were noted.

### **Collection**

- Multiple methods of payment are available to leaseholders paying the service charge. These are via direct debit, bank transfer, telephone, cheque, and in person with cash at the Customer Service Centre or Post Office.

### **Debt Management**

- The implementation of SAP at the Council has resulted in operational issues with the monitoring of payments received and outstanding invoices. At the time of the audit in October 2019, management was unable to effectively monitor the payment of service charge invoices as payments received were not always automatically posted against the corresponding invoice. Where this posting fails, payments enter the suspense account and are time consuming to manually allocate. The situation has since improved with receipt of payment being allocated to the correct customer account.
- From the implementation of SAP to the time of the audit in October 2019, management were unable to accurately identify the amount of outstanding service charges debt. This was due to issues with both the income received not being automatically posted on SAP and the aged debtor reports (referred to below) not distinguishing between service charge debt and major works debt. The Council is now using a software tool, Power BI, to report on all debt within SAP relating to service charges.
- Aged debtor reports are run on a monthly basis and presented to senior management. However, due to the issue with payments not posting correctly into SAP, these reports no longer accurately identify non-payment of Service Charges. At the time of the audit in October 2019, the reports were also not distinguishing between the different types of debt, for example, whether they relate to major works or for service charges, therefore making it more difficult to undertake recovery action. Following training and the continued use of the SAP system, management are now able to distinguish between service charge debt and major works debt. The monthly Corporate Revenue Monitoring (CRM) reports now include the debt separated between service charges and major works.
- The first stage of the debt recovery process is for reminder letters to be sent to the debtor and where the debt remains outstanding, it is referred to Legal Services to pursue. It was noted that there are no procedures in place with regards to the debt recovery process. Since the implementation of SAP, there have been difficulties with the issuing of reminder letters. Therefore at the time of the audit in October 2019, no debts had been pursued or referred to Legal Services. Recovery action on service charge debts has since commenced. As at December 2019, the outstanding debt for service charges was £2,507,020 compared to £3,408,218 for October 2019.
- A 'Dunning' service is available through SAP whereby three reminder letters can be automatically issued. However, a council wide decision was made to suspend this service due to issues encountered and subsequently the debt recovery process has become manual and reactive focussing on higher value debts which are generally for major works rather than service charges.

- There are plans to reactivate the 'Dunning' service. The Finance Systems Manager will also receive a weekly report detailing accounts with outstanding debt and these will be shared with relevant service areas, including Service Charges.
- No debts have been written off since the implementation of SAP.

#### **4 Acknowledgement**

We would like to thank the following members of staff for their time and assistance during the audit:

- Paul Hayward – Head of Leasehold Services
- Ciaran Maguire – Service Charge Manager
- Madhav Acharya – Systems Accountant
- Stephen Fitzgerald – Senior Service Charge Accountant
- Duncan Cheung – Senior Service Charge Accountant
- David Bellanfante – Leasehold Income Support Officer

## Appendix 1: Management Action Plan

### 1. Policies and Procedures – Implementation of SAP

Priority	Issue	Risk	Recommendation
Low	Policies and procedures are in place for the administration of Service Charges and the debt recovery process. However, procedures have not been updated since 2016 and refer to the previous finance system, Agresso rather than the new finance system, SAP. The team are in the process of updating all procedures to reflect the current system.	Where policies and procedures are not periodically reviewed and updated to reflect current working practices, there is an increased risk of inconsistent and inefficient working practices leading to non-compliance with legislation and management requirements.	The updating of policies and procedures relating to the administration of Service Charges should be expedited, with a timetable agreed for completion.
Management Response			
Agreed. Both policies and procedures will be updated to reflect the current finance systems.			
Responsible Officer			Deadline
Paul Hayward – Head of Leasehold Services Madhav Acharya – Systems Accountant			30 <sup>th</sup> June 2020




