Rother District Council

Report to:	Audit and Standards Committee
Date:	4 December 2023
Title:	Internal Audit Report to 30 September 2023
Report of:	Gary Angell, Audit Manager
Purpose of Report:	To report on Internal Audit activity in the second quarter of 2023/24, and to provide a progress update on the implementation of audit recommendations made in earlier periods.
Officer Recommendation(s):	It be **RESOLVED**: That the Internal Audit report to 30 September 2023 be noted.

Introduction

1. The Council is required to ensure that it has reliable and effective internal control systems in place. The adequacy of these systems is tested by both Internal and External Audit.

2. The Council's Internal Audit Service operates in accordance with the Public Sector Internal Audit Standards. It is a requirement of these Standards that we report to the Audit and Standards Committee on audit matters and any emerging issues not only in relation to audit, but also to risk management and corporate governance.

Current Position

3. Progress on the 2023/24 Audit Plan is currently running at least 5-6 weeks behind schedule due to major overruns on the Blackfriars Spine Road Project and Housing Company Governance audits. Both had proven to be far more complex than was originally anticipated and this has delayed other audit work. This delay also means that it will now be necessary to postpone the Licensing audit until 2024/25 as this particular review could not take place as planned in Quarter 1 owing to data migration issues. It is hoped that the rest of the Plan can still be delivered by reducing the coverage on some of the Governance Audits, which have just commenced.

Summary of Activity to 30 September 2023

4. Two audit reports were issued in the quarter. A third report (Housing Company Governance), which was completed in September 2023, but not issued until October 2023, is also included in this report because of its relevance to the Blackfriars development.

5. All three reports received negative assurance ratings, with ICT Asset Management providing limited assurance, and the Blackfriars Spine Road Project and Housing Company Governance only receiving minimal assurance, our worst category of assurance. The reasons for arriving at these

assessments, and the main issues found, are outlined in the Executive Summaries which are reproduced in Appendix A. Full details of all high risk recommendations made and management's response to them are also included for information.

Implementation of Audit Recommendations

6. Each quarter, Members are updated on the progress made on implementing the audit recommendations reported at previous meetings. Appendix B shows a summary of the current position.

7. There are currently 15 recommendations in the 'Old Years' section. Five of these are the same items reported previously and a further 10 cases in respect of recommendations made in 2022/23 have been added this quarter. The Audit Manager raised awareness of all these recommendations at a Senior Leadership Team meeting on 25 October and some recent progress has been made in most cases.

8. An update on the five oldest recommendations is given below.

   - **Procurement** (October 2018) – Progress is stalled as we continue to wait for Legal Services to produce a draft Service Level Agreement (or Inter Authority Agreement) for the East Sussex Procurement Hub. This was chased again by the Interim Deputy Chief Executive on 23 October 2023.
   - **ICT Governance** (April 2019) – Progress on the draft ICT Disaster Recovery Plan continues with version 3 currently being worked on following feedback from the Head of Digital and Customer Services and the Audit Manager.
   - **Data Protection** (June 2021) – (1) The Data Protection Officer (DPO) has now obtained information from all departments that hold special category data and will be updating our Privacy Policy accordingly. (2) The DPO is in the process of updating the privacy notices for the few activities identified at the audit that are not currently covered.
   - **Estates Income** (June 2021) – The service administrator has made progress in updating the ePIMS asset register database, entering new data and ensuring existing data is up to date. It is estimated that this work will be completed by the end of November 2023.

9. Only four recommendations had been made in the current year up to 30 June 2023. Half of these have already been resolved and the rest are work in progress.

Audits Planned Next Quarter

10. The audits currently scheduled to take place in the fourth quarter of 2023/24 are as follows:

January 2024	Creditors
	ICT Governance
February 2024	Treasury Management
	Payroll
March 2024	Debtors

11. The timing of some of these audits may however be pushed back depending on workload.

Conclusion

12. Progress on the 2023/24 Audit Plan is currently running behind schedule, primarily due to overruns on two audits. Some audit coverage may therefore need to be reduced to ensure that the rest of the plan is achievable.

13. Three audits were completed in the second quarter of 2023/24, all of which received negative assurance ratings.

14. Progress on the outstanding audit recommendations continues to be monitored.

Other Implications	Applies?	Other Implications	Applies?
Human Rights	No	Equalities and Diversity	No
Crime and Disorder	No	External Consultation	No
Environmental	No	Access to Information	No
Risk Management	No	Exempt from publication	No

Chief Executive:	Lorna Ford
Report Contact Officer:	Gary Angell, Audit Manager
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Appendices:	A – Audit Reports issued during Quarter to 30 September 2023 B – Summary of Progress on Recommendations Made up to 30 June 2023
Relevant Previous Minutes:	AS23/31 Internal Audit Report to 30 June 2023
Background Papers:	None.
Reference Documents:	None.

ICT ASSET MANAGEMENT AUDIT

Service Manager: Mark Adams

Officer(s) Responsible for Implementing Recommendations: Graham McCallum, Tom Alexander and Tom Martin

Overall Level of Assurance: **LIMITED**

Purpose and Objectives

The purpose of the audit is to provide organisational and departmental management with an assurance as to the adequacy of the control systems based on compliance with the control objectives set out in the table below.

These objectives are designed to assess the extent to which the organisation meets its legal requirements, its own needs and those of its stakeholders and how the control systems in place contribute to the overall governance arrangements and securing value for money from the Council's services and operations.

Control Objectives

The audit opinion is based on the extent of compliance with the objectives (below), which have either been met in full (**M**), partially met (**P**) or not met (**N**).

An up-to-date inventory is maintained of all ICT equipment, which includes details of the individual each item has been allocated to.	**P**
Deliveries of new ICT equipment are recorded in the inventory on receipt and are held in a secure area until required.	**P**
Checks are in place to ensure that leavers ICT equipment is returned promptly to the Council.	**P**
Redundant ICT equipment is removed from the inventory and locked away until securely disposed of.	**M**

Level of Assurance

Based on the findings from the audit, we have determined that only limited assurance can be given on the overall governance arrangements owing to the many discrepancies found with data held on the ICT Asset Management database and mobile phone records.

