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Internal Audit Report 2016/2017

Selective Licensing 16/17/01

**Hastings Borough
Council**

Final

September 2017

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Distribution list

For action: Matthew China (Housing Renewal Manager)

For information: Tom Davies (Head of Internal Audit)



Executive summary (1 of 3)

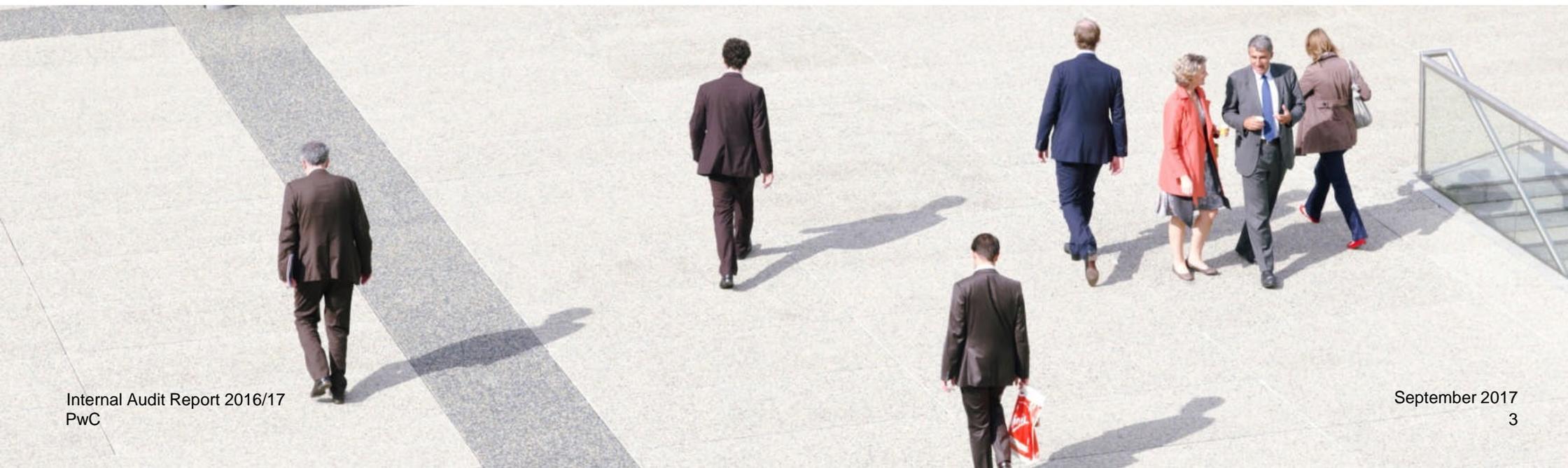
Report classification



High risk (20 points)

Total number of findings

	Critical	High	Medium	Low	Advisory
Control design	0	1	2	0	0
Operating effectiveness	0	0	1	1	0
Total	0	1	3	1	0



Executive summary (2 of 3)

