

Final Internal Audit Report

Housing - Leaseholder Service Charges 2022/23

October 2022

Distribution: Corporate Director of Housing
Interim Head of Tenancy & Resident Engagement
Operational Manager
Operational Manager
Corporate Director of Resources & S151 Officer

Assurance Level	Issues Identified	
Limited Assurance	Priority 1	1
	Priority 2	4
	Priority 3	2

Confidentiality and Disclosure Clause

This report ("Report") was prepared by Mazars LLP at the request of London Borough of Croydon and terms for the preparation and scope of the Report have been agreed with them. The matters raised in this Report are only those which came to our attention during our internal audit work. Whilst every care has been taken to ensure that the information provided in this Report is as accurate as possible, Internal Audit have only been able to base findings on the information and documentation provided and consequently no complete guarantee can be given that this Report is necessarily a comprehensive statement of all the weaknesses that exist, or of all the improvements that may be required.

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Please refer to the Statement of Responsibility in Appendix 3 of this report for further information about responsibilities, limitations and confidentiality.

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3. Statement of Responsibility

1. Introduction

- 1.1 The London Borough of Croydon ('the Council') currently owns and manages 863 freeholds, & 2600 Leaseholders for which it charges leaseholders/freeholders an annual service charge to cover a variety of services. The Council operates a variable service charge model and service charges are calculated in arrears to ensure the correct cost is passed on to the leaseholder. The service charge is typically calculated based on the following services provided:
- | | |
|--|---|
| a) Energy | f) Entry Phone maintenance (where applicable) |
| b) Communal Heating | g) Repairs and maintenance to block or estate |
| c) Landscape Services | h) Management and administration |
| d) Caretaking and Cleaning | |
| e) Lift maintenance (where applicable) | |
- 1.2 In respect of maintenance and improvement costs, the Council requires all leaseholders to pay a reasonable amount towards these costs. Charges for major building works can also be recharged to leaseholders; however, the Council cannot carry out such works (costing in excess of £250 per leaseholder) without first consulting with leaseholders as required by the Landlord & Tenant Act 1985 (as amended). In addition, leaseholders are charged contributions towards any major works that are completed under Section 20 of the Landlord and Tenant Act 1985.
- 1.3 Croydon's Leasehold & Home Ownership team is responsible for managing leaseholders' service charges. The team is made up of ten employees (both full-time employees and part-time employees), which the Operational Manager oversees.
- 1.4 At the time of the audit, the Council had approximately 863 freeholders and 2,600 leaseholders with a service charge. The annual service charge, ground rent and insurance amounted to £2,254M and previous years accumulated major works of £7,926M in the financial year 2021/22 (major works raised since 2005 figure).
- 1.5 The Council has the following policies relating to this area, accessible by staff on SharePoint:
- Leaseholders Guide
 - Arrear monitoring
 - Consultation team S20 procedure
 - Leaseholder dispute procedure
 - Direct debit procedure
 - Ground rent procedure

- Leasehold service charge team procedure and chart flow
- 1.6 This audit does not constitute a service charge audit under Tech 03/11 Residential Service Charge guidance and we have not validated the costs associated with the service charges. This audit also excludes tenant service charges, a separate audit having been performed in this area.
 - 1.7 While our review and testing were performed remotely, we have been able to obtain all relevant documents required to complete the review.
 - 1.8 The audit was undertaken as part of the agreed Internal Audit Plan for 2022/23. The objectives, approach and scope are contained in the Audit Terms of Reference at Appendix 1.

2. Key Issues

Priority 1 Issue

An error was identified in the 2021/22 service charge calculation relating to the repairs and maintenance element of the service charge. **(Issue 3)**

Priority 2 Issues

The departmental policy and procedures need to be reviewed and updated to reflect current practice and legislation. **(Issue 1)**

Webforms and guidance was unavailable for leaseholders wanting to raise comments, complaints and complements. **(Issue 2)**

Service charge calculations were only reviewed by a junior officer and evidence of this check was not recorded. **(Issue 4)**

The major works consultation process was not available to leaseholders on the Council's website. **(Issue 5)**

Priority 3 issues are included under section 4 below.

