

London Borough of Hammersmith and Fulham

Final Internal Audit Report

Service Charges

February 2017



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1 Introduction

As part of the internal audit plan for 2016/17, agreed by the Audit Pensions and Standards Committee, we have undertaken an audit of Service Charges in the London Borough of Hammersmith and Fulham.

Service charges are levied by Councils to recover the costs incurred in providing services to a building and/or estate. 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 has a statutory duty to write to leaseholders before going ahead with any work where their contribution is likely to exceed £250 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 annual service charge estimated invoices for the year ahead are sent at the 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.

2 Executive Summary

2.1 Assurance Opinion

	Nil	Limited	Satisfactory	Substantial
Audit Opinion (Operations)				
Audit Opinion (Agresso/Income)				

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	1	0
Identification and Allocation of Attributable Costs			0	0	0
Estimates and Invoicing			0	0	0
Collection			1	0	0
Debt Management			*	0	0
Total			1	1	1

*A recommendation relating to Debt Management has been raised in the Collection Area of the scope.

Please refer to the 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 with regards to operations in Leasehold Services.

Since the implementation of Agresso as the Council's financial system in April 2015, the Service Charges team have been unable to identify, pursue and recover outstanding debts as arrears cannot be reliably identified. The Head of Leasehold Services estimates that at the time of the audit approximately £1.5m of income received had not been allocated to the customers' accounts. As such a Limited assurance opinion has been provided for relating to income collection / Agresso.

We have been advised that this has since been addressed, although there are still large numbers of payments being allocated to suspense prior to being allocated to accounts. It is expected that this will be significantly reduced with the introduction of the new cash receipting system process and procedures where payments can only be received quoting a valid outstanding invoice number (this will not apply to BACS or Post Office payments).

Design of and compliance with controls to address the key risks identified

- Policies and procedures are in place for the administration of Service Charges. However, these were written when Cedar/Olas was the finance system as opposed to the Council's current finance system Agresso. The department is awaiting training on the Agresso system before procedures can be re-written.
- A database of all Council leaseholders is held on iWorld. This records the property account number, name of the leaseholder, property address, correspondence address, and the date of sale.
- Legal Services inform the leasehold services 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, it was confirmed in all cases that the leasehold services team had not been notified within a month of the transaction date.
- A spreadsheet is maintained by the Service Charges team, which records works planned on each building/block, and their corresponding costs. The policies and procedures in place provide guidance on which costs should be recharged to leaseholders.
- 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.
- 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 prior to the forthcoming financial year.
- Invoices of actual service charge costs are issued to leaseholders in the 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 previous financial year.

- 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 Town Hall or Post Office.
- The implementation of Agresso at the Council has resulted in operational issues with the monitoring of payments received and outstanding invoices. Management are currently unable to reliably monitor the payment of service charge invoices, as payments received are not always automatically posted against the corresponding invoice raised in Agresso.
- Where this posting fails, payments enter the suspense account, and are subsequently time consuming to allocate. Reconciliations between income expected and income received can be undertaken, but due to the amount of time this activity takes, we were informed it is impractical with the resources the department has in place.
- Aged debtor reports were previously run on a monthly basis prior to the implementation of Agresso. However, due to the issue with payments not posting correctly into Agresso, these reports no longer accurately identify non-payment of Service Charges. The reports are also not distinguishing between the different types of debt which makes focussed recovery action difficult.
- Policies and procedures are in place detailing the debt recovery process. The first stage of the debt recovery process is for reminder letters to be sent to the debtor, and if this fails, the Service Charges team liaise with Legal Services where legal action is required. The Council can then obtain a Judgement and consider its options for recovery which includes approaching the mortgage company. Due to the issues with identifying overdue debtors, no formal recovery action had taken place within the last 12 months.

4 Acknowledgement

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

- Jana Du Preez – Head of Leasehold Services
- Maylene Cave – Service Charge Manager
- Peter Graham – Systems Accountant
- William O'Brien – Team Leader Property Services

Appendix 1: Management Action Plan

1. Policies and Procedures – Implementation of Agresso

Priority	Issue	Risk	Recommendation
Low	Policies and procedures are in place for the administration of Service Charges. However, these were written when Cedar/Olas was the finance system as opposed to the Council's current finance system, Agresso. We were informed that the department is awaiting training on the Agresso system before procedures can be re-written.	Where policies and procedures are not periodically reviewed and updated where required, there is an increased risk of inconsistent and inefficient working practices, and non-compliance with legislation and management requirements.	Policies and procedures relating to the administration of Service Charges should be reviewed, updated and approved by management. If training is required prior to updating procedures, this should be arranged as soon as is practical.
Management Response			
<p>The Leasehold Services team would like the training to take place ASAP but were advised in March 2016 and again in October 2016 by the Agresso Client team that some functionality issues within Agresso will first need to be resolved. We are still awaiting this to happen. The training need is regularly flagged to the Financial Systems Manager and more senior officers in the Agresso Client team.</p> <p>We are however currently in the process of drafting as much of the service charge production process as possible and it will be available on the Intranet by the end of December 2016, but full implementation will not be possible until we have received the Agresso training, we are still waiting for a date for this from the Finance Systems Manager</p>			
Responsible Officer			Deadline
Pete Graham and Jana du Preez			July 2017