The issues found include examples of:

- New equipment that was not allocated an RSN (asset number) and was subsequently issued.
- Equipment issued with an RSN but not recorded on the ICT Asset Management database.
- Equipment currently held by someone other than the allocated user.
- Lax controls over the return of equipment when users leave the Council, especially in respect of agency workers and consultants. Some equipment

may never have been returned. (NB - It is the line manager's responsibility to ensure that all equipment is returned.)

The audit also found that there are 50 mobile phones in circulation that have not accessed the network in over six months. Each phone costs the Council £108 per year in contract fees regardless of usage. This means that up to £5,400 could be saved annually if this equipment is no longer required. Even greater savings could be achieved if the handsets were recovered and reallocated to other users rather than purchasing new phones.

The reason the audit found so many issues may well be linked to the COVID-19 pandemic and its immediate aftermath. In particular:

- There was no formal handover when the officer who previously recorded the ICT assets retired in March 2020, because this coincided with the first COVID-19 lockdown.
- Most people were expected to work from home during the lockdown, meaning that a lot of equipment was taken home by staff and the IT department were not necessarily informed of this.
- A large number of laptops had to be procured and configured to enable officers to work from home and it is likely that the urgency of this work meant that some equipment was not correctly recorded on the database.

Two significant office moves have also taken place since March 2020, and this too may have resulted in database updates being overlooked when office equipment moved from one department to another.

Nevertheless, the ICT Asset Management database and mobile phone records now badly need to be brought up to date, and it is recommended that a comprehensive review is carried out with priority given to tracing valuable, portable equipment first - e.g. laptops, tablets, and mobile phones.

The report also recommends that:

- Action be taken to ensure that all new equipment is allocated an asset number upon receipt and the RSN sticker attached to the device.
- Departments should be recharged the replacement cost of any ICT equipment that is not returned when their staff leave.
- Agency workers and consultants using Rother ICT equipment should be required to sign documentation when they receive it, stating that they will return the equipment when their contract ends, and that failure to do so will result in them being billed for the replacement costs.
- Agency workers and consultants should be recorded as such on the database along with the name of the line manager requesting their equipment. Monthly reports should then be sent to confirm that they continue to be employed by the Council and where not, what action they have taken to ensure the equipment has been returned.
- At the next mobile contract renewal (December 2023), the IT department should consider removing all devices that have not accessed the network for a period of six months or more unless there is a valid reason for this (e.g. the phone is held for emergency planning or is in storage awaiting re-allocation).

The need to improve and enforce leaver procedures is a corporate issue and will be raised separately with the Corporate Management Team by the Audit Manager.

In view of the issues found with the overall accuracy of the database records, this report could easily have been given a minimal assurance rating. However, we have decided not to do so on this occasion, as whilst the current situation is unsatisfactory, we believe that most ICT equipment is being correctly recorded at the time it is issued. The main problem appears to be keeping track of equipment once it is in circulation, and control in this area will need to improve once the records are brought up to date.

Executive Summary

Overall, the control objectives are considered to have only been partially met. We have made six medium and two low risk recommendations to management all of which are aimed at enhancing the governance arrangements and/or improving value for money.

Internal Audit Service
July 2023

Levels of Assurance:	
Good	Strong controls are in place and are complied with.
Substantial	Controls are in place, but improvements would be beneficial.
Limited	Improvements in controls or in the application of controls are required.
Minimal	Urgent improvements in controls or in the application of controls are required.

Management Update – November 2023

The Head of Digital and Customer Services can confirm that a lot of work has taken place following the audit to reinstate robust practices around our ICT asset management.

Delivery of new IT assets

Once a new asset is received it is stored in a secure location (only accessible by IT) and the asset does not leave the room until it has been given an RSN number and added to the ICT asset register on KACE. A service desk officer will perform this task once a week. Our Infrastructure and system developers are currently working on an electronic asset stock log – this will keep a real time log of all assets stored in the IT Stock cupboard along with basic stock items (e.g. mice, keyboards, headsets). The asset stock log will automatically update when an item is allocated to a user and also has the ability to create alerts when there is low stock of core items such as keyboards.

IT Asset Audit (amnesty)

There will be an ICT asset audit to re-establish who has been issued monitors (as during COVID-19 there was a mass allocation to staff without recording the asset to an individual). An electronic questionnaire is planned to be issued in December 2023 to ask all staff for the RSN for all their equipment and includes docks/monitors/ mobile/laptops. All items allocated to new staff are fully recorded on the asset management system and going forwards this issue will not occur again. Completion of this task will be by 31 March 2024.

Mobile Phones

We are currently undertaking a mobile phone asset review and awaiting information from our phone provider to confirm device usage. Following this, we will be contacting all managers where there has been an extended period of device inactivity and ending the need for a mobile phone. We are currently reviewing our mobile phone contract which is up for renewal and want to ensure we contract based on need rather than commission based on the previous contract.

Mobile phone assets are recorded in two places; the KACE asset register and our Sophos device management system. A discrepancy between the two systems has been identified and this is caused when an officer leaves and their phone is passed directly to a new member of staff by the department rather than being handed back to IT for it to be recommissioned and reallocated. This results in an inaccurate record of who the phone is allocated to. A new process for returning phones is being implemented as part of the leaver process. This will use Sophos device management to automatically prevent the leaver's phone from being used if it is handed out directly by the department, meaning it will need to be returned.

Agency Workers/Consultants

Currently, a monthly report is produced by IT regarding agency workers/consultants where all relevant managers are then asked to confirm if the agency officer or consultant is still working for Rother. If they are not, their network account is disabled, and a leaver process will need to be completed. A timeframe for the return of equipment does need to be established (ideally within two weeks of leaving the post) before escalation to their manager. The Head of Digital and Customer Services can confirm that if high value items are not returned then Rother does seek to recoup the cost of these items.