3. Actions and Key Findings/Rationale

Control Area 1: Legislative, Organisational and Management Requirements

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 1
2	<p>We hold several procedure notes and flow charts to cover all the Leasehold services procedures, staff have access to all these through SharePoint.</p> <p>As we are shortly going to be using a new system NEC, the procedures will require updating to relate the changes in working through the new system.</p> <p>This will have to be a work in progress with NEC and will be a large document each section will have to have a review date.</p> <p>This will be a major project and we will require additional resources to action this.</p>	<p>Expected Control</p> <p>An effective processes and procedures manual provides a way to communicate and apply consistent standards and practices within the Council's operations. It is important that this is up to date and that the practices and procedures are relevant and consistent with the legislation and the Council's operations framework.</p> <p>Issue/Finding</p> <p>The Leasehold & Home Ownership Team did not have a consolidated Standard Operating Procedure but had various policy and procedure documents that they used.</p> <p>A Leaseholder Guide was in place and was published in September 2007 (available as a PDF document and a webpage). A Leaseholders Services Collection – Procedures document was also in place and last reviewed in December 2017. There was no evidence that this had been reviewed after this date and it did not include any revision chart to demonstrate when this document was last reviewed and/or updated and the date for future review. We have not reviewed the adequacy of the policies and procedures.</p> <p>In addition to the above the team have a series of other procedure documents saved on their SharePoint piecemeal, such as:</p> <ul style="list-style-type: none"> • Arrears monitoring

Responsible Officer	Deadline	
Operational Manager / Development Officer	NEC procedure 1-Dec-22 One document Without extra resources no date to provide	<ul style="list-style-type: none"> • Consultation team S20 procedure • Leaseholder dispute procedure • Direct debit procedure • Ground rent procedure • Leasehold service charge team procedure and chart flow <p>Each of the documents standalone individually and were not grouped into a single manual containing page numbers and version controls.</p> <p>Risk</p> <p>Where policies, procedures, and guidance are not reviewed and, where appropriate, updated, there is a risk of inconsistent practices and the Council may not be in compliance with regulatory requirements. When key staff are absent, other staff may be unable to undertake actions required regarding services correctly or consistently.</p>

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 2				
2	<p>We can add this onto our web page.</p> <p>Compliments and complaints – there is currently no area on our page for this – we can create one and add the link Customer feedback and complaints form Croydon Council</p>	<p>Expected Control</p> <p>Compliments and complaints provide insight into what is working well and what is not working as well as it should be and create an opportunity to improve the current process. The process should be available and accessible to leaseholders.</p> <p>Issue/Finding</p> <p>According to the leaseholder's handbook, compliments, comments and complaints can be made using the Council's online feedback form, which can be found on the Council's website. The audit found that the webpage was no longer available, and leaseholders were not informed on how they can send feedback or complaints to the Service.</p> <p>Risk</p> <p>Where leaseholders are not informed on how to send in compliments, comments and complaints, there is a risk that the Service would not receive compliments, comments and complaints, and the opportunity to improve processes may not be explored.</p>				
	<table border="1"> <thead> <tr> <th>Responsible Officer</th> <th>Deadline</th> </tr> </thead> <tbody> <tr> <td>Operational Manager / Development Officer</td> <td>31-Oct-22</td> </tr> </tbody> </table>	Responsible Officer	Deadline	Operational Manager / Development Officer	31-Oct-22	
Responsible Officer	Deadline					
Operational Manager / Development Officer	31-Oct-22					

