

# **Internal Audit**

## **Final Report**

**Department of Neighbourhood and Planning**

**Housing**

**Service Charges on Council Properties  
Follow Up**

**28<sup>th</sup> May 2010**

## CONTENTS

	<b>Page</b>
EXECUTIVE SUMMARY	3 - 5
Overview	3
Audit Opinion	4
Medium Risk Issues	4
Risk Profile	5
AUDIT SCOPE AND OBJECTIVES	6
AUDIT FINDINGS	7 - 14
Control Objective 1 – Procedures for the administration of service charges are operated in accordance with statutory requirements and the Council's agreed written policy.	7
Control Objective 2 – Service charges are regularly reviewed and correctly assessed.	9
Control Objective 3 – Service charges are appropriately set, applied accurately to accounts and raised promptly.	13
ACTION PLAN	15 - 16
Explanation of Audit Opinion and Risk Rating	17

### **Distribution List**

Final Report to:

- Corporate Director – Neighbourhood & Planning, Mark Boden
- Service Director – Housing, Graham Hogg
- Head of Housing Management, Derek Streek
- Business Improvement Manager – Housing, John Pearce
- Systems Administrator – Housing, Simon Haugh
- Principal Accountant – Housing, Roz Pike

## EXECUTIVE SUMMARY

### Overview

This internal audit follow up review has been carried out in accordance with the Internal Audit Plan for the financial year 2009/10.

During the financial year 2007/08, an audit of service charges on council properties (sheltered schemes) found a number of significant risks which led to a no assurance being given.

The final report, issued in September 2007, found that a financial review of service charges had been commenced with the aim of providing scheme based details on committed, charged and recovered costs and income. From this work, it was intended to set revised service charges so as to address many of the risks identified in the audit.

In April 2008, the Head of Housing Management confirmed in a follow up request that the financial review had been completed and that revised service charges were applied from April 2008.

A follow up audit was undertaken in January 2009 and the impact on the application of these revised service charges was reviewed. A limited assurance was given as continued weaknesses were found in the system of control, which placed the system objectives at risk.

However, it was found that significant improvements had been made to the system, through the efforts of both Housing Management and Financial Services staff.

Many improvements were in relation to the value of charges applied to tenants; however there continued to be under-recovery of costs through income, resulting in the continued gap between the costs of services provided by the council and income receivable from tenants for these services. This is in part due to the Department for Communities and Local Government placing restrictions on the proportion or percentage with which councils can increase its charges to meet costs.

Nevertheless, on previous years, this funding gap had been reduced, with the intended further reduction year on year, as charges are increased over and above inflation in line with council policy and within the restrictions posed by government.

At the date of the last follow up audit, several key areas of weakness were found, the two principal risks identified were:

- The lack of a comprehensive and consistent charging policy to ensure transparency and equality in the application of service charges across all sheltered housing tenants means that the basis for the establishment of charges open to challenge, and the council may be in breach of statutory requirements.
- The incomplete identification and allocation of actual costs and income by scheme, and the limited extent of coding to those schemes within the ledger, thereby restricting the opportunity to obtain management information on the true costs of each scheme.

In this year's follow up audit, we have focused on those areas of weakness and risk identified in previous years' audits, which have continued to persist across the years, and therefore the scope of this audit has been written with these in mind. The **Action Plan on pages 15 and 16** of this report shows the risks identified during this audit which we believe require consideration by managers.

Managers have been requested to complete this section of the report by carrying out their own risk assessments in terms of impact and likelihood using the four point scales as detailed in the **Risk Profile section on page 5**. Managers were also asked to show what actions they will be taking, if any, to manage the identified risks, as well as the target dates for the completion of these actions.

## Audit Opinion

The Internal Audit opinion for Service Charges on Council Properties is a substantial assurance. This means that whilst there is a basically sound system of control, there are weaknesses which may put some of the service objectives at risk.