Leaver Process

There have already been improvements introduced. There are two forms that need to be completed; a HR leavers form and an IT leavers form. The IT form is for the closing of network accounts and returning of IT items. The HR form is for the physical return of security passes, car park permits, etc. A reminder has been added to both forms to advise that both need to be completed. Ideally, all items should be returned on the last day of employment or a maximum of two weeks from the leaving date. The Head of Digital and Customer Services will be working with HR and IT to see how this can be implemented and will look to recover the value of these items from final salary payments, if needed.

Going forwards a new process is being worked on to try and automate many of the manual steps. This should also help to ensure that managers approve all requests for additional equipment and are required to provide a cost code for each purchase to be allocated to. This will mean that departments are correctly charged for their items, and it will provide for better budgetary control.

BLACKFRIARS SPINE ROAD PROJECT AUDIT

Service Manager: Nicola Mitchell/Senior Leadership Team

Officer(s) Responsible for Implementing Recommendations:

Operational Issues: Nicola Mitchell, Sasha Kulidzan and Amy Fearn

Corporate Issues: Ben Hook and Duncan Ellis

Overall Level of Assurance: **MINIMAL**

Purpose and Objectives

The purpose of the audit is to provide organisational and departmental management with an assurance as to the adequacy of the control systems based on compliance with the control objectives set out in the table below.

These objectives are designed to assess the extent to which the organisation meets its legal requirements, its own needs and those of its stakeholders and how the control systems in place contribute to the overall governance arrangements and securing value for money from the Council's services and operations.

Background Information

The Blackfriars development is in two parts; the construction of the spine road and the housing development. The responsibility for the first part, including all infrastructure costs, rests with the Council. The housing development is the responsibility of the Rother DC Housing Company, the Council’s arm’s length housing delivery vehicle.

The site had been identified as an area for potential housing development for many years and although housing companies had acquired parcels of land, development had stalled. The Government then made infrastructure funding available to local authorities to facilitate the building of homes on these types of site.

In February 2018, the Council was informed that it had provisionally been awarded £3.24m in grant funding by the Ministry for Housing, Communities and Local Government (MHCLG) as part of the Housing Infrastructure Fund (HIF) marginal viability fund to finance the construction of the road and related infrastructure necessary to develop 200 homes. This was subsequently increased to £8.7m by Homes England in late 2019 following their acceptance of the uplift in costs. Without this funding and without the intervention of the Council, the site would have remained unviable and undeveloped, depriving the Battle community of much needed homes. However, the HIF grant came with an expectation on Homes England’s part that the project would be completed within defined milestones.

Scope of Audit and Limitations

The sole focus of this review has been on the delivery of the spine road. An Internal Audit review of the Housing Company’s governance arrangements will be undertaken shortly, as part of a separate exercise.

The Blackfriars Spine Road Project has proven to be a particularly complex development and the audit has been made even more challenging by:

- the loss of corporate knowledge due to staff turnover in both the Project Team and in Finance;

- the recent change of Employer's Agent; and
- the Internal Audit Team's need to familiarise itself with the terms and conditions of a NEC4 Engineering and Construction Contract as used by the main contractor.

Nevertheless, the staff currently involved in the project have been very helpful and have endeavoured to fill in these knowledge gaps wherever they can.

It should be noted that Internal Audit was already well aware of some of the problems with the delivery of this project prior to commencing this review. However, the purpose of this audit is not to apportion blame for past shortcomings, but to highlight the main issues currently facing the Council, which if addressed, should help improve the chances of the spine road being successfully delivered so that housing development can commence.

Control Objectives

The audit opinion is based on the extent of compliance with the objectives (below), which have either been met in full (**M**), partially met (**P**) or not met (**N**).

Appointment of Main Contractor – The work was tendered for and let in accordance with Procurement Procedure Rules and Financial Procedure Rules.	**M**
Contract Payments – Contract payments are effectively monitored and paid in accordance with the contract terms. Site inspections are carried out by a quantity surveyor who evaluates the value of work carried out on the main contract and certifies this prior to any stage payments. Work to other contractors is procured in accordance with Procurement Procedure Rules and work is checked prior to payment.	**P**
External Funding – Grant funding conditions are adhered to and being closely monitored. Grant receipts are monitored to ensure they are correct.	**N ***
Monitoring and Reporting of Works, Costs and Project Risks – The project is monitored to reduce the risk of overspends and slippage. Any overspends or project delays are reported promptly to senior management and to Members.	**N**

* Grant funding and receipts are being monitored but this control objective is shown as 'not met' because milestones have been missed, putting the funding at risk. This point is explained in more detail below in the **Audit Findings and Recommendations** section.

Level of Assurance

Based on the findings from the audit we have determined that despite recent improvements in control, only minimal assurance can be given on the overall governance arrangements owing to the seriousness of the issues found. These are explained below.

Project Overview

To date, a number of issues have affected the delivery of the Blackfriars Spine Road Project. These include:

- A lack of corporate knowledge and experience in delivering such a large-scale development at the outset of the project. This situation was further exacerbated by the early departure of the original Project Manager.

- Pressure to meet HIF grant milestones. The need to make progress in order to meet these milestones meant that the project commenced (and continued to progress) when certain costs were unknown or unclear.

- The failure of the original Employer's Agent to adequately monitor the delivery of the main contract which led to performance issues. NB - The company concerned has since been replaced.

- The challenging nature of the site itself (being on relatively steep ground with wooded areas and containing protected species and potential areas of archaeological interest). All of which have resulted in project delays and additional cost.

- A substantial increase in the overall cost of the project. This is largely due to unforeseen changes in the economic and commercial environment (e.g. the UK exiting the EU, the COVID-19 pandemic, and world-wide inflationary pressures, etc.) and their effect on the cost of building materials, labour and borrowing. However, project management issues and other factors such as changes in the requirements for embankment works and drainage, and greater than anticipated land acquisition and professional fees have all contributed to the additional cost.

The control issues facing this project are therefore multi-faceted and have occurred over a long period of time, involving many agencies, staff, and consultants.