Control Area 3: Billing & Collection of Ground Rents and Service Charges

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 3
1	<p>Agree the current arrangement of the Operational manager calculating the service charge should be done by a Leasehold officer and checked by the manager. Or if this is not possible the charges calculated by the Operational manager should be signed off by the Head of service.</p> <p>It is currently within the Operational managers job description to do the calculation of the end of year service charges and this is not included in the Leaseholders JD.</p> <p>The 2022/23 service charge calculations will be passed to the Head of service for checking and sign off at the end of year.</p> <p>May 2023 is the next time for service charge calculations.</p>	<p>Expected Control</p> <p>Leasehold service charges should be calculated by an officer and reviewed by a more senior officer. Segregation of duties is a proactive control activity to reduce the risk of error or fraud by requiring that more than one person is involved in completing a particular process. As per the Council’s Annual Service Charge Calculations Procedure, the annual service charge is calculated in arrears so that leaseholders’ charge is accurate with the actual cost of prior years’ services, including any repairs and maintenance costs.</p> <p>Issue/Finding</p> <p>We recalculated the leaseholder service charge for ten randomly selected leaseholder service charges in 2021/22 to ensure that these were charged the right amount. Nine of the ten service charges were recalculated to the same amount charged. In one exception, the leaseholder had not been charged the repairs and maintenance element that should have been included.</p> <p>The Leaseholder and Home Ownership acknowledged that the exception was an error and no explanation was provided with reasons for the charge being omitted. As this error was detected through sampling, further errors may exist.</p> <p>Risk</p> <p>Where errors occur and are not detected, there is a risk that leaseholders are not charged the correct amount. This may result in financial loss for the Council.</p>

Leaseholder Service Charge 2022-23

Responsible Officer	Deadline	
Operational Manager	Jun -23	

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 4
2	<p>The process of new sold and assignments will change within the new NEC system and the updating of the system will be done by the Leasehold services officer and the Operational manager will check this has been completed as per the procedures for the new system.</p> <p>Agreed Leasehold officer will refer to Operational manager/Head of service for check off.</p>	<p>Expected Control</p> <p>Leasehold service charges should be calculated by an officer and reviewed by a more senior officer; likewise, creating new sold/right to buy and the assignment of new leaseholders' accounts on OHMS should be done by an officer and reviewed by a more senior officer. Segregation of duties is a proactive control activity to reduce the risk of error or fraud by requiring that more than one person is involved in completing a particular process.</p> <p>Issue/Finding</p> <p>We observed that the service charge calculation process included segregation of duties between preparation of service charge calculations and review of the charges.</p> <p>However, upon examination of the calculations for 2021/22 and interviews with management, we identified that the service charges were calculated by the Operational Manager – Leasehold and Home Ownership and reviewed by a junior officer within the team. Furthermore, there was no supporting evidence to demonstrate that these checks took place.</p> <p>Separately, where there is a newly sold council property or a new right to buy, the Development Officer (Leasehold) creates the property on OHMS, which a more senior officer does not review to ensure there are no errors. The Operational Manager is responsible for the assignment of the leases and then assigns the leaseholders' account on OHMS. This also is not reviewed and signed off by a more senior officer to ensure there are no errors.</p> <p>Risk</p>

Leaseholder Service Charge 2022-23

Responsible Officer	Deadline	
Operational Manager	Ongoing from Nov 22 with new NEC system.	Where there is no segregation of duties, or segregation involves a junior officer reviewing a more senior officers work, there is a risk that error could go undetected or unchallenged, resulting in financial loss to the Council. Where appropriate level of authority is not responsible for reviewing and signing off service charge calculations, there is a risk that errors may go undetected leading to financial loss for the Council.

