

Final Internal Audit Report

Croydon Enterprise Loan Fund (CELF)

May 2018

Distribution:

- Executive Director of Place (Final only)
- Director of Economic Growth
- Economic Development Manager
- Economic Development Officer

Assurance Level	Recommendations Made	
Limited assurance	Priority 1	2
	Priority 2	2
	Priority 3	1

Status of Our Reports

This report ("Report") was prepared by Mazars Public Sector Internal Audit Ltd 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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1. Introduction

- 1.1 The Croydon Enterprise Loan Fund (CELF) is part of the London Borough of Croydon Council's plan for Economic Development. The scheme is designed to provide financial support businesses unable to secure funding through the conventional avenues, but are able to demonstrate 'that their business model is sound and a business plan is in place, including the ability to repay back the loan' (Croydon Economic Development Plan 2013-2018).
- 1.2 On 1 March 2017, a contract was agreed between Croydon Council, CELF and the East London Small Business Centre Limited. This was to appoint East London Small Business Centre Limited as the delivery body to provide certain loan management and administration services to the Croydon Enterprise Loan Fund.
- 1.3 As of April 2017, the forecast targets were not being met, as follows:
- Only one start-up loan application had been received, compared with three forecasted.
 - Five non-fast growth loan applications were received and only one approved, in comparison to the target of twelve received and eight approved.
 - The value of the non-fast growth loan approved was £10,000 – significantly short of the £90,000 overall target.

As a result, an action plan was put in place and implemented to help improve on these targets, with some improvement being seen by December 2017.

- 1.4 The contract is valued at £534,080 from 1st February 2017 to 31st July 2020.

2. Key Issues

Priority 1 Issue 2

An appropriate data sharing agreement was not in place, personal data was being collected using an on-line application form, which did not include appropriate clauses for the collection and use of personal information in line with the requirements of the Data Protection Act 1998, or GDPR (**Issue 2**).

There was a relatively high number of bad and doubtful debts, although the actual rate by volume, has been maintained within satisfactory tolerance levels between 15-17% (taking into consideration the nature of the customer group and the purpose of the loans to address market failure). However, updated evidence of regular recovery actions taken, has not been continuously reflected on the quarterly arrears report (**Issue 4**).

Priority 2 Issues

The policies and procedures in place were still in draft (**Issue 1**).

Sample testing of 10 loans approved by the previous delivery partner, identified instances where the checklist on the application forms were not completed, or where panel and other decision documents, while approved, were not dated, (**Issue 3**).

The Priority 3 issue is included under item 4 below.

3. Actions and Key Findings/Rationale

Control Area 1: Legislative, Organisational, and Management Requirements					
Priority	Action Proposed by Management				
2	Continue to liaise with LSBC, in order to finalise the GDPR compliant CELF procedures for approval by the CELF Board.				
	<p>Detailed Finding/Rational – Issue 1</p> <p>In order to help ensure consistency of approach and achievement of desired objectives, appropriate procedural guidance should be in place and available to staff.</p> <p>It was confirmed that Croydon Enterprise Loan Fund (CELF) has a range of procedures in place, including Records management; Application process; Provision of financial services; Collections & recoveries; Compliance monitoring; Anti-money laundering; and Data protection. Examination of these procedure notes, all in draft and dated January 2017, and CELF Board minutes determined that these procedures were due to be reviewed and approved by the CELF Board Meeting. At the October 2017 Board Meeting, 10 months after the policies and procedures were originally developed, the members refused to retrospectively approve the policies and procedures and requested these to be updated and re-presented at the May 2018 CELF Board for approval.</p> <p>It was explained that, 'The draft procedures were necessary as part of the documentation within the agreement, following the contract negotiations with LSBC during the initial transition period. However, it was anticipated that the procedures would be approved retrospectively at the Board meeting. Unfortunately, due to changes including a staff restructure; the procedures became outdated. The Board therefore requested further updates to the procedures to reflect the current status, prior to providing approval. These initial changes were made as requested, but additional changes have become necessary due to the GDPR requirements. These extra amendments are currently being implemented in advance of the May 2018 deadline.'</p> <p>Where the procedures and procedures in place are draft and not approved, there is a risk that are not undertaking their roles appropriately and that service objectives may not be achieved.</p>				
	<table border="1"> <thead> <tr> <th>Responsible officer</th> <th>Deadline</th> </tr> </thead> <tbody> <tr> <td>Economic Development Officer</td> <td>May 2018</td> </tr> </tbody> </table>	Responsible officer	Deadline	Economic Development Officer	May 2018
Responsible officer	Deadline				
Economic Development Officer	May 2018				