Recent Improvements

Whilst this audit has identified a number of weaknesses in control, it should be acknowledged that the Council appears to be in a much stronger position than it was six months ago. It has worked to address the onsite issues and quantify the full extent of the current budgetary overspend, a new Employer's Agent is now in place, and progress on the project is being closely monitored.

Audit Findings and Recommendations

The recommendations made in this report are categorised as either operational issues (to be resolved by the Project Team) or corporate issues (to be addressed by the Senior Leadership Team). All of the following matters are operational issues unless otherwise stated.

High risk recommendations have been made concerning:

- **Grant Funding Agreement** – The latest deadline set by Homes England to complete the spine road works and draw down the funds was 31 March 2023. This date has now passed despite numerous Change Requests having been sent to Homes England since July 2022. Homes England have now issued a Reservation of Rights letter, requesting an urgent action plan be prepared detailing amended milestones, the final drawdown date of funds and other relevant information. This has now been sent, but until such time these new arrangements are agreed, there is a risk that the £8.7m HIF grant could be withdrawn as the Council has failed to reach its agreed milestones. Furthermore, any new agreement is likely to have a final drawdown date of 31 March 2024, after which time, no further funds will be paid out. An audit recommendation was therefore made for management to finalise the arrangement as soon as possible and ensure that the final drawdown date is both achievable, and closely monitored.

- **Capital Programme Reporting (Corporate Issue)** – Management did not report the overspend on this project when it was first known. While it is accepted that the true extent of the overspend may not have been fully evaluated at the time of the February 2023 Capital Programme Update, officers would have been aware at that stage that the overspend was significant and this should have been formally reported to Cabinet. Instead Members were briefed internally while officers actively worked to find savings elsewhere in the project. Cabinet has since been updated about this issue in July 2023, but given the magnitude of the overspend, which is currently forecast to be £7.2m [now £7.9m], the audit recommends that future capital overspends must be promptly reported to Cabinet in accordance with Financial Procedure Rules. Management accept this point but state that they did not do so sooner in this case because of the complexities of the project and the need to ensure that the correct figures were reported.

Other issues identified at the audit include:

- **Utilities Infrastructure Provider** – It was unclear at the time of the audit whether Networx Utilities, the company providing the utilities infrastructure, was acting as a subcontractor of the main contractor, Breheny Civil Engineering, or whether a separate contract was required. However, the Consultant Project Manager has since confirmed that the costs incurred to date by Networx Utilities only relate to preliminary design work commissioned via a Project Management Instruction. The Consultant Project Manager also advised that a separate legal agreement with Networx Utilities is currently being drafted and that they would not be permitted to start onsite until it is signed.

- **Appointment of Consultants (Corporate Issue)** – Consultants/agency workers have been employed throughout most of the project to assist with its monitoring and delivery, but none have been appointed in accordance with Procurement Procedure Rules (PPRs) to ensure best value. Financial Procedure Rules state that the appointment of consultants should be made in accordance with PPRs, and the East Sussex Procurement Hub advise the same, but this appears to be at odds with current working practices. Management has therefore agreed that further legal advice will now be sought regarding the procurement of this type of work.

- **Reporting Arrangements** – The need to regularly update Members on the physical progress of this project. An audit recommendation is made for more formal reporting.

- **Risk Register** – The need to monitor and update the RDC project risk register. It is understood that a separate risk register is also kept in the Corporate Programme Board documentation and this information will need to be transferred across.

- **Budgetary Control (Corporate Issue)** – The budgetary monitoring spreadsheets should be updated to include £2.5m of approved spend in relation to land purchase costs. The omission of this item from financial records would appear to be an oversight and management have advised that this has now been corrected.

- **Contingency Sum (Corporate Issue)** – No contingency sum was included in the initial budget for the spine road, but it would have been prudent to have done so given the uncertainties regarding cost at the start of this project. Management accept this point and have agreed that contingency sums and realistic budgets for support costs will be included in future projects.

The only other issues found were minor in nature and were dealt with in the report.

Executive Summary

Overall, the control objectives are not considered to have been met and we have made two high, six medium and two low risk recommendations to management in order to improve the governance arrangements. All high risk recommendations and management's response to them will be included in the quarterly report to the Audit and Standards Committee.

Internal Audit Service
August 2023

Levels of Assurance:	
Good	Strong controls are in place and are complied with.
Substantial	Controls are in place, but improvements would be beneficial.
Limited	Improvements in controls or in the application of controls are required.
Minimal	Urgent improvements in controls or in the application of controls are required.

Management Update – November 2023

Since the audit was undertaken, Officers have already progressed action to reduce the audit risks identified. Updates have been provided below for Members to demonstrate progress since the completion of the audit in respect of the main recommendations. In summary, the two main risks identified relating to grant funding and capital programme reporting are both expected to be resolved by end of December 2023, subject to Homes England's reporting timescales. Progress has also been made on all the remaining items.

Grant Funding Agreement

It is not untypical for projects to experience delays when receiving central government grant; it is important therefore to be open and transparent with funders to share challenges and the reasons for delays and minimise any risk of clawback. To this end, an Action Plan to include the previous Change Request information was submitted within the required timescales. Officers have responded to various clarification queries since this time Homes England is now finalising its report and an update is expected imminently to confirm the outcome of the extended HIF funding milestones and request for additional funding.

Capital Programme Reporting (Corporate Issue)

Significant work has progressed to ensure Members are fully informed of the financial position of the Blackfriars Programme. This included the above mentioned Cabinet report in July updating Members of the project finances, also required to progress the loan arrangements with the Housing Company. Additionally, a Member briefing was held in October and included a full update on both the housing and infrastructure project. Followed by a Cabinet report in November, to regularise the Infrastructure budget of £21m. The recommendations included in the report were approved and remain subject to Full Council approval in December. Regular meetings are held between the Shareholder Representative and Leader of the Council to update on key financial changes.

Utilities Infrastructure Provider

Legal has been instructed and the first part of the Networx Utilities agreement is nearing completion. This is currently being updated to reflect the new housing layout changes. The agreement is expected to be signed by end of December 2023. The second part of the utility's agreement will follow separately via the Housing Company, relative to the utility connections from the road to the houses. This remains subject to planning approval of the new redesign and will progress next year.