2. Identification of Leaseholders – Notification of Lease Sales/Transfers

Priority	Issue	Risk	Recommendation
Medium	<p>From a sample of ten leaseholder sales/transfers tested, in all cases the Service Charges team had not been notified by Legal Services of the change of leaseholder within a month of the transaction date.</p> <p>We were informed that there is currently a backlog of notices to be sent to the Service Charges team.</p> <p>The Head of Leasehold Services is currently negotiating with the Head of Legal Services for these notices to be administered by the Service Charges team.</p>	<p>Where Legal Services do not notify the Service Charges team of a change of leaseholder for a property promptly, there is an increased risk that the Service Charges team cannot invoice the liable party accurately and in a timely manner. This could lead to a financial loss for the Council.</p>	<p>To reduce delays in notification of changes to leaseholders, the Service Charges team should agree working arrangements with Legal Services that will allow for notifications of lease sales/transfers to be received in a timely manner.</p>
Management Response			
<p>The Legal team has recently employed paralegals who are working through the notices and have significantly reduced the backlog. The aim remains for the Service Charge team to administer the notices in future and the Leasehold team has recently gone through a restructure to prepare for this work to be taken over by the team.</p> <p>Leasehold Services and Legal Services have a standing arrangement where all Notices of Assignment are brought up to date before the invoices are issued in March and September to ensure that the invoices are issued correctly. Any RTS invoices are investigated promptly by Leasehold Services and re-issued. The risk to income is therefore minimal.</p>			
Responsible Officer			Deadline
David Walker and Jana du Preez			April 2017

3. Collection – Agresso Income Posting

Priority	Issue	Risk	Recommendation
High	<p>Since the implementation of Agresso as the Council's financial system in April 2015, there have been issues preventing income received from being automatically posted against service charge invoices raised.</p> <p>Reconciliations between income expected and income received can take place, but due to the time it would take to clear the suspense account, we were informed it is impractical with the resources the team currently has in place.</p> <p>As such, the Service Charges team have been unable to identify, pursue and recover outstanding debts as these cannot be reliably identified.</p> <p>The Head of Leasehold Services estimates annual service charge income of around £4m, of which approximately £1.5m was in suspense and yet to be allocated to the customers' accounts. We were informed that the Council has raised these issues with the service provider, BT, however they have not yet been resolved.</p>	Where income collected cannot be reliably matched to invoices, there is a risk that overdue service charge income is not identified and debt recovery action taken leading to financial loss to the Council.	<p>Management should further escalate the issues raised with the service provider, BT, to resolve the functionality issues in Agresso, preventing service charge income from being automatically allocated to service charge accounts.</p> <p>Once resolved, the Council should develop a plan of action to pursue outstanding service charge debts.</p>

Management Response




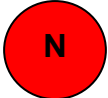
These issues have been repeatedly escalated to BT on several occasions but we have had practically no engagement from them. The issues have also been escalated to the Agresso Client team by the HRD Director of Finance and Resources. This has recently resulted in a project to address the high priority issues. The Financial Systems Manager confirmed on 17th November 2016 Project Update that the suspense account was significantly reduced (100 transactions remaining) and that his team is currently up to date allocating the cash daily.

This has now resulted in money allocated to accounts which needs to be allocated to the individual outstanding invoices. Leasehold Services officers are in the process of completing the backlog. Officers are undertaking ad hoc recovery of arrears and implementing a full recovery plan after the Christmas holiday period.

Responsible Officer	Deadline
Jana du Preez	June 2017

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
	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.
	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.
	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.
	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
High	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.
Medium	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.
Low	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.

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	22/09/2016
Draft Report Issued	29/09/2016
Responses Received	17/02/2017
Final Report Issued	17/02/2017

Audit Team
Client Engagement Manager: James Graham
Auditor: Niall Gilchrist
Auditee
Jana Du Preez – Head of Leasehold Services
Maylene Cave – Service Charge Manager
Peter Graham – Systems Accountant
Client Sponsor
Kath Corbett – Director for Finance and Resources

Report Distribution List
Jana Du Preez – Head of Leasehold Services
Maylene Cave – Service Charge Manager
Peter Graham – Systems Accountant
Copy Recipients of Report
Kath Corbett – Director for Finance and Resources

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.