

INTERNAL AUDIT REPORT



THE KING CENTRE 2018/19

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THE KING CENTRE 2018/19 EXECUTIVE SUMMARY

1. INTRODUCTION & OVERALL OPINION

Rutland County Council (RCC) has successfully converted a former college building, into approx. 12,000 sqft of fully-serviced commercial office space intended to support new and expanding businesses. The site also provides a source of income for the Council which can support the provision of local services. Out of 32 units at King Centre 28 are already occupied. Assurance was sought from the Audit review that lease agreements are commercially viable, subject to a robust tenancy application process and that income due from tenants is suitably recovered.

An internal audit review of a sample of ten units highlighted that controls over the administration of tenancy applications and pre-tenancy checks are operating effectively and are fully embedded. Audit trail of credit checks, trade reference checks and identification verification was evident in all tenants within the audit sample and all of tenants did complete a tenancy application form.

Copies of signed and sealed lease agreements were available for 100% of the sample and included key areas such as rent charged, details of any break clauses, length of term, renewal rights, service charges, repair obligations and subletting arrangements. Tenants are required to sign a Statutory Declaration giving the landlord automatic possession at the end of the lease. In all ten cases reviewed a signed Statutory Declaration had been signed by the tenant. A Heads of Terms document setting out the key commercial terms that parties intend to incorporate in a binding agreement had been confirmed via email to all the tenants in the audit sample. Rent Bonds setting out the amount of deposit paid had also been signed and sealed in all cases reviewed.

Tenants were found to be invoiced accurately and timely in accordance with the terms agreed in the lease and market rental values. Rental income is recovered in a structured, timely manner and in line with the Council's debt recovery procedures. Deposits received are held in the Council's deposit holding account. From a sample of ten units, all with the exception of one deposit paid (as noted on the rent bond and the unit database) could be traced to the Council's deposit holding account. It is understood that the one remaining deposit is currently being re-invoiced.

The audit was carried out in accordance with the agreed Audit Planning Record (APR), which outlined the scope, terms and limitations to the audit. The auditor's assurance opinion is summarised in the table below:

Internal Audit Assurance Opinion			
Control environment	Substantial ●		
Compliance	Good ●		
Organisational impact	Minor ●		
Risk	High	Medium	Low
01 - Lease agreements are not commercially viable, possibly leading to financial losses and reputational damage.	0	0	0
02 - Inadequate tenancy application process, leading to potential fraud and financial losses.	0	0	2
03 - Increase in bad debt due to insufficient income monitoring and recovery.	0	0	0
Total Number of Recommendations	0	0	2

2. SUMMARY OF FINDINGS

Risk 1: Lease agreements are not commercially viable, possibly leading to financial losses and reputational damage.

The King Centre rental figures were agreed with Chartered Surveyors (Innes England) and Local Estate Agents as being an appropriate market rent for the local area. Comparable offices in the outskirts of Oakham on Rightmove were checked and officers continue to monitor these to ensure that The King Centre is not below the average market rate. Office spaces were set for £10 per/sqft with service charges of £7.66 per/sqft including utilities and all other annual overheads. It was explained that the average price for offices on Rightmove outside Oakhamtown centre is currently £6.86/sqft + a modest service charge, putting The King Centre well above this average. Audit testing was undertaken to determine if the rent charged was within the open market rental figure and the marketing figure agreed. Testing confirmed that all ten units reviewed had been given a rental price that was within the guidelines provided by Innes England and agreed to lease documents held for each unit. Leases include a provision for a rent review every three years and the Commercial Investment Project Board convenes regularly and gives consideration to rental levels for new tenants. The first floor laboratories which are due to be converted to offices for example are due to be let at an increased rate of up to £12/sqft plus service charge to reflect higher demand for smaller units and to optimise the desired ROI following the conversion works. Two of the smaller offices on the ground floor are already let at a rate of just over £12/sqft plus service charge. VAT is added in all cases at the standard rate of 20%.

A Heads of Terms letter or document sets out the key commercial terms that parties intend to incorporate in a binding agreement. The Heads of Terms set out the basis for negotiating a subsequent longer term agreement and are often useful in establishing what will and will not be included in any future agreement. A review of a sample of ten units found Head of Terms used in all cases. The Heads of Terms were confirmed through the email to the tenant setting out details of the agreed term, unit information, rent, service charges and deposit amounts to be paid, and other important terms.