Appointment of Consultants (Corporate Issue)

Following this audit recommendation, Officers have agreed that in future, consultancy/agency services will be procured via a recognised procurement framework.

Reporting Arrangements

The Blackfriars programme is presented to the Corporate Programme Board and Member Board quarterly. The website is updated monthly with activity in the last month and planned upcoming works.

Risk Register

A detailed risk register is regularly updated by the Employers Agent and overseen by the Project Manager. High level programme risks are now reported via the Shareholder Representative group. A Programme Risk register is being developed and will be incorporated into the Corporate Programme Board reporting accordingly.

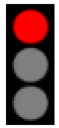
Contingency Sum (Corporate Issue)

A 5.5% contingency of the Infrastructure project has been incorporated within the £21m budget reported to Cabinet in November to be ratified by Full Council in December.

High Risk Recommendations and Management Responses

The recommendations below arise from audit findings which carry a **High** risk and which have resulted in the control objective not being met **(N)**. Management's response to the recommendation is also included and where the recommendation or an alternative action which will satisfy the control objective is agreed, an implementation date is shown. Progress against these recommendations will be included in the quarterly report to Audit and Standards Committee.

CORP = Corporate issue

Audit Ref	Finding/Risk	Recommendation	Risk	Management Response
3.1	**Finding** A Grant Funding Agreement is in place with Homes England regarding the Housing Infrastructure Funding (HIF) and confirms the final drawdown date for funds. A Deed of Amendment was seen at the audit which confirmed that the grant availability period had been extended by one year to 31 March 2023. This date has now passed, despite repeated contact by the Housing Development Manager requesting an amendment. Homes England have now issued a Reservation of Rights letter to the Council, requiring an urgent action plan be prepared detailing amended milestones, the final drawdown date of funds and other relevant information. Until such time as this is formalised, there is a risk that the funding could be withdrawn as the Council has failed to reach its agreed milestones. Furthermore, any new agreement is likely to have a final drawdown date of 31 March 2024, after which time, no further funds will be paid out.	Management should provide Homes England with a revised action plan as soon as possible and ensure that the final drawdown date is both achievable, and closely monitored.	High 	The Corporate Policy & Projects Manager advised that the action plan required by Homes England is being drafted by the Housing Development Manager and will be completed within the stipulated timescale of five working days. The Housing Development Manager will then monitor the situation to ensure that: 1) Homes England agree the Council's action plan and formalise any changes to the final drawdown date of funds. 2) Cashflow is continually monitored to ensure all funds are drawn down before the final drawdown date. **Agreed Implementation Date** 7 August 2023 for submission of action plan to Homes England. [Implemented] 31 March 2024 for the final draw down. **Responsible Officer** Amy Fearn

Audit Ref	Finding/Risk	Recommendation	Risk	Management Response
	Risk Withdrawal of the HIF grant, or failure to drawdown funds within the specified period of time, leading to a large funding deficit and significant financial loss to the Council.			
4.4 (1) **CORP**	**Finding** A recommendation was made at last year's Capital Programme Audit to ensure capital programme overspends were reported in accordance with Financial Procedure Rules. This recommendation was accepted by management at the time. However, the overspend on this project was not reported to Cabinet in February 2023. It is acknowledged that the full extent of the overspend may not have been fully evaluated at this point, but officers would have been aware that the overspend was significant and this should have been reported to Members. **Risk** Lack of transparency; increased risk that budgets may not be effectively monitored and controlled; missed opportunity for early intervention.	Budgets must be effectively monitored, and capital overspends exceeding £25,000 must be promptly reported to Cabinet in accordance with Financial Procedure Rules.	High	The Blackfriars project has been complex and challenging. Management felt that the reporting of overspends on this particular project needed to be accurate and credible before being formally reported. Members were informed in meetings once the true extent of the overspend had become clear. Management are also now actively looking at different ways in which further savings could be made on the project as a whole. Nevertheless, it is accepted that budgetary overspends should be reported to Cabinet in accordance with Financial Procedure Rules and this will be done in future. **Agreed Implementation Date** 30 September 2023 **Responsible Officer** Duncan Ellis

HOUSING COMPANY GOVERNANCE AUDIT

Service Manager: Shareholder Representative Group

Officer(s) Responsible for Implementing Recommendations: Statutory Officers Group, Shareholder Representative Group, Duncan Ellis, and Joe Powell

Overall Level of Assurance: **MINIMAL**

Purpose and Objectives

The purpose of the audit is to provide strategic, organisational, and departmental management with an assurance as to the adequacy of the control systems based on compliance with the control objectives set out in the table below.

These objectives are designed to assess the extent to which the organisation meets its legal requirements, its own needs and those of its stakeholders and how the control systems in place contribute to the overall governance arrangements and securing value for money from the Council's services and operations.

Background Information

The Rother DC Housing Company Ltd (formerly Alliance Homes (Rother) Ltd) was set up by the Council in October 2020 with the principal aim of increasing all forms of housing supply in Rother, to include delivery of much needed affordable housing.

The Housing Company is currently working in partnership with the Council to develop the Blackfriars site in Battle.

Scope of Audit and Challenges

This audit focuses on the governance arrangements in place for the sole shareholder of the Housing Company i.e. Rother District Council. It is not concerned with the Housing Company's internal procedures except where they impact on these governance arrangements.

This audit has proven to be extremely challenging because of:

- Limited documentation provided by the Shareholder's side (the majority of the evidence examined during the audit was obtained from the Housing Company).

- Changes of personnel. The composition of the Strategic Management Team/Senior Leadership Team has changed several times since the Housing Company was first set up and a new Chief Executive (Shareholder's Representative) is now in place.

- Difficulty in determining who made certain decisions and in what capacity. Two members of the Shareholder Representative Group have also acted as Chief Operating Officer (COO) for the Housing Company at some point, in addition to their existing Council duties, and all officers currently responsible for administering the Housing Company also split their time between the Housing Company and Council business.