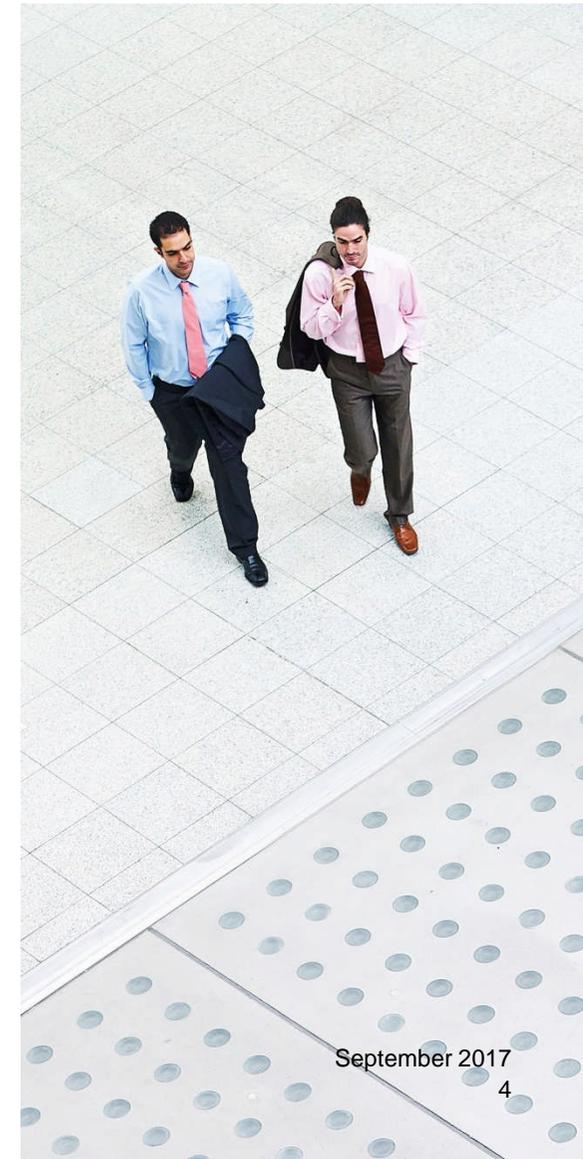


Summary of findings

The Council launched a Selective Licensing scheme (“the scheme”) in October 2015 which required a licence to be obtained for all privately rented accommodation across seven wards of Hastings and St Leonards . Our review of the scheme and sample testing of key controls around its operation has confirmed that progress with key processes and controls has been made. However, we have identified areas that require management attention, particularly around having a robust business plan, effective management information and monitoring of licence fee collection. The key controls in these areas need to be robust to ensure that the scheme meet its objectives and results in a minimal financial loss for the Council at the end of its five year period. We have summarised our key findings below:

- No sensitivity analysis of the key assumptions or how scheme objectives would be measured was included within the business case. This has meant that it is difficult to track performance and meant the Council did not effectively consider the impact of high demand of the early bird discount offer on the schemes financial performance. **(High risk)**
- The scheme is likely to make a financial loss. Even if all expected future applications are made and paid for at a full fee there would be an overall loss of £110k. There is not currently a plan in place to appropriately address this and minimise the loss to the Council. **(Medium risk)**
- There is unreliable data for scheme operational and financial performance monitoring. This is due to unresolved data quality issues between key systems leading to unreconciled differences in relation to income levels for the scheme. **(Medium risk)**
- Property inspections have not been carried out as planned and sanctions for non-compliance have not been effectively enforced. **(Medium risk)**
- Policies and procedures have not been fully updated to reflect current practice **(Low risk)**

We would like to thank the selective licencing team for their support and assistance during this review.



Executive summary (3 of 3)

1 **Sensitivity analysis and performance measurement within the business plan – control design**

High

2 **Ineffective management information due to poor data quality – control design**

Medium

3 **Ineffective monitoring of the licence fee collection – control design**

Medium

4 **Inspections and sanctions for non-compliance have not been carried out as planned – operating effectiveness**

Medium

5 **Policies and procedures have not been updated – operating effectiveness**

Low

Summary of findings by areas of scope:

Area of scope	Number of findings				Finding ref
	Critical	High	Medium	Low	
Presenting an effective business case and sign-off of the scheme		1			1
Monitoring against the business plan and taking effective action where necessary		1			1
Policies, procedures and compliance with statutory requirements				1	5
Roles, responsibilities and adequate separation of duties					
Management information			1		2
Budgetary control			1		3
Licence fee collection			1		3
Use of sanctions on unlicensed landlords			1		4

Background and scope



Background

The Council launched a Selective Licensing scheme in October 2015 which required a licence to be obtained for all privately rented accommodation across seven wards of Hastings and St Leonards. The main objectives of this scheme were as follows:

- To ensure safety and improve living conditions of tenants.
- To improve housing standards and reduce the level of anti-social behaviour.
- To improve investment and availability of privately rented homes and build effective partnerships with the key stakeholders (tenants, landlords, estate agents, etc.).
- To support owners and managing agents of the privately rented properties in achieving the required housing standards and to facilitate stable and integrated communities through robust implementation of the policy.

Originally, it was estimated that around 7,000 properties would be required to obtain a licence for renting private accommodation. At the time of this review around 5,400 licence applications had been received, out of which around 3,000 (56%) had been issued a licence. This scheme runs for a five year period. One of the key requirements is that the entire expenditure for the operation of the scheme is covered through the collection of licence fees, so that it will ultimately breakeven with no cost to the Council at the end of the scheme in October 2020.

We have performed our work in line with the attached terms of reference in Appendix B.