The standard lease template originally drafted by Peterborough City Council (PCC) Legal is used for The King Centre and does not change other than tenants' details and specific terms. Business Support Assistants change unit numbers/names and insert tenants details and rent/service charge etc. using issued heads of terms emails. The Economic Development and Tourism Manager then checks the lease and sends out to tenants for approval/completion. Evidence of lease agreements were seen in all ten cases reviewed signed by the tenants and also signed and sealed by the Council's Chief Executive and Council Leader. In all cases signed lease documentation covered rent and rent deposits and guarantees, length of term, break clause and renewal rights. Also rent review arrangements were detailed. Lease agreements explained whether or not tenant had the security of tenure, right to assign, sublet and share the premises. Repair obligations and management of lease, along with the schedule of all service charges were included within the lease documentation. All tenants are also required to sign the Statutory Declaration. In all ten cases reviewed the leases were accompanied by the Statutory Declaration signed by the tenant giving the landlord automatic possession at the end of the lease.

Risk 2: Inadequate tenancy application process, leading to potential fraud and financial losses.

A tenancy Checklist is available and is used to ensure all relevant documentation is completed during the tenancy application process. The evidence of use of the checklist was seen in all ten cases reviewed.

A Commercial Lettings Policy is also available, however it does not include any references to The King Centre, and there is no evidence of a recent policy review. To ensure that the correct procedures are followed the policy should be reviewed and updated. **Recommendation 1** addresses this finding.

All potential tenants are required to complete and sign a tenancy application form. From a sample of ten units, all tenants had completed and signed an application for tenancy. The Commercial Lettings Policy sets out some guidance in the applicant's selection process. It states that Rutland County Council is keen to support start-up businesses and priority will normally be given to applications from new businesses. Preferences will also be given to businesses that create or protect jobs and in particular to light industrial or manufacturing businesses in order to offer greater employment opportunities and employment diversity. To further strengthen the processes and promote transparency for the units that receive interest from multiple parties, officers may want to keep a record of any shortlisting activity to evidence the reasons for the decision in selecting the preferred tenant.

Pre-tenancy checks such as the verification of tenant identity, performing credit checks and checking trade references are carried out. The evidence that tenants' ID was obtained and verified was seen in all but one case which related to an existing tenant who was known to officers (as the tenant was relocating from a tenancy at Oakham Enterprise Park), hence the ID was not requested. It was noted that as a result of General Data Protection Regulation (GDPR), officers decided (having sought advice from the Corporate Governance team) not to retain copies of the identification documents, rather it was agreed to keep a written note confirming that ID was seen. However, two instances were found where original copies of passports were erroneously still saved on file and had not been deleted in some cases a separate note was saved on file confirming that identification was checked, whilst in other cases the tenancy checklist was used to evidence the ID check. To ensure a consistent approach is used it is recommended to adopt one standard practice of evidencing verification of ID. Officers may wish to use the tenancy checklist to record who checked the ID and when and what type of document was checked. **Recommendation 2** addresses this finding.

The application for tenancy form requires the tenant to provide two references. Two references were received for four out of ten tenants reviewed by audit. Another two cases were noted where no references were obtained, of which one case related to an existing tenant from the Oakham enterprise Park (OEP) site and it was confirmed in writing with the Estates Surveyor that no concerns were raised previously in relation to the tenant. The other case where no references were obtained related to a new start up business, and it was confirmed that to mitigate the risk three months deposit was taken. In the four remaining cases one reference was received.

The Council carries out appropriate financial checks especially for higher value leases (over £5,000 per annum) with the exception of start-up businesses. The review of a sample of ten units confirmed that credit checks were undertaken where required. However, two cases were noted where the annual lease was over £5,000 but no credit checks were completed. The Economic Development & Tourism Manager explained that these related to unincorporated business i.e. the lease is in name of the owners of the company meaning they will be personally liable for any arrears should they occur. In both of these cases, deposit equivalent to three months' rent was taken to mitigate the risk.

Risk 3: Increase in bad debt due to insufficient income monitoring and recovery.

The Commercial Investment Project Board meet regularly to review progress, approve expenditure and review and agree larger lease agreements. It is also an opportunity for members of the board to discuss any issues or concerns regarding the King Centre. The project board meetings are attended by the Head of Property Services who chairs the meetings, the Leader of the Council, Portfolio Holder for Places, Finance Manager and Economic Development & Tourism Manager. Minutes from the last twelve months were obtained and reviewed. The review of minutes demonstrated that The King Centre is a standing agenda item at every meeting. Matters relating to The King Centre discussed included new occupancy enquiries, proposed refurbishment works, any planned or required maintenance, rent arrears, budget position etc.

The review of the invoices raised for the sample of ten units demonstrated that all invoices were issued promptly and accurately in accordance with the Lease Agreement.