Limitations on Coverage

Whilst the Blackfriars housing development is the primary focus of the Housing Company at present, and the complexities of this undertaking and its funding arrangements will no doubt have influenced the Council's approach to governance, the development is not specifically covered by the audit. This is because a separate Internal Audit review of the Blackfriars Spine Road Project (covering the Council's obligations regarding the delivery of this development) has already been completed.

The arrangements for the transfer of ownership of the Blackfriars site were not covered either since the land valuation, which would enable the transaction to be completed, is yet to be agreed.

Finally, the report does not consider the Community Infrastructure Levy liability or Section 106 obligations on the Blackfriars site as these will be the responsibility of the Housing Company.

Control Objectives

The audit opinion is based on the extent of compliance with the objectives (below), which have either been met in full (**M**), partially met (**P**) or not met (**N**).

Business Case and Company Structure – A business case has been made setting out the key aims and objectives of the Housing Company; its aims and objectives are consistent with the Council's overall strategy; and the risks involved in establishing a stand-alone company have been properly assessed	**N**
Shareholder Responsibilities – As the sole shareholder, the Council is sufficiently scrutinising the Housing Company's activity to ensure that its investment is protected.	**P**
Governance Arrangements – The Housing Company has developed its own controls, policies, and best practice to ensure that its risk management and corporate governance processes are effective.	**P**
Financial Procedures and Budgetary Monitoring – The Housing Company has its own financial procedure rules and procurement procedure rules, and its accounting and banking arrangements are separate to those of the Council; income and expenditure is monitored on an ongoing basis and reported to the Board.	**N**

Level of Assurance

Based on the findings from the audit we have determined that only minimal assurance can be given on the overall governance arrangements owing to the seriousness of the issues found.

Audit Findings and Recommendations

High risk recommendations have been made concerning:

- **The Company's NCA Status** – The audit raises concerns about whether the Housing Company is currently operating as a Contracting Authority (CA) - i.e. bound by public procurement rules, or as a Non-Contracting Authority (NCA) which allows for greater commercial freedom. This is an important distinction as it has implications both for compliance with public procurement rules and Council policy.

  Management state that it has always been their intention for the Housing Company to operate on a commercial basis, however, proper consideration does not appear to have been given to how this would be achieved before the Housing Company began trading. Moreover, certain aspects of the Housing Company's operation (e.g. only building new homes on Council-owned land of marginal viability, and its current reliance on the Council for financial support) do not appear to be characteristics of a commercial enterprise. Consequently, the Housing Company now wishes to remove key clauses from the Articles of Association and draft Shareholder Agreement which would potentially reduce the level of control that the Council has over the Housing Company, but which could also make its NCA status clearer.

  Given the varied legal advice that has been received over the years in relation to the Housing Company's NCA status and the more forensic analysis which could be anticipated if this were challenged in the courts, the report recommends that management should carry out a detailed risk analysis of the current status of the Company, and any implications for the delivery of current and future housing projects in order to determine the best way forward. This will be reviewed by the new Statutory Officers Group comprised of the Head of Paid Service, S151 Officer, and Monitoring Officer.

- **Loan Arrangements** – To date, the Housing Company has borrowed £2.9m from the Council in multiple tranches over a period of more than 12 months. However, no loan agreements are currently in place for any of these loans and the Housing Company will shortly be looking to borrow more. The Council should recharge the Housing Company at a commercial rate to comply with UK subsidy rules. The audit therefore recommends that the Council formalise the arrangements for doing so as soon as possible and starts applying interest on the borrowing to date. Management has already taken steps to address this and has drafted a Working Capital Agreement to cover the borrowing to date and the Housing Company's operational costs in 2023/24 which they hope to finalise by December 2023. A separate Loan Agreement will also be introduced by March 2024 to cover future borrowing.

Other issues identified at the audit include:

- **Draft or Incomplete Documentation** – Key documentation (i.e. the Shareholder Agreement, Service Level Agreement, Working Capital Agreement and Loan Agreement) have still not been finalised despite the Housing Company having been incorporated almost three years ago. Various recommendations have therefore been made to address this. NB – Whilst the draft Shareholder Agreement was agreed by Cabinet in July 2020, it has never been signed and sealed, and the Housing Company are now looking to amend it.

- **Records of Meetings** – The minutes of the Shareholder Officer Group seen at the audit were found to be lacking in detail and did not provide a clear record of what was discussed or the action points arising. Action has since been taken to correct this issue.

- **Conflicts of Interest** – A draft Conflicts of Interest Policy has been produced by the Housing Company focusing on conflicts relating to the Housing Company itself. However, there is currently no policy covering potential conflicts between the Council and the Housing Company especially in respect of officers who work for both organisations, or who have worked for one or other of the organisations in the recent past. The audit recommends that the Council should produce its own Conflicts of Interest Policy to cover such issues.

- **Internal Audits** – There is no legal requirement for the Housing Company to carry out internal audits. However, the report recommends that the Council request that the Housing Company considers undertaking periodic internal audits to give assurance that it is operating in a sound control environment and is taking action to correct any failures in internal control.

- **Procurement** – The Housing Company does not currently have a Procurement Policy. The only scrutiny that the Council has is on contracts awarded over £10m where shareholder approval is required before the Housing Company can proceed. The report recommends that the Housing Company urgently produces a Procurement Policy to ensure that best value is obtained when using public funds and to safeguard against fraud and error.

- **Monitoring of Operational Costs** – The operational costs of the Housing Company are projected to increase significantly in 2023/24 but this aspect is not specifically reviewed by the Shareholder Representative Group (SHRG). Management confirmed that the Company's operational costs have been subject to scrutiny from the Council, particularly when drawing up the draft Working Capital Agreement. However, they accept that this scrutiny should be documented in future by including a standing item in future SHRG meetings.