Current year findings (1 of 5)

Sensitivity analysis and performance measurement within the business plan

Control design

1

Rating

High

Finding and root cause

Before the Selective Licensing scheme commenced in October 2015 it went through a consultation process and a business case was approved by Cabinet. We have reviewed the business case and it was broadly in line with good practice including key financial data such as the anticipated number of licences, available discounts, timing of applications, and application fees. However no sensitivity analysis was performed over this data to understand the point at which variability in these key metrics meant the scheme would fail to meet its financial and operational objectives. For instance, one of the key assumptions within the business plan was that 27% of the applicants will take advantage of the early bird discount which reduced the licence fee by up to 67%. At the time of this review, 57% of the total applications received to date took advantage of the early bird discount. This will equate to 44% if all the anticipated applicants (c7,000) apply by the end of the scheme. This translates to a difference of around 17% in one of the key assumptions, resulting in a £369k reduction in income.

We were able to confirm that the overall objectives of the scheme (summarised and referenced within the background section of this report) have been clearly documented within the business plan. However, the measurement of success against these objectives has not been documented. One of the key objectives of the scheme was to tackle anti-social behaviour but it does not indicate how the achievement of this objective will be measured. For example, whether that would mean a certain level of reduction in complaints. It is impossible to understand the success or not of the scheme if desired outcomes are not measured.

Finally, the objectives of the scheme within the business plan have not been translated into relevant action or operational plans which can then be monitored by the management. It has been confirmed that the operational performance of the scheme is regularly monitored and any issues identified as a result are included within action plans for follow up. However, these action plans have not been linked to the overall objectives of the scheme and are more relevant to day to day running of the scheme.

Current year findings (1 of 5)

Sensitivity analysis and performance measurement within the business plan

Control design

1

Rating

High

Implications

If business plans do not include sensitivity analysis over key financial and / or operational assumptions then the point at which projected benefits of the project will not be met is not understood. This inhibits appropriate challenge and debate over the robustness (or otherwise) of key assumptions and could lead to incorrect decision making over whether or not to approve / proceed with business cases.

If outcomes do not have measurable KPIs then it will be challenging to understand whether or not the schemes has been a success and met the objectives of the business plan.

Action plan

The business plan for the scheme will be reviewed to understand the sensitivity of the key assumptions and include clear measurements of success for all the objectives of the scheme. These will be regularly monitored by management to ensure that the risk of changes in key assumptions and failure of the scheme to meet its objectives is adequately managed.

In order to do this a mid project review will be undertaken in the Autumn of 2017. The purpose of this review is to assess the financial position of the project and determine if any alteration of the fee structure is required to ensure the scheme is cost neutral at the end of the scheme.

Management have already developed a number of indicators to measure the outcomes of the scheme based on the data used in the initial assessment for the need for the scheme. These will be reported to the Licensing Project Team on a quarterly basis (although it should be noted that some of the external data is only updated periodically). These KPIs are shown on the next page of this report.

Responsible person/title:

Matthew China (Housing Renewals Manager)

Target date:

31st October 2017

Reference number:

16/17/01-01

Current year findings (1 of 5)

Sensitivity analysis and performance measurement within the business plan

Control design

1

Rating

High

<i>Outcome</i>	<i>Data</i>	<i>Source</i>
<i>Reduction in anti-social behaviour</i>	Crime reports	Sussex Police
	Noise reports	Environmental Health
	Environmental crime	Business Wardens
	Alcohol and substance abuse	JSNA
<i>Improvement in housing conditions for private tenants</i>	No of licensing housing inspections (and those with action taken)	Housing Renewal
	Housing statistics	IMD/Sussex in figures
	Properties improved	Housing Renewal (existing corporate performance indicator)
	Improvement notices served	Housing Renewal
<i>Improved management standards</i>	No of gas/electric certificates obtained	Housing Renewal
	HMO Management Regulation letters served	Housing Renewal
	No of landlord training days	Housing Options
<i>Reduction of empty properties</i>	Empty Property Statistics	Empty Homes Officer
	Deposits to help homeless	Housing Options

Current year findings (2 of 5)

Ineffective management information due to poor data quality

Control design

2

Rating

Medium

Finding and root cause

A budget for the Selective Licensing scheme is allocated for the year and is regularly reviewed by the Housing Renewals Manager and the Regeneration Accountant. However, there is limited evidence that significant variations have been followed up and addressed within any action plans. The monitoring report for February 2017 suggests a forecast year end surplus of £50k compared to a budget surplus of £233k. Furthermore, there is limited evidence of robust reporting of financial and operational performance to management which is then monitored by them to ensure performance is in line with expectations. This links to finding 1 above – without measurable objectives being set in the business plan, the monitoring of performance is more difficult to define.