Tenants' debts are managed in line with the standard Rutland County Council (RCC) debt recovery procedures. Tenants are invoiced one month in advance. They then have 30 days to pay the invoice. The King Centre being a fairly new arrangement has not encountered any major issues of tenants not paying rents. At the time of the audit there was only one tenant that had accumulated rent arrears since July 2018. During the last project board meeting in September 2018 officers discussed the matter and highlighted that RCC is continuing with the recovery of rent and has exhausted options for the first invoice, continuing with second and third. However, there are issues with the ground floor roof which leaks and is directly impacting the tenant. The Board acknowledged that issue of the leaks needing to be resolved and assistance offered to the tenant. The Economic Development and Tourism Manager also discussed the matter during a recent Property Services team meeting and is keen to prevent further arrears from building whilst repair works for the roof leak are ongoing. The Estates Surveyor was tasked to review the tenant's lease and advise with the best course of action, with legal involvement as necessary.

Rent Bonds setting out the amount of deposit paid have been signed by all tenants in the reviewed sample. Deposits received are held in the Council's deposit holding account (BZ534). From a sample of ten units all except one deposit were paid (as noted on the rent bond and the unit database) and could be traced to the Council's deposit holding account. The one that could not be found in the deposit holdings account related to the tenant who had been credited for the deposit they paid and new invoices have been raised for their respective deposit amounts, following a change in unit. The Economic and Development Manager explained that these transactions are currently being processed via the Finance team.

3. LIMITATIONS TO THE SCOPE OF THE AUDIT

This is an assurance piece of work and an opinion is provided on the effectiveness of arrangements for managing only the risks specified in the Audit Planning Record.

The Auditor's work does not provide any guarantee against material errors, loss or fraud. It does not provide absolute assurance that material error, loss or fraud does not exist.

Rec No.	ISSUE	RECOMMENDATION	Management Comments	Priority	Officer Responsible	Due date
1	<p>A Commercial Lettings Policy does not include any references to The King Centre, and there is no evidence of a recent policy review.</p> <p>To ensure that the correct procedures are followed the policy should be reviewed and updated.</p>	<p>Review and update the Commercial Lettings Policy.</p> <p>The policy must include a policy owner, a next review date and be version controlled.</p>	Agreed	<p>Low</p> <p>●</p>	The Economic Development and Tourism Manager	31/12/18
2	<p>Inconsistencies in evidencing verification of tenants' ID was noted. In two instances original copies of passports were saved on file, in some cases a separate note was saved on file confirming that identification was checked, whilst in other cases tenancy checklist was used to evidence the ID check.</p> <p>Improving record keeping and ensuring consistent approach will assist officers in complying with the GDPR.</p>	<p>Adopt a standard approach to evidence verification of ID.</p> <p>Officers may wish to use the tenancy checklist to record who checked the ID and when, and what type of document was checked.</p>	Agreed	<p>Low</p> <p>●</p>	The Economic Development and Tourism Manager	31/12/18

GLOSSARY

The Auditor's Opinion

The Auditor's Opinion for the assignment is based on the fieldwork carried out to evaluate the design of the controls upon which management rely and to establish the extent to which controls are being complied with. The tables below explain what the opinions mean.

Compliance Assurances			
Level		Control environment assurance	Compliance assurance
Substantial	●	There are minimal control weaknesses that present very low risk to the control environment.	The control environment has substantially operated as intended although some minor errors have been detected.
Good	●	There are minor control weaknesses that present low risk to the control environment.	The control environment has largely operated as intended although some errors have been detected.
Satisfactory	●	There are some control weaknesses that present a medium risk to the control environment.	The control environment has mainly operated as intended although errors have been detected.
Limited	●	There are significant control weaknesses that present a high risk to the control environment.	The control environment has not operated as intended. Significant errors have been detected.
No	●	There are fundamental control weaknesses that present an unacceptable level of risk to the control environment.	The control environment has fundamentally broken down and is open to significant error or abuse.

Organisational Impact		
Level		Definition
Major	●	The weaknesses identified during the review have left the Council open to significant risk. If the risk materialises it would have a major impact upon the organisation as a whole.
Moderate	●	The weaknesses identified during the review have left the Council open to medium risk. If the risk materialises it would have a moderate impact upon the organisation as a whole.
Minor	●	The weaknesses identified during the review have left the Council open to low risk. This could have a minor impact on the organisation as a whole.

Category of Recommendations

The Auditor prioritises recommendations to give management an indication of their importance and how urgent it is that they be implemented. By implementing recommendations made managers can mitigate risks to the achievement of service objectives for the area(s) covered by the assignment.

Priority		Impact & Timescale
High	●	Action is imperative to ensure that the objectives for the area under review are met.
Medium	●	Requires actions to avoid exposure to significant risks in achieving objectives for the area.
Low	●	Action recommended to enhance control or improve operational efficiency.