The following Action Plans have been proposed by management to ensure that risk management strategies are put in place to avoid or reduce the identified risks, and to ensure that any residual risks are appropriately managed to reduce any impact or likelihood of these risks materialising. Frequent monitoring of the management of identified risks is essential.

### Medium Risk Issues (as risk rated by service management)

Risk	Action Proposed by Management	Profile Ref
Failure to formally finalise and adopt policies and procedures risks challenge to their enforceability, inconsistencies in implementation and non-compliance with legislation.	The draft policy and procedures will be updated and put before Cabinet by December 2010.	1
Due to restrictions placed on the council by Housing legislation, and previous inadequate increases in charges to tenants, the council will be unable to levy charges and recover adequate income to meet all reasonable service costs associated with the fulfilment of its responsibilities.	We will continue with our policy of reducing the deficit annually.	2
Not allocating all costs and income to schemes undermines the provision of effective financial management information.	We will work with our colleagues in Finance to improve the information they make available to us.	4
Inadequate and incomplete financial information on the performance of schemes precludes proper review, because transactions are not correctly identified and allocated in the ledger.	We will work with our colleagues in Finance to improve the information they make available to us.	5

One low risk issue has also been identified. This is discussed in the Audit Findings section and Action Plan included in the body of this report.

## Risk Profile

The following profile shows management's assessment of the likelihood and impact of the risks identified during the audit.

The numbers stated on the risk map refer to the risk references identified above, as well as to any low level risks detailed in the body of the report.

<b>Impact</b>	<b>Significant</b>	<b>L</b>	<b>M</b>	<b>H</b>	<b>H</b>
	<b>Moderate</b>	<b>L</b>	<b>M</b> <b>Risk 1</b>	<b>M</b>	<b>H</b>
	<b>Minor</b>	<b>L</b>	<b>L</b> <b>Risk 3</b>	<b>M</b>	<b>M</b> <b>Risks 2, 4 and 5</b>
	<b>Insignificant</b>	<b>L</b>	<b>L</b>	<b>L</b>	<b>L</b>
		<b>Rare</b>	<b>Unlikely</b>	<b>Possible</b>	<b>Almost Certain</b>
		<b>Likelihood</b>			

## **AUDIT SCOPE AND OBJECTIVES**

### **Audit Scope**

To undertake and follow up review and to provide assurance that the systems of internal control established for the administration of Service Charges on council owned properties are operating adequately and effectively.

### **Control Objectives**

The objectives of the audit are to seek assurance that:

1. Procedures for the administration of service charges are operated in accordance with statutory requirements and the Council's agreed written policy.
2. Service Charges are regularly reviewed and correctly assessed.
3. Charges are appropriately set, applied accurately to accounts and raised promptly.

## AUDIT FINDINGS

### Control Objective 1:

**Procedures for the administration of service charges are operated in accordance with statutory requirements and the Council's agreed written policy.**

#### 1.1 Service Charges Policy

In 2007, both the Head of Housing Management and the Head of Strategic Housing Services expressed serious concerns regarding the administration of service charges and the current budget deficit arising from the insufficient level of cost recharges. It was found that current charges were not based on a planned rational policy.

In January 2008, a new charging regime was calculated out by Financial Services for application from April 2008. This regime sought to reduce the deficit year on year over a number of years. Rates of increase were set based on an assessment of actual increases incurred by the council.

From April 2008, utilities charges were increased by 10% and water charges by 5%. Inflation was 3.9%. In April 2009, utilities charges were increased again by 8%. Inflation currently stands at 2.9%.

Following the 2007/08 internal audit of service charges, and in November 2008, the Housing Manager produced a draft Policy for Service Charges in Council Owned Sheltered Schemes. This policy reflected the service objectives and the need to reflect actual costs as far as possible in charges, with the aim of ensuring that tenants pay for services actually received. This draft policy was reviewed in December 2009, and some updating is now required.