The total number of applications received since the inception of the scheme in October 2015 was 5,369 and the total cash that has been collected is £1,200,303. The budgeted expenditure for the scheme is £2,114,716 at present and the total number of licences anticipated are 7,118. Therefore, the amount required from each further licence application to break even is £523.82. This compares to a current maximum fee of £460. Even if the Council receives the full fee for the remaining population there will be a deficit of £109,873 against the budgeted expenditure by the end of the scheme.

Implications

If the operational and financial performance of the scheme is not being adequately monitored and reconciled through robust reporting of management information, significant deviations in performance will not be identified. This may result in the scheme failing to meet its objectives leading to adverse reputational and financial implications for the Council.

Current year findings (2 of 5)

Ineffective management information due to poor data quality

Control design

2

Rating

Medium

Action plan

Considerable work has been undertaken by colleagues in financial services to regularise reconciliation processes. The Council is presently reviewing its financial management system; integration with existing IT systems is to be considered as part of this.

Once reconciled, operational and financial performance will be regularly reported and monitored by the management in line with the objectives of the scheme.

Reconciliation to be undertaken on a quarterly basis and all discrepancies will be remedied immediately. Reconciliation will be included as a standard item every quarter on the Housing Renewal Management Team agenda.

Responsible person/title:

Matthew China (Housing Renewals Manager)

Target date:

31st December 2017

Reference number:

16/17/01-02

Current year findings (3 of 5)

Ineffective monitoring of licence fee collection

Control design

3

Rating

Medium

Finding and root cause

We selected a sample of 30 licence applications for detailed testing and it was noted that the individual amounts that have been paid for the licence fee cannot be traced from M3 (the selective licencing database) to the general ledger in Agresso. Of these, six cases have been waiting for more than six months (the current target time for processing the application) with the oldest application being received in January 2016. Furthermore when a letter is sent to the landlord to follow up incomplete applications, due to resource limitations, the landlords are not chased in the event no response.

Of particular concern in relation to financial reporting is that the information within the key systems (M3), Firmstep (online application system for the licence), and Agresso (General Ledger) for the scheme cannot be accurately reconciled and therefore there is limited assurance over the reliability of the reported data. This data quality issue has then impacted on the quality of management information for the financial and operational performance of the scheme.

It was been noted that the issues with the accurate reconciliation of data between the key systems and resource limitations as identified in finding 2 have contributed to ineffective monitoring of the above issues.

Implications

If sufficient effort is not being placed into obtaining the required information to issue licences or data within the systems cannot be fully relied on, the Council may not be issuing licences appropriately, identifying when action should be taken against landlords or fully collecting all income.

Current year findings (3 of 5)

Ineffective monitoring of licence fee collection

Control design

3

Rating

Medium

Action plan

A review of the cash balance from the licence fee collection and the budgeted expenditure will be undertaken to devise a management plan of action to ensure that the scheme makes a minimal financial loss at the end of five years. This will include addressing the processing and monitoring of applications within the required timeframe to ensure that income is effectively processed and licenses issued. For further detail on this please see the action plan for finding one.

Responsible person/title:

Matthew China (Housing Renewals Manager)

Target date:

31st December 2017

Reference number:

16/17/01-03

Current year findings (4 of 5)

Inspections and sanctions for non-compliance have not been carried out as planned

Operating effectiveness

4

Rating

Medium

Finding and root cause

To meet some of objectives of the scheme, which included ensuring tenant safety and tackling anti social behaviour, the original plan was to inspect every property after a licence has been issued to ensure compliance. We have obtained the list of inspections performed to date and only around 58% of the total properties that have been issued a licence have been inspected.

We tested a sample of 25 inspections that have been undertaken to ensure that they have been carried out adequately and there is supporting evidence available for review. We identified three cases in which inspections have not been recorded as undertaken even though the scheduled date has now passed. It was confirmed by the management that these inspections were postponed and performed subsequently. However, the system was not updated to reflect this.