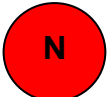


**2. Debt Management – Debt recovery**

Priority	Issue	Risk	Recommendation
High	<p>Whilst aged debtor reports are run on a monthly basis, due to issues with SAP, these are not accurately identifying non-payment of service charges or distinguishing between major works debt and service charges debt.</p> <p>Since the implementation of SAP, there have also been issues with the sending of reminder letters. Therefore, the Service Charges team have been unable to identify, pursue or recover outstanding service charge debts.</p>	<p>Where prompt recovery action is not taken on outstanding debts, there is an increased risk that income due will not be recovered leading to financial loss.</p>	<p>Management should liaise with the service provider, SAP, to resolve the functionality issues, preventing service charge debt from being automatically pursued via the 'Dunning' service.</p> <p>Once resolved, debt recovery procedures should be developed and include the timescales for sending out reminder letters.</p> <p>A plan of action to pursue outstanding service charge debts should also be developed.</p>
<b>Management Response</b>			
<p>Agreed.</p> <p>The team have a number of workarounds in place to pursue arrears, service charge debts are distinguishable. Following the Covid 19 outbreak a corporate decision has been taken to put on hold dunning debt recovery letters issued from SAP GUI. Once this restriction is lifted dunning will be switched back on. The longer term plan to resolve the functionality issues is to move service charge recovery out of SAP GUI and into the Integrated Housing Management system – Northgate. A project team has been set up to implement this change.</p>			
<b>Responsible Officer</b>			<b>Deadline</b>
Paul Hayward – Head of Leasehold Services			31 <sup>st</sup> December 2020

## Appendix 2: Definition of Assurance Opinions and Recommendation Priorities

In order to help put the audit opinion and recommendation priority ratings in context the following tables detail the current ratings used by Internal Audit.

Rating	Description
 <b>Su</b>	There is a sound system of control designed to achieve the objectives. Compliance with the control process is considered to be substantial and no material errors or weaknesses were found.
 <b>Sa</b>	While there is a basically sound system, there are weaknesses and/or omissions which put some of the system objectives at risk, and/or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
 <b>L</b>	Weaknesses and / or omissions in the system of controls are such as to put the system objectives at risk, and/or the level of non-compliance puts the system objectives at risk.
 <b>N</b>	Control is generally weak, leaving the system open to significant error or abuse, and/or significant non-compliance with basic controls leaves the system open to error or abuse.

Priority	Description
<b>High</b>	Recommendation addresses fundamental weaknesses, which seriously compromise the effective accomplishment of the system's objectives. Risks presented by the control weaknesses could be damaging in the short term. The management action required should be implemented as soon as possible, certainly within 0-3 months.
<b>Medium</b>	Recommendation addresses serious weakness, which affect the reliance to be placed on the system. Risks presented by control weaknesses could be damaging in the medium term. Management action is required within 0-6 months.
<b>Low</b>	Recommendation addresses minor weaknesses or suggests a desirable improvement. Risks presented by control weaknesses are unlikely and inconsequential. Management action is recommended to address concerns within 0-9 months.

### Appendix 3: Audit Scope & Limitations

This audit was a full risk based review of the arrangements for the Council's administration of leaseholder Service Charges and included the following areas:

Ref	Audit Area - Description	Comments on Coverage / Area Objectives
1	Policies and Procedures	Policies and procedures in place are comprehensive, up-to-date and available to all relevant members of staff to help staff perform duties in an efficient and effective manner.
2	Identification of Leaseholders	All leaseholders who are liable to pay service charges to the Council are identified by the Council in a timely manner.
3	Identification and Allocation of Attributable Costs	All eligible service charge expenditure is identified and accurately allocated to leaseholders.
4	Estimates and Invoicing	Estimates and invoices are completely, accurately and promptly raised for all leaseholders in line with management and regulatory requirements.
5	Collection	Service charge income received is completely, accurately, and promptly recorded in the authority's accounts.
6	Debt Management	Management are provided with accurate and timely management information regarding outstanding debts and debt recovery activity. Where appropriate, debts are referred to Legal Services. Accounts in arrears are reviewed periodically and any debts deemed irrecoverable are written off.