Under the move to One Council, as the policy remained unchanged as Salisbury is the only former district with such properties, it was advised that formal adoption by the new WC Implementation Executive was unnecessary. Therefore, this policy has never been finalised nor formally adopted by either the former Salisbury District Council or Wiltshire Council.

#### **Risk 1**

**Failure to formally finalise and adopt policies and procedures risks challenge to their enforceability, inconsistencies in implementation and non-compliance with legislation.**

#### 1.2 Service Charges Procedures

In 2007, in addition to the absence of any policy on service charges, written procedures did not exist on the administration of these charges. Full written procedures are a key control to ensure that all staff involved in the administration of service charges are able to apply the policy consistently. Housing management agreed that full written procedures should be generated as soon as a new charging regime had been agreed and was being implemented.

In November 2008, the Housing Manager produced draft Service Charge Procedures for consultation. These procedures included information on what services are included and how income and expenditure are to be accounted for. Consideration was given to the terms of tenants' rent agreements as well as to applicable housing and rent legislation. These draft procedures were reviewed in December 2009, and some updating is now required.

As for the draft policy, under the move to One Council, it was advised that formal adoption by the new WC Implementation Executive was unnecessary, as the policy remained unchanged as Salisbury is the only former district with such properties. However, again this means that the procedures have never been finalised nor formally adopted by either the former Salisbury District Council or Wiltshire Council.

**Risk 1**

As per section 1.1 above.

**Control Objective 2:**

**Service Charges are regularly reviewed and correctly assessed.**

**2.1 Compliance with Legislation**

The Head of Housing Management and the Head of Financial Services stated in their report to Cabinet on Wednesday 28<sup>th</sup> January 2009 that service charges and utility recoveries have “been subject of a thorough review in 2007/08.... It will lead to convergence of costs and income on these elements..... [as] approved by the tenant panel and sheltered housing forum”.

Therefore, over the next few years the HRA will continue to subsidize service charge costs, although in ever decreasing amounts, and a policy is in place to eliminate subsidization in due course. This has been agreed with interested parties, and will limit the extent of annual increases to tenants.

**2.2 Maintenance of Records**

Records are maintained by the Housing Systems Administrator, who administers the Housing databases, and who ensures that an up to date list of all tenants is known. However, the charges included in these records for tenants only include some utility and premises costs, such as heating, hot water, light, water, communal utilities and rebatable service charges. Costs in relation to telephones, window cleaning and grounds maintenance, for example, are not included.

**2.3 Charging of Costs to Tenants**

Service charges were increased by a maximum of RPI with effect from 1<sup>st</sup> April 2009, as assessed in the subsidy determination, with utility recharges being increased by a maximum of utility inflation plus £1 per week. A similar increase occurred in April 2008.

These increases should lead to a convergence of service costs and income receivable from tenants to address the fact that, in previous years, charges applied to tenants have been inadequate in meeting the costs of the administration, maintenance and servicing of the sheltered schemes.

Indeed, the deficit on service charges funded from the HRA was:

£457,441 in 2006/07  
£453,814 in 2007/08  
£417,613 in 2008/09

A month 12 review of service charges costs against income received revealed that the deficit for 2009/10 will be approximately £230k. This will be a further reduction in the deficit on the previous year.

**Risk 2**

**Due to restrictions placed on the council by Housing legislation, and previous inadequate increases in charges to tenants, the council will be unable to levy charges and recover adequate income to meet all reasonable service costs associated with the fulfilment of its responsibilities.**

## 2.4 Charging of Costs to Tenants – Sampled Scheme

Housing management have only partially accurate information on the true costs and incomes being incurred and received from tenants in relation to each of the sheltered schemes. Consequently, no clear judgement can be made on whether a scheme is being run on a financially sound basis or whether income is being forgone.