- **Share Capital** – Inconsistencies were found between the statement of share capital shown on documents held at Companies House, the issued share certificates and the share capital shown on both the Housing Company and Council's financial records. To date, a total of 100,001 £1 shares have been issued, but this is not accurately recorded in either the Council or Housing Company records. The report recommends that action is taken to ensure that these records reflect the true shareholding.

The only other issues found were minor in nature and were dealt with in the report.

Executive Summary

Overall, the control objectives are not considered to have been met and we have made two high, eight medium, and one low risk recommendations to management in order to improve the governance arrangements. All high risk recommendations and management's response to them will be included in the quarterly report to the Audit and Standards Committee.

Internal Audit Service

Completed: September 2023
Issued: October 2023

Levels of Assurance:	
Good	Strong controls are in place and are complied with.
Substantial	Controls are in place, but improvements would be beneficial.
Limited	Improvements in controls or in the application of controls are required.
Minimal	Urgent improvements in controls or in the application of controls are required.

Management Update – November 2023

Since the audit was undertaken, Officers have already progressed action to reduce the audit risks identified. Updates have been provided below for Members to demonstrate progress since the completion of the audit in respect of the main recommendations. In summary, necessary actions on the two high risk items are due to be completed by end of December 2023, and progress is underway to address the remaining eight medium risk items.

The Company's NCA Status

The importance of the Housing Company sustaining a non-contracting status has been previously reported to ASC in December 2022. During August this year, the Council instructed Bevan Brittan legal services to undertake an independent assessment of the Company's status. This included a review of the Company's governance documents and governance arrangements Bevan Brittan confirmed that the Company has an industrial and commercial character, meaning the Company would be ineligible for contracting authority status and, as a result, is 'non-contracting'. This is principally because the Company (i) aims to make a profit, (ii) operates in normal market conditions; and (ii) bears the risks associated with its activities. The Company is also expected to be financially independent (with any loan provided by the Council to be on market terms) which is being regularised under the Working Capital Agreement being progressed, as set out in the July 2023 Cabinet report (Minute CB23/19 refers) included under the second high risk audit item below.

In addition, the Bevan Brittan assessment prompted the Council to undertake a more formal review of its governance arrangements with support from Bevan Brittan, in partnership with the Housing Company and its legal team Trowers & Hamlins. The review was also prompted by a request from the Company's legal team Trowers & Hamlins, to consider some updates to the Articles and Shareholder Agreement to support the Company's Non-Contracting Authority status, and underline that the business of the Company is to operate as a commercial company.

A set of amendments, and a consideration of any risks to the Council has been undertaken with the support of Bevan Brittan. The outcome was a number of amendments to the Articles of Association and Shareholders Agreement, that were recently approved by Cabinet.

Loan Agreements

The principle of a loan facility was first previously approved by Cabinet totalling £80m to support delivery of the Company's business plan (Minute CB21/29 refers) on 6 September 2021. All parties have always understood that all monies provided to the Company by the Council is to be loaned at a commercial rate of interest. The existing funding arrangement is currently being formalised into a Working Capital Agreement (WCA) to regularise company spend to date and up to March 2024 (up to £10m) was approved at July Cabinet 2023.

Finance has since issued a draft Working Capital Agreement (WCA). This is now being considered by the Company's legal team and currently remains on track to complete by end of December this year.

Working Capital Agreement

See above update. To complete by end of December 2023.

Service Level Agreement

The draft Service Level Agreement has been agreed by both parties in principle and will be signed imminently. As has previously been reported to ASC in July and December 2022, it has been challenging for all parties to prioritise formalising the service level arrangements into a formal agreement, in the context of a range of operational challenges associated with the Blackfriars project.

Signing of Shareholder Agreement

The Company recognises that the original Shareholder Agreement (SHA) should have been signed at the same time as the Articles were approved and incorporated on Companies House. This issue was both known and recorded in the Company's own risk register at the time. The subsequent advice from the Company's legal advisers, Trowers & Hamlins, was to amend the SHA, before signing. This was to strengthen the Company's Non-Contracting Authority status and the proposed amendments and final signing is excepted to complete by end of December, as outlined under the first high risk item above.

Conflicts of Interest

The Council is working with its HR team to develop a policy.

Internal Audits

The Housing Company acknowledges this recommendation and will be commissioning its own audit during 2024 for the financial year 2023/24, as well as using the outcome of this audit to continue to improve the existing governance arrangements.

Procurement

The Company acknowledges that a procurement policy is required, and progress has been made to develop this policy by end of December.

It should be noted that since the Company's inception, the Company has always sought to achieve best value by undertaking a tender process for high value contracts, outlined and agreed by the Board on a case-by-case basis.

Monitoring of Operational Costs

It should be noted that since the departure of the Council's accountant working on behalf of the Company in November 2022. The Company were unsuccessful with recruitment for some months, due to a high demand and lack of accountancy services available.

Monitoring practices have improved as summarised below. This has largely been because of the Company commissioning new accountants (Kreston Reeves) in July of this year, standardising the Company's approach to accounting, with improved software. This has been overseen and supported by the Council's Interim Strategic Capital Finance Partner and Interim Chief Finance Officer.

Other actions taken to improve monitoring of operational costs;

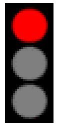
- Papers circulated to the SHRG ahead of the 13 October 2023 meeting to include a Profit & Loss statement.
- Finance reports provided on request to include; Management report, Balance Sheet and Profit & Loss statements.
- End of year accounts in progress. Draft to be shared imminently with the Shareholder, to be provided by Kreston Reeves.
- Draft Cashflow shared and being updated to include the new housing delivery Option 2) required to underwrite the WCA above.
- Finance procedure agreed for future monitoring purposes.

Share Capital

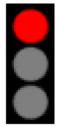
The company acknowledges these discrepancies and is taking appropriate action to update records to reflect the true shareholding accordingly.

High Risk Recommendations and Management Responses

The recommendations below arise from audit findings which carry a **High** risk and which have resulted in the control objective not being met **(N)**. Management's response to the recommendation is also included and where the recommendation or an alternative action which will satisfy the control objective is agreed, an implementation date is shown. Progress against these recommendations will be included in the quarterly report to Audit and Standards Committee.