Control Area 3: Loan Fund Administration	
Priority	Action Proposed by Management
1	<p>We will liaise with LSBC for them to update:</p> <ul style="list-style-type: none"> • Privacy policy on CELF and EFL websites with immediate effect. • Policies for GDPR compliance before May 2018 deadline. • Although data is not shared with Startup Loans Ltd; additional clarity will be provided on the application form (including a review of the information requested within it). • A separate data sharing agreement will be provided to include relevant parties. • Any personal data held prior to 1 March 2017.
	<p>Detailed Finding/Rational – Issue 2</p> <p>In line with the Data Protection Act 1998, where personal information is shared between the Council and any third parties, a data sharing agreement must be in place.</p> <p>It was confirmed that a 'Confidentiality Letter Agreement' is in place with East London Small Business Centre Limited (LSBC), who administer the loan process for Croydon Enterprise Loan Fund (CELF). However, liaison with the Council's Information Management team established that this agreement was not the Council's standard data sharing agreement and was not sufficient. Furthermore, as the agreement was only signed on behalf of East London Small Business Centre Limited and not on behalf of CELF or the Council, it is not a valid agreement.</p> <p>Examination of the contract agreed between Croydon Council, CELF and LSBC dated 1 March 2017, found that this contract also includes, in Schedule 2, Enterprise for London as a subcontractor. This party needs to be part of the data sharing agreement.</p> <p>The contract also includes all of the tender documents and specifically a copy of the loan application form to be used and the 'Data Protection Policy' to be complied with. It was; however, found that an online application form, which requires business and personal data to be provided, was in use at the time of audit, which differed to the required loan application form as detailed in the contract. Furthermore, examination of the online application form noted that:</p> <ul style="list-style-type: none"> • The form is hosted by SurveyGizmo, an American based company, although it is accepted that it holds the privacy shield which was adopted by The European Commission on 12 July 2016. • It is noted that the 'condensed guide to the use of your personal information' contained on the application form is provided by Start Up Loans Ltd. However, discussion established that the relevant personal information is not shared with this party. • It is noted that the application form caters for both individuals as sole traders, or as guarantors for businesses/limited companies. Its purpose is to capture details

Responsible officer	Deadline	
Economic Development Officer	April 2018	<p>of individuals; either as sole traders, or as guarantors for businesses/limited companies.</p> <ul style="list-style-type: none"> There is no requirement for the individual to confirm that the information provided in the form is true and there is no explanation as to what action will be taken, if any, if incorrect and untrue information is provided. <p>Staff have shared assurances from Pinsents (the legal team who prepared the CELF agreement) confirming suitability and compliance with legislation, in respect of the data protection provisions in the CELF Agreement, including that under Clause 23 for any third parties LSBC share data with they are to ensure they comply with all data protection legislation including the Data Protection Act 1998. Notwithstanding these assurances, a separate data sharing agreement is not in place as required.</p> <p>It was also established that it was planned that LSBC would be using its own website within the next few weeks when they roll out their new company policies to help ensure they are in line with GDPR launch for 25 May.</p> <p>There is also a need to review the personal data collected and stored prior to 1 March 2017, when the contract with LSBC commenced.</p> <p>There is a risk that personal information is being collected and stored in breach of the Data Protection Act 1998, which may result in a significant fine by the Data Commissioner.</p>

Control Area 3: Loan Fund Administration		Detailed Finding/Rational – Issue 3
Priority	Action Proposed by Management	
2	<p>We have already updated the current delivery partner with the findings from the 10 loans approved by the previous delivery partner. However, we will ensure our administration of loan requests from the current delivery partner includes an additional quality assurance check to reduce the likelihood of these errors occurring.</p>	<p>Information should be retained and clearly labelled to ensure efficiency within the Croydon Enterprise Loan Fund process.</p> <p>Examination of a sample of 10 approved loan applications identified a number of instances of incomplete or missing information, as follows:</p> <ul style="list-style-type: none"> • For 3: the checklist on page 2 on of the application forms were not completed to verify that required documents had been seen. • For 2: there were no dates on the drawdown form credit assessor and panellist. • For 1: The panel form did not include dates for line manager signature. • For 1: No review dates on the panel assessment form for creditor and panellist. • For 1: The application form was not signed by the applicant. <p>It is accepted that the above omissions related to the previous delivery partner.</p> <p>Where forms are not properly completed and/ or documents dated, there is a risk that loans have been either inappropriately awarded or not processed in a timely manner.</p>
Responsible officer	Deadline	
Economic Development Officer	March 2018	

Control Area 4: Contract Payments	
Priority	Action Proposed by Management
1	<p>We will liaise with LSBC to ensure recovery activities undertaken are in accordance with specified process & procedures.</p>
	<p>Detailed Finding/Rational – Issue 4</p> <p>The 'Recovery Process' procedure details the actions to be taken when loans and interest payments are defaulted on, including:</p> <ul style="list-style-type: none"> • contacting the client and/or issuing a 'Default letter 1' within 7 days of the 'unpaid list', • issuing a 'Default 2 letter' 14 days after the 'Default 1 letter', • Recommend action (e.g. County Court Judgement) to CELF Board 1 month from date of Demand letter. <p>Examination of the CELF Loans Status Report 31st December 2017 identified that of the total £3,134,850 'principle lent to businesses' (for 308 loans) a total of £498,024 (or 98 loans) were 'Bad and Doubtful'. This consisted of:</p> <ul style="list-style-type: none"> • £71,472 (or 18 loans) which were '>3 months in Arrears' • £285,908 (or 56 loans) which were 'In recovery'. • £140,944 (or 24 loans) which were 'Written Off'. <p>It was explained that no loans have been written off since December 2016.</p> <p>A separate arrears report, dated 5 December 2017, was provided detailing the action/s that had been taken for the accounts in arrears; however, this did not evidence the regular follow up of debts. For example:</p> <ul style="list-style-type: none"> • For 2 there was a period between February 2017 and December 2017, where no follow up or recovery action appears to have been undertaken. • For 1 there was a period between March 2017 and December 2017, where no follow up or recovery action appears to have been undertaken. <p>Where action is not consistently taken to recover outstanding loans and interest payments, there is a risk that these outstanding amounts will never be recovered. In addition where money that is unlikely to be recovered is not written off there is a risk that the financial state of CELF is overestimated.</p>
Responsible officer	Deadline
Economic Development Officer	April 2018