From information gathered when looking at all schemes, further review and analysis in relation to a sampled scheme, Downside, found that discrepancies still exist between the various costs charged to tenants. For example:

- The usual rent debit of £63.09 per week is not charged to 4 tenants who each pay a different amount. i.e. No 3 = £63.92; No 8 = £64.34; No 11 = £61.43 and No 16 = £63.92. It is noted however, that this is a historical discrepancy, which will be standardised across the scheme by 2017.
- One of the 14 tenants (No 10) is not charged for communal utilities, whilst all other tenants are charged £3 per week. This is in error.
- The usual REBSC of £8.19 per week is not charged to 6 tenants who each pay a different amount. i.e. No's 3, 8, 11 and 16 = £6.28; No 10 = £11.28 and No 18 = £8.28. Again, these discrepancies are historical with the exception of No 10, and standardisation should occur by 2017.

Therefore, current charging within this scheme, and as is likely in other schemes also, still fails to ensure equality amongst tenants in the charges levied.

### Risk 3

**Failure to ensure consistency in charges applied within schemes risks an inability to prove the basis for the establishment of charges levied, rendering the council open to challenge by tenants.**

## 2.5 Recording Costs and Income in the Ledger

A spreadsheet was set up to allocate and appropriately apportion all costs charged to all of the 23 sheltered schemes for the year to date (as at week 50), both directly to cost centres 79120 to 79340 and indirectly to cost centres 79360 (Landlord Costs) and 79370 (Grouped Costs). The allocations and apportionments were made as follows:

Cost Type	Cost Element	Cost Centre	Method of Apportionment
Utilities	200000 to 450000	79120 to 79340	Direct allocation
Direct income	720000	79120 to 79340	Direct allocation
Landlord costs	100000 to 434100	79360	Number of properties
Landlord recharges	660000 to 660039	79360	Number of schemes
Landlord income	720000 to 720063	79360	Number of properties
Grouped costs	100000 to 434100	79370	Number of properties
Grouped recharges	660000 to 661001	79370	Number of schemes
Grouped income	720055 and 721370	79370	Number of properties
SP income	720057	79370	Number of non HB tenants

An improvement on the previous years' audit findings is the direct allocation of all utilities costs, to their appropriate schemes. However, all landlord and grouped costs and income are still being charged to central codes (79360 and 79370 respectively).

Until appropriate apportionment bases are identified and applied to these costs and income, so as to allow their coding to scheme cost centres, the full cost of each scheme to the council cannot be properly known.

It is essential that whilst the council seeks to bring about a breakeven position for the schemes, tenants' costs are only increased in proportion to their scheme's contribution.

To achieve this, and ensure that the distinct characteristics of each scheme, their size, numbers of residents, utility types and maintenance needs are taken into account, it is important that:

- All invoices received are adequately detailed to allow accurate coding;
- All income received is coded to the scheme to which it relates;
- Appropriate apportionment bases are identified and applied to landlord and grouped costs and income;
- Schemes are considered independently when increases in charges are applied, so as to relate only that scheme's service costs;

The council must continue to ensure that within a few years, all reasonable costs associated with the fulfilment of the council's responsibilities and obligations are being recharged.

#### **Risk 4**

**Not allocating all costs and income to schemes undermines the provision of effective financial management information.**

### **2.6 Recording Costs and Income in the Ledger - Sample Scheme**

For Downside, it was found that service charge debits charged to tenants and applied to the rent accounts in Simdell total £27,690 in the full year. However, the full year costs charged in SAP (as at week 50) total just £16,010.

Furthermore, service charge credits received from tenants and applied to the rent accounts in Simdell exceeds £27,690 by a few pounds in the full year. However, the full year income received in SAP (as at week 50) was just £30.

Therefore, there is little correlation between the figures in Simdell and those entered into SAP. This is because many charges and income are still being coded centrally (to Landlord 79360 and Grouped 79370), and until direct coding of costs and income is implemented, details within Simdell will not be reflected within SAP.

