

INTERNAL AUDIT REPORT

FROM: Audit and Risk Manager

TO: Deputy Chief Executives
Business Support Manager

C.C. Chief Executive
Head of Finance

SUBJECT: Leaseholder
Service Charges

DATE: 24 March 2014

1. Introduction

- 1.1. In accordance with the Audit Plan for 2013/14, an examination of the above subject area has been completed recently and this report is intended to present the findings and conclusions for information and action where appropriate.
- 1.2. Wherever possible, results obtained have been discussed with the staff involved in the various procedures examined and their views are incorporated, where appropriate, in any recommendations made. My thanks are extended to all concerned for the help and co-operation received during the audit.

2. Scope and Objectives of Audit

- 2.1. The purpose of the audit examination was to report a level of assurance on the adequacy of systems in place for setting, levying and collection of leaseholder service charges to ensure compliance with legislation, inclusion of all chargeable persons and effective recovery of applicable service and management costs.
- 2.2. The examination focused on policies and procedures for the setting, levying and collection of service charges due from leaseholders of former HRA dwellings for which the Council retains the freehold. The elements of the process reviewed were:
- § accounting for leasehold dwellings and liable persons;
 - § formulation of annual charges;
 - § billing;
 - § communication and liaison with leaseholders.
- 2.3. The recommendations from the previous audit report were considered and implementation status ascertained.
- 2.4. The findings are based on consultations with Anna Monkton, Leasehold Officer, and reference to relevant documentation and records. Data matching and exception testing was to verify the integrity of key records.

3. **Recommendations from Previous Report**

3.1 The current position in respect of the recommendations from the audit reported in September 2011 is shown below:

Recommendation	Management Response	Current Status
Concerted efforts should be made to ensure that a new Leaseholder Management System is put in place. <i>(Medium risk)</i>	Other authorities using the MIS system to be consulted on establish how they use the system for leasehold management.	Management have been looking at a Scheme Accounting module to run on MIS. The Leasehold Officer has a remit to prepare a business case (in progress at the time of this report).
Discussions should be held on a regular basis between Technical Administration staff and Surveyors (and other relevant staff) to ensure that Technical Administration are aware of any major works projects that are forthcoming for which leaseholders need to be recharged. <i>(Medium risk)</i>	Advised that this had become a standing item discussed at the weekly Managers' briefing in Housing and Property Services.	The Leasehold Officer advised that there is still an issue with this area. The post has a remit to improve awareness of consultation responsibilities.
The leaseholder handbook should be updated and reissued as soon as possible. <i>(Medium risk)</i>	Advised that this was being addressed in consultation with the Chair of the Leaseholder Action Group.	The current version of the Leaseholder Handbook was updated in August 2013 and is retrievable on the Council's website.

4 **Findings**

4.1 General Matters

- 4.1.1 The review was undertaken at a time of considerable change in Housing and Property Services with a service redesign programme in full flow. A new temporary post of Leasehold Officer (reporting to the Business Support Manager) has only recently been created and the appointee to the post officially took over the duties during the audit itself.
- 4.1.2 The main contact officer for the previous audit is still in the Council's employ, but on protracted absence due to injury so has not been available for consultation in conducting this assignment. Also the procedures have not been documented in detail to date despite their intricacy and painstaking nature (this is just one of several inter-dependent matters to be addressed as part of the Leasehold Officer's role).

- 4.1.3 It also became clear that the property database previously underpinning the charging process has been decommissioned. Although the current housing and property business application (MIS ActiveH) has been populated with basic data on the leasehold properties and their respective leaseholders, the functionality of the application does not extend to attributing chargeable service, repair and maintenance costs to facilitate charging by individual property.
- 4.1.4 The effect is that the formulation of charges centres around an Excel spreadsheet model processed independently of MIS, which in turn draws on other independently compiled Excel workbooks. A major part of the audit centred around familiarisation with these spreadsheet operations and the testing performed has had a dual purpose of gaining assurance on the completeness and integrity of key data resources and supporting the more immediate priority tasks being undertaken by the Leasehold Officer.
- 4.1.5 The Leasehold Officer has lead responsibility for a programme over 12 months to develop and improve the service to leaseholders. A key element of this is to formulate proposals for implementing the MIS Scheme Accounting module that, if approved, will greatly transform the processes and have the potential to make them more robust and efficient.
- 4.1.6 The following sections summarise the findings under the discrete areas reviewed.
- 4.2 Accounting for Leasehold Dwellings and Liable Persons
- 4.2.1 At the time of the audit there were recorded 539 leasehold dwellings subject to service charge. The core database of these properties identifying the leaseholders is now established on the MIS system.
- 4.2.2 The Right to Buy process highlights up-and-coming leases and the completion statements received from Shared Legal Services (and distributed by e-mail to various recipients within the Council) traditionally constitute the primary source for updating the relevant asset records.
- 4.2.3 The updating process has been seen over time as duly robust, but a recent discovery showed it to be not entirely failsafe — the Leasehold Officer recently traced a property that had escaped charging since its sale in 2007. That the core records of leasehold properties were at the time isolated from MIS has to be considered a contributory factor.
- 4.2.4 This property in question has now been incorporated into the charge formulation process for 2014/15 onwards and data match tests have confirmed conclusively that no other leasehold properties have been omitted to date.
- 4.2.3 Where there is a change of leaseholder, the picture is not quite so clear. While Shared Legal Services are again involved, they often first come to light when service charge bills are queried by recipients or during the annual insurance renewal process. A data match exercise highlighted two changes of leaseholder not updated to MIS, although both were fairly recent. The Leasehold Officer advised that this area is being looked at in consultation with Shared Legal Services.