At present the Council is unable to issue civil fines for non-compliance and is only able to prosecute through the legal team. There are 12 cases that are currently in prosecution. However, even if the Council is successful there is no financial benefit from the case as only costs relating to the prosecution can be recovered. This is likely to change in May 2017 and the Council will be able to issue civil fines for non-compliance which will result in direct income for the scheme.

It was also noted within an enforcement update presented to the Councillors in January 2017 that some of the inspection visits identified a number of non-compliance issues which fall within Trading Standards' responsibilities. Eleven cases were identified where Trading Standards would normally consider issuing penalty charge notices. These were not issued as the Council does not have the required memorandum of understanding with the County Council.

Current year findings (4 of 5)

Inspections and sanctions for non-compliance have not been carried out as planned

Operating effectiveness

4

Rating

Medium

Implications

If property inspections are not undertaken in line with the objectives of the scheme then scheme outcomes may not be achieved and the safety of tenant and reduction in anti-social behaviour not achieved.

If non compliance is not identified via inspections then appropriate legal action cannot be taken (to safeguard tenants and achieve scheme outcomes) and, in due course, penalties for non compliance not issued.

Action plan

- | | |
|--|--|
| <p>1. The original business plan proposed to inspect every licenced property. Initial experience of the scheme highlights a number of properties that are well managed and are able to provide evidence of such (including up to date property inspections, gas safety certificates, electrical safety checks). It is felt by management that inspections should be risk based and officer time is focussed on those properties that appear to be poorly managed. It is therefore proposed as part of the mid project review to include a risk matrix to determine prioritisation of inspections. It is proposed to achieve a 60% inspection rate throughout the scheme.</p> | <p><i>Responsible person/title:</i>
.....
<i>Matthew China (Housing Renewals Manager)</i>
.....
<i>Target date:</i>
.....
<i>31st December 2017</i>
.....
<i>Reference number:</i>
.....
<i>16/17/01-04</i></p> |
| <p>2. Civil penalties will be robustly enforced for non-compliance to contributing to the scheme meeting its objectives. A new Housing Renewal Enforcement Policy has been adopted which includes provision for civil penalties.</p> | |

Current year findings (5 of 5)

Polices and procedures have not been updated

Operating effectiveness

5

Rating

Low

Finding and root cause

There are documented policies and procedures for the operation of the scheme. The Team Leader is responsible for monitoring and updating them for any changes as per the applicable legislation.

However, these procedure documents are not regularly reviewed to ensure that they reflect current practice. For instance, procedures have been documented based on the expectation that inspections will be carried out for each property which is no longer the case due to resource limitations.

Implications

If policies and procedures are not up to date then staff may not fully understand the processes and controls required when undertaking their responsibilities. Errors or gaps in controls may occur. Comprehensive and up to date policies and procedures enable the Council to demonstrate intent to comply with statutory duties.

Action plan

Following the mid project review there are likely to be amendments to existing policies and procedures. It is proposed by March 2018 to review all the scheme procedures and then these will be uploaded onto the Council SharePoint server which will ensure effective document management.

Responsible person/title:

Matthew China (Housing Renewals Manager)

Target date:

31st March 2018

Reference number:

16/17/01-05

**Appendix A: Basis of our
classifications**

**Appendix B: Terms of
reference**

**Appendix C: Limitations
and responsibilities**

Appendices

Appendix A: Basis of our classifications

Individual finding ratings

Critical

A finding that could have a:

- **Critical** impact on operational performance; or
- **Critical** monetary or financial statement impact; or
- **Critical** breach in laws and regulations that could result in material fines or consequences; or
- **Critical** impact on the reputation or brand of the organisation which could threaten its future viability

High

A finding that could have a:

- **Significant** impact on operational performance; or
- **Significant** monetary or financial statement impact; or
- **Significant** breach in laws and regulations resulting in significant fines and consequences; or
- **Significant** impact on the reputation or brand of the organisation.

Medium

A finding that could have a:

- **Moderate** impact on operational performance; or
- **Moderate** monetary or financial statement impact; or
- **Moderate** breach in laws and regulations resulting in fines and consequences; or
- **Moderate** impact on the reputation or brand of the organisation.