Control Area 4: Major Work Recharges

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 5
2	Review of the website information – to update the major works consultation information.	<p>Expected Control</p> <p>There should be clear guidance on the major works consultation process, and leaseholders should have adequate information about their rights at the consultation stage. Where practices have changed, the guidance document and Council's webpage should be updated to reflect current practices. According to the information on the Council's website (consulting with leaseholders), the Council will consult leaseholders regarding planned repairs with an estimated cost of over £250 per leaseholder. The consultation process involves:</p> <p>Letter 1 - Notice of Intent, which includes details of work to be carried out within a 30-day consultation window.</p> <p>Letter 2 - Section 20 Notice. Details of the two lowest quotes received an estimate of the size of the individual leaseholder's contribution, and a further 30-day consultation.</p> <p>Letter 3 – Details the qualifying works being carried out under an existing long-term agreement)</p> <p>Issue/Finding</p> <p>Examination of a sample of ten major works during 2021/22 confirmed that the letter 1 and schedule letter 3 were issued to all leaseholders sampled. A letter two was not required to be issued as all works were completed under an existing long-term agreement, however the agreement was over ten years and has not been subject to retender to assess best value.</p> <p>In addition, whilst the schedule 3 letter is in line with the S20 Leaseholder Consultation toolkit, as per the Landlord and Tenant Act 1985, the Council’s Leaseholder Handbook</p>

Responsible Officer	Deadline	and webpage on leaseholder consultations do not contain these details. The Council's website details that competitive tenders are required for major works and that the Council will usually select the lowest price.
Operational Manager / Development Officer	April 23	<p>Risk</p> <p>Where the major works and repair works are not retendered within a reasonable contract period, there is a risk that value for money is not achieved.</p> <p>Where guidance is not updated and clear, there is a risk of inconsistent practices and unrealistic leaseholders' expectations, leading to leaseholders dis-satisfaction</p>

5. Priority 3 Issues

Agreed action	Findings
<p>Control Area 3: Billing & Collection of Ground Rents and Service Charges</p> <p><u>Action proposed by management:</u></p> <p>Continue with KPI monthly reports to be sent to Head of service and will include comments on the collection rate and any concerns about this.</p> <p>NEC system will change the way we work and how we report arrears figures.</p>	<p>Expected Control</p> <p>In order to help monitor performance and the effectiveness of the Service in achieving its objectives, appropriate performance indicators should be in place, which is regularly monitored and, where appropriate, actions taken to improve the performance of these.</p> <p>Issue/Finding</p> <p>The Operation Manager Leasehold & Home Ownership team produces a KPI report, which is sent to the Directorate monthly. The report contains the current arrears and a 3-yr variance (%) in arrears. The report did not; however, contain commentaries and other KPIs on the arrears collection procedure.</p> <p>Risk</p> <p>Where KPIs are not properly monitored, there is a risk that the performance of the Service does not improve and, in worst-case scenarios, deteriorates.</p>
<p>Control Area 4: Major Work Recharges</p> <p><u>Action proposed by management:</u></p> <p>Continue with the Leasehold services officer calculating the final major works accounts and send the Operational manager for checking and sign off. This is the current procedure and there</p>	<p>Expected Control</p> <p>Major works charges should be calculated by an officer and reviewed by a more senior officer before the final account charges are sent to the leaseholders, and evidence of review should be documented.</p> <p>Issue/Finding</p> <p>A review of a sample of five major works calculations charged to leaseholders during 2021/22 showed that the calculations were correct as per the contractor's cost schedule, which was then apportioned to the</p>

Agreed action	Findings
<p>is a form for which the figures are prepared and sent to the Operational manager for signing.</p>	<p>number of habitable rooms where applicable. However, we noted that the final cost calculation schedule breakdown for four of the five leaseholders was not reviewed by a senior officer and then signed off as correct.</p> <p>Risk</p> <p>Where an appropriate level of authority is not responsible for reviewing and signing off major works calculations, there is a risk that errors may go undetected, leading to financial loss for the Council.</p>

TERMS OF REFERENCE

Housing - Leaseholder Service Charges

1. INTRODUCTION

1.1 The London Borough of Croydon ('the Council') currently owns and manages a variety of different housing property types, which it rents out. Some of the tenants, under the Right to Buy scheme have purchased these properties and through this process are now leaseholders.