4. Priority 3 Recommendation

Action Proposed by Management	Findings
<p>The current supplier (LSBC) has been made aware of the issue with the previous delivery partner and that information and evidence needs to be provided for reasoning behind payments to avoid the risk that inappropriate or incorrect amounts are deducted, which adversely affect the borrower's financial position.</p>	<p>Evidence should be retained to support transactions and should be accurate, so borrowers can be assured that necessary and correct payments are being taken and done so with their consent.</p> <p>Testing of ten randomly-selected transactions between December 2016 and May 2017 (inclusive) found that one transaction was an adjustment. No evidence was provided as to why it had had this adjustment. The adjustment was for £369.42.</p> <p>There were two instances where the payments made did not match the amounts agreed. Payments per the agreements were £149.80 and £300.55 respectively but payments paid were £149.55 and 299.69 respectively. No information was provided of the reasoning behind the underpayments.</p> <p>Where evidence is not retained for payments, there is a risk that inappropriate or incorrect amounts are deducted, which adversely affect the borrower's financial position.</p>

TERMS OF REFERENCE

Economic Development/Dedicated Loans Company

(Croydon Enterprise Loan Fund Limited)

1. INTRODUCTION AND BACKGROUND

- 1.1 The Economic Development scheme is currently being delivered by an outsourced organisation called The East London Small Business Centre Limited (LSBC). This contract runs from April 2017 until July 2020 with the option of a further 3.5 years extension in the form of a 1.5 + 1 + 1 contract.
- 1.2 The LSBC has been contracted in by the Council in order to market, manage and deliver the loan fund, which currently stands at £1.25m with an agreed Cabinet fund addition of £2.5m.
- 1.3 The funding is ring fenced and those organisations that wish to gain funding are required to meet certain criteria. The aim of the money is to try and address gaps in the business community, promote job and business growth.
- 1.4 The LSBC contract is valued at £543,080 over 3.5 years.
- 1.5 The Croydon Enterprise Loan Fund Board set the parameters for the borrowing of funds. These currently stand at:
 - 2% for arrangement fees
 - 5% for start-up loans
 - 8% for growth/fast growth
- 1.6 The LSBC also provides advice and weekly workshops, in addition to helping provide loans to businesses. The workshops and advice that is provided to organisations are free.
- 1.7 This audit is being undertaken as part of the Internal Audit Plan for 2017/18.

2. OBJECTIVES AND METHODOLOGY

- 2.1 The overall audit objective is to provide an objective independent opinion on the adequacy and effectiveness of the control environment relating to Economic Development/Dedicated Loans Company (Croydon Enterprise Loan Fund Limited).
- 2.2 In order to achieve the overall objectives, a risk based systems audit approach will be carried out, documenting and evaluating the actual controls against those expected and based on this, undertaking appropriate testing conducted.
- 2.3 The key findings and conclusions will be presented at an exit meeting and followed by the circulation of a draft report for consideration and for management to identify suitable actions. Once agreed, a final audit report will be issued.

3. SCOPE





3.1 The audit included the following areas:

Control Areas/Risks	Issues Identified		
	Priority 1 (High)	Priority 2 (Medium)	Priority 3 (Low)
Regulatory, Organisational and Management requirements	0	1	0
Contract Formalities	0	0	0
Loan Fund Administration	1	1	0
Contract Payments	1	0	1
Contract Monitoring and Inspections	0	0	0
Monitoring Meetings and Reporting	0	0	0
Total	2	2	1

DEFINITIONS FOR AUDIT OPINIONS AND RECOMMENDATIONS

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 consistently 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 which may put this achievement at risk.
	Limited Assurance	There are significant weaknesses in key areas of system controls and/or non-compliance that puts achieving the system objectives at risk.
	No Assurance	Controls are non-existent or weak and/or there are high levels of non-compliance, leaving the system open to the high risk of error or abuse which could result in financial loss and/or reputational damage.

Priorities assigned to recommendations are based on the following criteria:

Priority 1 (High)	Fundamental control weaknesses that require the immediate attention of management to mitigate significant exposure to risk.
Priority 2 (Medium)	Control weakness that represent an exposure to risk and require timely action.
Priority 3 (Low)	Although control weaknesses are considered to be relatively minor and low risk, action to address still provides an opportunity for improvement. May also apply to areas considered to be of best practice.

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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