If appropriate apportionment bases are applied to all landlord and grouped costs, an assessment can be made as to whether the true costs of the scheme are being charged out as rent and service charges on the rent accounts.

A simple exercise was undertaken for Downside (cost centre 79250), with the direct and apportioned allocation of costs and income. It was found that the total net cost for the scheme was approximately £18,250:

	<u>£</u>
Direct Utilities	16,010
Direct Income	- 30
Apportioned Landlord Costs	1,829
Apportioned Grouped Costs	15,279
Apportioned Landlord Income	-10,608
Apportioned Grouped Income	- 10
Supporting People Income	<u>- 4,223</u>
Net Total Cost	18,247

A comparison of costs and income actually charged to this scheme's ledger code, against those chargeable by apportionment (as an example), and with those actually recorded in the Simdell rent accounts, found the following:

	<u>Costs</u> <u>£</u>	<u>Income</u> <u>£</u>	<u>Discrepancy</u> <u>£</u>
Ledger (actual)	16,010	30	15,980
Ledger (apportioned)	33,118	14,871	18,247
Database (Simdell)	27,690	27,905	- 215

This shows that whilst all costs actually being charged on the rent accounts is being recovered from tenants through a mixture of tenant payments, Housing Benefit and supporting people income, actual costs and income on SAP do not reflect these charges and receipts accurately.

It is important for enabling effective financial management for all actual costs and income to be allocated to individual schemes within SAP.

#### **Risk 5**

**Inadequate and incomplete financial information on the performance of schemes precludes proper review, because transactions are not correctly identified and allocated in the ledger.**

**Control Objective 3:**

**Charges are appropriately set, applied accurately to accounts and raised promptly.**

**3.1 Setting of Charges and Application to Accounts**

Testing was undertaken to determine whether adequate records are kept of all liable clients and that charges are applied to rent accounts on a weekly basis. Two properties were selected at random from each scheme, a total of 46 properties in all.

Testing in this year's audit found greatly improved consistency, pattern and apparent equality in the types of charges incurred by tenants and the cost to tenants of these various charges.

However, a few anomalies were found in 3 of the 23 schemes (Downside, Westwood House and Norfolk Road) where tenants appeared to have been charged incorrectly, or at least inconsistently and inequitably, in relation to rebatable service charges.

Of the 23 schemes, 20 schemes have tenants paying the same charge (over 20 different tariffs ranging from £2.54 to £8.19), whilst 3 schemes had tenants paying differing charges:

- Downside Nos 3 & 5: £6.28 & £8.19
- Westwood House Nos 5 & 6: £3.01 & £4.72
- Norfolk Road Nos 60 & 62: £4.56 & £5.82

As stated in section 2.4 above, it is recognised that these are historical discrepancies, which will be standardised across the scheme by 2017. However, the continued failure of the council to charge all tenants with the costs of services rendered in a consistent and equitable manner, means that the council is missing the opportunity to recover some of its costs.

**3.2 Statistical Data on Annual Average Service Charges**

As part of the previous years' audits, a statistical report has been run to compare the annual average service charges on sheltered schemes levied by non-metropolitan district councils in England, as compared to those levied by Salisbury.

In respect of 2009 data, it was confirmed that data was submitted under the name of the former Salisbury District Council on 14<sup>th</sup> April 2009. However, a review of the CIPFA Stats website, where comparative snapshots can be viewed of an authority against a selected group of other authorities, found that Salisbury data was not included. The reason for this absence of data should be investigated with CIPFA.

It is highly recommended that Housing Management continue to collect data and submit these statistics to CIPFA, as it provides Housing Management with a powerful tool for comparisons with other similar authorities and the charges set by them.