Appendix A: Basis of our classifications

Individual finding ratings

Low

A finding that could have a:

- **Minor** impact on the organisation’s operational performance; or
- **Minor** monetary or financial statement impact; or
- **Minor** breach in laws and regulations with limited consequences; or
- **Minor** impact on the reputation of the organisation.

Advisory

A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.

Report classifications

The report classification is determined by allocating points to each of the findings included in the report.

Findings rating	Points	Report classification	Option A	Option B	Points
Critical	40 points per finding		Low risk	Satisfactory	6 points or less
High	10 points per finding		Medium risk	Satisfactory with exceptions	7 – 15 points
Medium	3 points per finding		High risk	Needs improvement	16 – 39 points
Low	1 point per finding		Critical risk	Unsatisfactory	40 points and over

Appendix B: Terms of reference

The terms of reference was prepared by Tom Davies, Head of Internal Audit, and the scope of this review remains the Head of Internal Audit’s responsibility. We designed our testing procedures to address the scope which was provided to us by the Head of Internal Audit.

Scope area

Presenting an effective business case and sign-off of the scheme

Test

Review the business case and surrounding documentation to confirm:

1. A Selective Licensing business case has been prepared for the scheme. This includes:
 - a. An assessment of the opportunities and risks.
 - b. A financial appraisal.
 - c. Key assumptions and their sensitivity.
 - d. Details of alternative arrangements and why they have been rejected.
 - e. Objectives and measurements of success.

2. The business case has been subject to senior officer review and challenge.

3. The business case has been signed off by an appropriate committee.
 1. Confirm that objectives and measurements detailed in the business case have been extracted and compiled into an action plan or equivalent.

2. Review the action plan to validate whether each objective has been broken down (where relevant), with specific actions identified. Each action should have a named owner, due date and progress tracked.

3. Where actions are not on track, confirm these have been escalated and action is being taken to address.

1. Review key policies and procedures to confirm they have been reviewed on a regular basis and reflect current practice.

2. Evaluate the process the Council has in place to ensure compliance with statutory requirements. In particular who has responsibility to monitor and apply changes in applicable legislation.

1. Review job descriptions and hierarchy structure to confirm that roles are clearly defined.

2. Obtain understanding of key controls through the license fee collection process and ensure that it is designed such that no one person has the ability to process an entire transaction.

Monitoring against the business plan and taking effective action where necessary

Policies, procedures and compliance with statutory requirements

Roles, responsibilities and adequate separation of duties

Appendix B: Terms of reference

Scope area

Management information

Budgetary control

Licence fee collection

Use of sanctions on unlicensed landlords

Test

1. Obtain a list of management reports and ensure that these have been consistently produced during the year.
 2. Select a sample of reports and ensure that they agree to the relevant database with minimal manipulation.
 3. Verify that the reports have been discussed by management and identified issues have resulted in agreed actions that have been addressed.
1. Confirm that an agreed budget is in place and monitored during the year.
 2. Verify that significant deviations from the budget have been discussed by management and identified issues have resulted in agreed actions that have been addressed.
1. Obtain listing of all transactions in financial year to date. Select a sample and confirm each of the key controls, as identified above, have been applied appropriately with sufficient segregation of duties.
1. Obtain an understanding of the sanctions at disposal to the Council for unlicensed landlords.
 2. Evaluate whether the policy in relation to the use of sanctions is clear and would allow consistency in enforcement.
 3. Sample test a selection of applications of sanctions to confirm that they have been applied consistently, in line with policy and with appropriate consideration of the context.

Appendix C: Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken this review subject to the limitations outlined below:

Internal control

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Future periods

Our assessment of controls is for the period specified only. Historic evaluation of effectiveness is not relevant to future periods due to the risk that:

- The design of controls may become inadequate because of changes in operating environment, law, regulation or other changes; or
- The degree of compliance with policies and procedures may deteriorate.

Responsibilities of management and internal auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.

This document has been prepared only for Hastings Borough Council and solely for the purpose and on the terms agreed with Hastings Borough Council in our agreement dated 20/03/2017. The work was performed in accordance with Hastings Borough Council's internal audit methodology and the findings reported to the Head of Internal Audit, who remains responsible for the final conclusions expressed and ratings assigned therein. We accept no liability (including for negligence) to anyone else in connection with this document, and it may not be provided to anyone else.

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