Audit Ref	Finding/Risk	Recommendation	Risk	Management Response
1.1	**Finding** A Cabinet report produced in December 2019 detailed the Council's rationale for setting up a Housing Company. The report looked at the broad aims of the Company but also stated that the governance arrangements for the Company would be brought back to Council at a later date following consultation with Members. No evidence of this was seen at the audit. The Company's status as either a Contracting Authority (CA) or Non-Contracting Authority (NCA) was not discussed in this initial report. This was an important issue to consider in relation to the adherence of procurement rules. Given the varied legal advice that has been received over the years in relation to the Company's NCA status and the more forensic analysis which could be anticipated if this were challenged in the courts, Management should carry out a detailed risk analysis of the current position to determine the best way forward. The Council's significant investment in the Company in relation to the Blackfriars	Management should carry out a detailed risk analysis of the current status of the company, and any implications for the delivery of current and future housing projects in order to determine the best way forward. Legal, financial and procurement risks must all be assessed, and further independent advice may need to be obtained. Depending on the outcome of the aforementioned recommended risk analysis, the Council may need to consider revising its policy to deliver 1,000 new homes by 2035, to ensure compliance with procurement rules.	High 	The Statutory Officers Group will look to carry out a review to determine the best way forward in order mitigate the risk to the Council as much as possible. **Agreed Implementation Date** To be confirmed by the Chief Executive based on the availability of Linda Walker, the new Interim Monitoring Officer. **Responsible Officer** Statutory Officers Group

Audit Ref	Finding/Risk	Recommendation	Risk	Management Response
	development is an especially relevant factor. The Company's status as either a CA or NCA is determined by law, based on how the Company operates and behaves. Council officers and Members need to be aware of the significant political and financial risks for this project and the extent to which Council oversight may be more limited if the Company is operating as an NCA. Furthermore, depending on the outcome of the aforementioned recommended risk analysis, the Council may need to consider revising its policy to deliver 1,000 new homes by 2035, to ensure compliance with procurement rules. **Risks** Legal challenge if the Company has not been adhering to public procurement rules; affordability and financial risks as the Company is wholly reliant on loan funding which should be charged at a commercial rate; a potential lack of financial control if the Council cedes to the Company's wishes to remove certain reserved matters; the impact of high inflation and high interest rates on the Company's business plan.			

Audit Ref	Finding/Risk	Recommendation	Risk	Management Response
4.5	**Finding** As at 31 March 2023, the Company had borrowed £2.9m from the Council in multiple tranches over a period of more than 12 months. However, no loan agreements were in place for any of these loans. The Council should recharge the Company at a commercial rate for these loans to avoid any subsidy implications. There have previously been two draft loan agreements which have never been signed. A Working Capital Agreement has now been produced in draft form which will cover the borrowing to date and the Company's operational costs in 2023/24. It had been hoped that this would be signed by the end of July 2023, but this remained unsigned as at 3 October 2023. A draft Loan Agreement has also been produced for future borrowing which it is hoped will be signed by the end of the year. **Risks** The Council is losing interest income until such time as the loan arrangements are formalised; potential legal disputes with the Company: potential breaches of subsidy rules.	Given that there have been two previous draft loan agreements and neither of these were ever progressed, a recommendation is made to ensure that both the Working Capital Agreement and Loan Agreement are agreed and signed as soon as possible, and the Council then applies interest to the borrowing to date. Management should also ensure that the agreements adhere to subsidy rules.	High 	The Working Capital Agreement is a work in progress and the Interim Strategic Capital Finance Partner is currently looking at moving this forward. The Loan Agreement is still on course to be finalised by the end of the financial year. The S151 Officer advised that adjustments for accrued interest at the proposed interest rate have been made in the Council's accounts. **Agreed Implementation Date** December 2023 for Working Capital Agreement and March 2024 for the Loan Agreement. **Responsible Officer** Duncan Ellis

Summary of Progress on Recommendations Made up to 30 June 2023

Old Years: Audit recommendations made in 2018/19 (2), 2021/22 (3) and 2022/23 (10)

Previous quarter's performance shown in brackets.

Risk	Issued		Implemented		Work-in-Progress		Not Started	
High	6	(4)	5	*(4)*	1	*(0)*	0	*(0)*
Medium	99	(64)	91	*(60)*	8	*(4)*	0	*(0)*
Low	72	(46)	64	*(45)*	6	*(1)*	0	*(0)*
Total	**177**	**(114)**	**162**	***(109)***	**15**	***(5)***	**0**	***(0)***
			91.5%	*(95.6%)*	**8.5%**	*(4.4%)*	**0%**	*(0%)*

Note – All audit recommendations made in 2019/20 and 2020/21 have been resolved.

Breakdown of the five oldest (pre-2022/23) audit recommendations by Service Manager:

Mark Adams (Head of Digital and Customer Services)

- ICT Governance (2018/19) – issued 12/04/19. Recommendation to produce a new ICT Disaster Recovery Plan (Medium).
- Data Protection (2021/22) – issued 25/06/21. (1) Recommendation to determine which Council systems hold special category data and to confirm that there is a lawful basis for processing such data (Medium) and (2) Recommendation to establish if privacy notices still need to be produced for certain processes (Low).

Duncan Ellis (Interim Deputy Chief Executive)

- Procurement (2018/19) – issued 05/10/18. Recommendation to formalise an SLA for the service provided by the East Sussex Procurement Hub (Medium).

Joe Powell (Head of Housing and Regeneration)

- Estates Income (2021/22) – issued 30/06/21. Recommendation to update the tenancy details stored on the ePIMS asset register database to correct the discrepancies found at the audit and to ensure it is properly maintained from now on (Medium).

Current Year: Audit recommendations made in 2023/24 (up to 30 June 2023)

Risk	Issued	Implemented	Work-in-Progress	Not Started
High	0	0	0	0
Medium	1	0	1	0
Low	3	2	1	0
Total	**4**	**2**	**2**	**0**
		50.0%	**50.0%**	**0%**