1.2 Service charges are the process the Council uses to recover the proportion of maintenance and improvement costs the leaseholder is liable for. These include cleaning, maintaining, and repairing the exterior and communal parts of the building. The Council requires all leaseholders to pay a reasonable amount towards these costs.

Service charges are made up of several different items. The main items are listed below, but not all items will be applicable to every home with a service charge:

- Ground rent
- Energy
- Communal heating
- Landscape (Horticultural) Services
- Caretaking and Cleaning
- Lift Maintenance (where applicable)
- Entry Phone Maintenance (where applicable)
- Repairs and Maintenance to the Block
- Repairs and Maintenance to the Estate
- Management and Administration
- Major Repairs and Improvements

1.3 This audit is being undertaken as part of the agreed Internal Audit Plan for 2022/23.

2. OBJECTIVES AND METHOD

2.1 The overall audit objective is to provide an objective independent opinion on the adequacy and effectiveness of controls / processes.

2.2 The audit will for each controls / process being considered:

- Walkthrough the processes to consider the key controls;
- Conduct sample testing of the identified key controls; and
- Report on these accordingly.

3. SCOPE

3.1 This audit included the following areas (and issues raised):





Control Areas/Risks	Issues Raised		
	Priority 1 (High)	Priority 2 (Medium)	Priority 3 (Low)
Legislative, Organisational and Management Requirements	0	2	0
Leaseholder Records	0	0	0
Billing & Collection of Ground Rents and Service Charges	1	1	1
Major Work Recharges	0	1	1
Retention of Records & Information	0	0	0
Total	1	4	2

Appendix 2

Definitions for Audit Opinions and Identified Issues

In order to assist management in using our reports:

We categorise our **audit assurance opinion** according to our overall assessment of the risk management system, effectiveness of the controls in place and the level of compliance with these controls and the action being taken to remedy significant findings or weaknesses.

	Full Assurance	There is a sound system of control designed to achieve the system objectives and the controls are constantly applied.
	Substantial Assurance	While there is basically a sound system of control to achieve the system objectives, there are weaknesses in the design or level of non-compliance of the controls which may put this achievement at risk.
	Limited Assurance	There are significant weaknesses in key areas of system controls and non-compliance that puts achieving the system objectives at risk.
	No Assurance	Controls are non-existent or extremely weak, leaving the system open to the high risk of error, abuse and reputational damage.

Priorities assigned to identified issues are based on the following criteria:

Priority 1 (High)	Fundamental control weaknesses that require immediate attention by management to action and mitigate significant exposure to risk.
Priority 2 (Medium)	Control weakness that still represent an exposure to risk and need to be addressed within a reasonable period.
Priority 3 (Low)	Although control weaknesses are considered to be relatively minor and low risk, still provides an opportunity for improvement. May also apply to areas considered to be of best practice that can improve for example the value for money of the review area.

Statement of Responsibility

We take responsibility to the London Borough of Croydon for this report which is prepared on the basis of the limitations set out below.

The responsibility for designing and maintaining a sound system of internal control and the prevention and detection of fraud and other irregularities rests with management, with internal audit providing a service to management to enable them to achieve this objective. Specifically, we assess the adequacy and effectiveness of the system of internal control arrangements implemented by management and perform sample testing on those controls in the period under review with a view to providing an opinion on the extent to which risks in this area are managed.

We plan our work in order to ensure that we have a reasonable expectation of detecting significant control weaknesses. However, our procedures alone should not be relied upon to identify all strengths and weaknesses in internal controls, nor relied upon to identify any circumstances of fraud or irregularity. Even sound systems of internal control can only provide reasonable and not absolute assurance and may not be proof against collusive fraud.

The matters raised in this report are only those which came to our attention during the course of our work and are not necessarily a comprehensive statement of all the weaknesses that exist or all improvements that might be made. Recommendations for improvements should be assessed by you for their full impact before they are implemented. The performance of our work is not and should not be taken as a substitute for management's responsibilities for the application of sound management practices.

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