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## Key risks

Key generic risk factors that affect this service are:

- All Council leaseholders may not be identified and included in service charge calculations
- Leaseholder service charges may not be properly identified, apportioned and recharged
- Income received from leaseholders may not be allocated promptly to the correct account
- Leaseholder services charges may not be recovered in a timely manner

## Limitations to the Scope of the Audit

The internal audit approach was developed through an assessment of risks and management controls operating within the agreed scope. The following procedures were adopted:

- Identification of the role and objectives of each area;
- Identification of risks within each area which threaten the achievement of objectives;
- Identification of controls in existence within each area to manage the risks identified;
- Assessment of the adequacy of controls in existence to manage the risks and identification of additional proposed controls where appropriate; and
- Testing of the effectiveness of key controls in existence within each area.

Management should be aware that our internal audit work was performed in accordance with the Public Sector Internal; Audit Standards which are different from audits performed in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board.

Similarly, the assurance gradings provided in our internal audit report are not comparable with the International Standard on Assurance Engagements (ISAE 3000) issued by the International Audit and Assurance Standards Board.

Our internal audit testing was performed on a judgemental sample basis and focussed on the key controls mitigating risks. Internal audit testing is designed to assess the adequacy and effectiveness of key controls in operation at the time of the audit.

Please note that, in relation to the agreed scope, whilst our internal audit will assess the efficiency and effectiveness of key controls from an operational perspective, it is not within our remit as internal auditors to assess the efficiency and effectiveness of policy decisions.

## Appendix 4: Timetable and Distribution List

Stage	Date
End of Fieldwork	06/01/2020
Draft Report Issued	13/02/2020
Revised Draft Report Issued	04/03/2020
Responses Received	06/04/2020
Final Report Issued	06/04/2020

Audit Team
James Graham – Client Engagement Manager
Dilen Navsaria – Auditor
Auditee
Paul Hayward – Head of Housing Income
Madhav Acharya – Finance Manager (The Economy Department)
Stephen Fitzgerald – Senior Service Charge Accountant
Duncan Cheung – Service Charge Accountant
Client Sponsor
Hitesh Jolapara – Strategic Director of Finance and Governance

Report Distribution List
Hitesh Jolapara – Strategic Director of Finance and Governance
Fiona Darby – Assistant Director of Place Services
Mark Brayford – Assistant Director Direct Delivery
Paul Hayward – Head of Housing Income
Madhav Acharya – Finance Manager (The Economy Department)

The matters raised in this report are only those which came to our attention during our internal audit work and are not necessarily a comprehensive statement of all the weaknesses that exist, or of all the improvements that may be required. Recommendations for improvements should be assessed by management for their full impact before they are implemented. The performance of internal audit work is not and should not be taken as a substitute for management's responsibilities for the application of sound management practices. We emphasise that the responsibility for a sound system of internal controls and the prevention and detection of fraud and other irregularities rests with management and work performed by internal audit should not be relied upon to identify all strengths and weaknesses in internal controls, nor relied upon to identify all circumstances of fraud or irregularity. Auditors, in conducting their work, are required to have regards to the possibility of fraud or irregularities. Even sound systems of internal control can only provide reasonable and not absolute assurance and may not be proof against collusive fraud. Internal audit procedures are designed to focus on areas as identified by management as being of greatest risk and significance and as such we rely on management to provide us full access to their accounting records and transactions for the purposes of our audit work and to ensure the authenticity of these documents. Effective and timely implementation of our recommendations by management is important for the maintenance of a reliable internal control system.

This report is prepared solely for the use of Audit Committees and senior management of the London Borough of Hammersmith and Fulham. Details may be made available to specified external agencies, including external auditors, but otherwise the report should not be quoted or referred to in whole or in part without prior consent. No responsibility to any third party is accepted as the report has not been prepared, and is not intended for any other purpose.