4.3 Formulation of Annual Charges

- 4.3.1 The annual income from service charges shows a tendency to fluctuate, averaging around £150,000. For illustrative purposes, an approximate breakdown of the expected total for 2013/14 into the cost elements that make them up is given below with reference to their respective sources.

Cost Element	Data Source	Amount (000)
Site cleaning	Flat supervision and services estimates	26
Repairs to building and communal parts	MIS repairs extract	17
External decorations	Decorations contract valuations spreadsheet	16
Communal electrical checks	MIS repairs extract	15
Caretaking	Flat supervision and services estimates	14
Administration charge	Flat supervision and services estimates	14
Communal electricity supply	MIS repairs extract	10
Communal electrical repairs	MIS repairs extract	10
Repairs to development - external area	MIS repairs extract	9
Internal decorations	Decorations contract valuations spreadsheet	8
Ground rent	(Standard fixed amount carried over year-on-year)	5
Grass cutting	Flat supervision and services estimates	3
Door entry repairs and maintenance	MIS repairs extract	2
Lifts - repairs and maintenance	MIS repairs extract	1
Window cleaning	Flat supervision and services estimates	1
Other	Flat supervision and services estimates	2
Total		153

- 4.3.2 The flat supervision and services estimates are put together annually into a spreadsheet by Finance. They include notional unit costs for various elements, some of which are no longer used for charging as they have been replaced by extracts of actual amounts from MIS Repairs.
- 4.3.3 The decorations contract valuations spreadsheet is supplied from the Asset Management division of Housing and Property Services. Factoring in costs from the MIS repairs extract is by far the most intricate and painstaking part of the whole process and this is where potential for streamlining the process through the Scheme accounting module is seen as most marked.
- 4.3.4 One element missing in the above breakdown is major building works affecting leasehold properties. There is a long standing issue where the Council has been constrained from charging leaseholders what would otherwise be regarded as a fair contribution towards major works from which they have benefited because of statutory consultation provisions.

- 4.3.5 Section 20 of the Landlord and Tenant Act 1985 requires, in effect, advance consultation on any proposed works for which a contribution exceeding £250 is to be sought from any leaseholder affected. Failure to follow the strict Section 20 procedures deprives the Council of the right to seek any contribution.
- 4.3.6 It has not been possible to gauge the extent of income foregone by reason of failure to institute Section 20 procedures. Ensuring effective Section 20 consultation is a prominent area within Leasehold Officer's remit and the improvement programme outlines communication and staff engagement measures to facilitate it.
- 4.4 Billing
- 4.4.1 The billing process utilises the Total Debtors periodic income module and is overseen by Finance (FS Team). The responsible officer in Housing and Property Services has been required annually to populate a spreadsheet prepared by the FS Team with the total charge for each property (at the time of this report the task is shortly to be undertaken for 2014/15 by the Leasehold Officer). Comparison with previous year charges is a built-in factor of this process and increases of more than 25 per cent are flagged up for re-checking.
- 4.4.2 Testing covering the current financial year showed the charges levied to cover all properties except for a recent Right to Buy and the omitted property discovered (see 4.2.3 above). Data matching of the charges themselves showed a significant incidence of variance between the Housing and Property Services figures and the billed amounts (around 6 per cent of cases). The great majority proved to be accounted for by agreed reductions of charge for various reasons, although it is not clear whether any of them have a Section 20 connection.
- 4.4.3 The data match outcomes have been provided to the Leasehold Officer to assist with the charge determination for 2014/15.
- 4.4.4 It has been advised that use of the Scheme Accounting for billing is being considered in place of Total, assuming that the package is implemented. It should be borne in mind that in such an eventuality the collection and recovery service provided by the FS Team would be impaired if not discontinued outright.
- 4.4 Communication and Liaison with Leaseholders
- 4.4.1 An up-to-date Leaseholder Handbook is published on the Council's website as the main reference on respective rights and responsibilities. Other resources include reference to the Leaseholder Action Group (LAG) established to represent the interests of leaseholders of Council dwelling.
- 4.4.2 Contact details for Housing and Property Services are incorporated in the Leaseholder Handbook and are quoted on all invoices for service charges.

- 4.4.3 An annual statement showing the breakdown of the service charge is now sent to the leaseholder to dovetail with the first invoice for the year being raised. The statements are despatched independently and, invariably in the past, after the invoices. The Leasehold Officer has re-designed the statement format as a Word merge document with the aim of a mailshot for 2014/15 in advance of the invoices.

5 **Conclusions**

- 5.1 The transitional state of the leaseholder service aside, several issues serve to qualify the level of assurance. Two of these are effectively carried over from the previous audit:
- § a more robust and efficient alternative to the current system for formulating service charges still to be actioned;
 - § continued doubts over the effectiveness of communication on major works with potential adverse impact on income from inability to undertake Section 20 consultations.
- 5.2 The service charges function has traditionally relied on the expertise of a single officer to handle somewhat intricate, and to date virtually undocumented, processes. It is recognised, however, that a clear change agenda has taken hold through the remit of the temporary Leasehold Officer post which includes addressing the above issues as part of a wider programme of improvements.
- 5.3 While the programme is in its early stages at the time of this report, it is noted that significant progress has already been made.
- 5.4 As things currently stand, we are able to give MODERATE assurance that the systems in place are adequate to administer leaseholder service charging economically, efficiently and effectively. However, in the light of the programme in place committed to addressing the known issues, formal recommendations are not considered necessary in this instance.

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