Despite the lack of data on the website, submission documentation nevertheless enables some comparison. Upper and lower quartile figures are £14.03 and £4.27 respectively, and the median charge is £7.72:

<b>Rank</b>	<b>Local Authority</b>	<b>Charge £</b>
1	Babergh	31.71
9	Taunton Deane	14.50
17	New Forest	7.92
<b>24</b>	<b>Salisbury</b>	<b>7.72</b>
31	South Kesteven	1.48

It was found that in 2008, Salisbury ranked 21 out of 30; the highest charge being £37.07, Salisbury's being £6.70 and the lowest being £1.38, with Salisbury's charge in the lower quartile.

Over the year, although Salisbury's ranking has diminished, it is noted that the charge has risen from the lower quartile to equalling the median.

**ACTION PLAN**

<b>Risk Ref</b>	<b>Cross Ref</b>	<b>Risk &amp; Implications</b>	<b>Audit's Risk Rating</b>	<b>Management's Risk Rating</b>	<b>Action Proposed by Management</b>	<b>Responsible Officer and Target Date</b>
1	1.1 and 1.2	Failure to formally finalise and adopt policies and procedures risks challenge to their enforceability, inconsistencies in implementation and non-compliance with legislation.	<b>Medium</b>	<b>Medium</b> Impact: Moderate Likelihood: Unlikely	The draft policy and procedures will be updated and put before Cabinet by December 2010.	Business Improvement Manager  December 2010
2	2.3	Due to restrictions placed on the council by Housing legislation, and previous inadequate increases in charges to tenants, the council will be unable to levy charges and recover adequate income to meet all reasonable service costs associated with the fulfilment of its responsibilities.	<b>Medium</b>	<b>Medium</b> Impact: Minor Likelihood: Almost certain	We will continue with our policy of reducing the deficit annually	Head of Housing Management / Central Finance  September 2010
3	2.4	Failure to ensure consistency in charges applied within schemes risks an inability to prove the basis for the establishment of charges levied, rendering the council open to challenge by tenants.	<b>Low</b>	<b>Low</b> Impact: Minor Likelihood: Unlikely	We will investigate any anomalies and adjust where appropriate	Systems Administrator – Housing  July 2010

Risk Ref	Cross Ref	Risk & Implications	Audit's Risk Rating	Management's Risk Rating	Action Proposed by Management	Responsible Officer and Target Date
4	2.5	Not allocating all costs and income to schemes undermines the provision of effective financial management information.	<b>Medium</b>	<b>Medium</b> Impact: Minor Likelihood: Almost certain	We will work with our colleagues in Finance to improve the information they make available to us	Head of Housing Management / Central Finance  September 2010
5	2.6	Inadequate and incomplete financial information on the performance of schemes precludes proper review, because transactions are not correctly identified and allocated in the ledger.	<b>Medium</b>	<b>Medium</b> Impact: Minor Likelihood: Almost certain	We will work with our colleagues in Finance to improve the information they make available to us	Head of Housing Management / Central Finance  September 2010

## Explanation of Audit Opinion and Risk Rating

### Audit Opinion

**Full Assurance** – There is a sound system of control designed to achieve the service objectives, with key controls being consistently applied.

**Substantial Assurance** – Whilst there is a basically sound system of control, there are weaknesses which may put some of the service objectives at risk.

**Limited Assurance** – Weaknesses in the system of control are such as to put service objectives at risk.

**No Assurance** – Control is generally weak leaving the system open to significant error or abuse.

### Risk Profile Matrix Rating

**Red** = High Risk

High level risks are significant risks to the effective delivery of the service. Risk management strategies should be put in place to appropriately manage the identified risks within a short timescale. Frequent monitoring of the management of identified risks is essential.

**Amber** = Medium Risk

Medium level risks are risks which must be managed to ensure the effective delivery of the service. Monitoring of the risk should be regularly undertaken.

**Green** = Low Risk

Low level risks are risks which are not considered significant to the effective delivery of the service, but which should nevertheless be managed and monitored using existing management processes.