

## INTERNAL AUDIT REPORT



### OAKHAM ENTERPRISE PARK 2015/16

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## **OAKHAM ENTERPRISE PARK EXECUTIVE SUMMARY**

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### **1. INTRODUCTION & OVERALL OPINION**

Oakham Enterprise Park (OEP) is a 25 acre business park that offers businesses affordable office, storage and industrial premises for rent. The Council purchased the site in December 2012 and put in place a business plan which anticipated that by April 2015 it would be generating rental income of £190,500. The main project targets were to have 103,000 sqft of business space made available to market, to have let 77,000 sqft of remediated business space, to have created or safeguarded 250 new jobs and supported 35 businesses all by 2018/19. Currently around 96,000 sqft has been let which excludes external areas and the Events Zone. More than 90 tenants currently have leases at OEP and progress towards other targets are good with 24 start-up businesses being supported to date and an estimated 150 jobs created or safeguarded at the site. An accurate employment survey is proposed early 2016 now that the site is approaching capacity.

Since opening for business, the demand for the site has been exceeded expectations with existing local businesses and new businesses to Rutland requiring units, often even before they were finished. In September 2013, the Council appointed an OEP business manager and the park is currently at more than 98% capacity and continues to expand with a total revenue projection of £404k in 2015/16 increasing to over £530k total budgeted income for 2016/17 and these figures exclude any additional income from business rates. The wider economy, especially the tourism sector has benefitted from side-line activities such as filming at the site and it's financial success has led to the Council being shortlisted for an LGC award for 'Entrepreneurial Council of The Year'.

The pace of change has been such that the systems underpinning its operation have been developed alongside ongoing activity. The Council recognises that robust systems need to be put in place and in this context, the Director requested a review which was supported by the Audit & Risk Committee. 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.

Internal Audit recognises that the Council has taken positive steps to improve the controls over the tenancy application process for prospective tenants at Oakham Enterprise Park. Tenants' credit, trade reference, age (to ensure they are over 18 and thus legally entitled to hold a lease) & citizenship checks have recently been introduced and any new lease agreements are now independently reviewed by an Estates Surveyor to ensure they are accurate and commercially viable prior to them being forwarded to Legal Services.

An internal audit review of a sample of ten units highlighted that controls over the administration of tenancy applications and pre-tenancy checks were found to be limited in places and not fully embedded. Credit checks, trade reference checks and identification verification did not take place for all tenants within the audit sample and 50% of tenants did not complete a tenancy application form.

Lease agreements were available for 90% 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. However rent review arrangements and rent deposit information were inconsistently documented and lacking suitable audit trails. In addition, lease agreements could not be located for one tenant, who occupies two units.

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 payments plans have been put into place where required. However, on occasions it was noted that cash payments are received directly at the OEP site rather

than through customer services. This handling of cash and an insufficient audit trail could potentially expose the Council to an increased risk of fraud and should be avoided in future. This has already been addressed and rent is only accepted by cheque or BACS with most tenants now paying by standing order.

The audit was carried out in accordance with the agreed Audit Planning Record (APR). It is the Auditor's Opinion that the current overall design and operation of controls provides **Limited Assurance**, as summarised below:

Internal Audit Assurance Opinion	Direction of Travel				
<b>Limited Assurance</b>	<b>N/A</b>				
Risk	Design	Comply	Recommendations		
			H	M	L
<b>Risk 1: Lease agreements are not commercially viable, possibly leading to financial losses and reputational damage.</b>	Sufficient Assurance	Limited Assurance	1	0	3
<b>Risk 2: Inadequate tenancy application process, leading to potential fraud and financial losses.</b>	Sufficient Assurance	Limited Assurance	2	0	2
<b>Risk 3: Increase in bad debt due to insufficient income monitoring and recovery.</b>	Substantial Assurance	Sufficient Assurance	1	0	0
<b>Total Number of Recommendations</b>			<b>4</b>	<b>0</b>	<b>5</b>

## 2. SUMMARY OF FINDINGS

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

Chartered Surveyors (Innes England) carried out valuations on Oakham Enterprise Park in March 2013 and were asked to provide open market rental values for the units proposed to be offered as business units. The council was provided with an open market rental figure and a marketing figure. For office spaces a price of £7-£8 per square foot was recommended and for a workshop/studio a rate of £3-£4 per square meter was recommended. All ten units sampled by Internal Audit had been given a rental price that was within the guidelines provided by Innes England. Further analysis highlighted on occasions that units may be charged lower than the recommend rates due to market conditions and the condition of the unit, in examples reviewed this was suitably justified.

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 form agreement and are often useful in establishing what will and will not be included in any future agreement. Just one unit from a sample of ten had a heads of term document, highlighting that the requirements for a Heads of Terms document have not yet been established or are unclear. **Recommendation 2 addresses this issue.**

A process has recently been introduced whereby an Estates Surveyor independently reviews all lease agreements prior to finalising. It was noted that none of the ten leases included in sample testing during the audit had been independently reviewed. Furthermore, fully signed certified copies of leases could only be found for 60% of the sample. Of leases reviewed, 30% had not been signed by the Council or signed copies were not available for review and a lease agreement could not be located for Unit 11a and Unit 1, both of which are occupied by the same tenant. **Recommendations 1 and 3 address these issues.**

Of the nine leases reviewed by Internal Audit, key details such as the rent charged, details of any break clauses, length of term, renewal rights, service charges, repair obligations and subletting arrangements were all documented and included in the agreements. Details relating to rent review arrangements and rent deposits were not always documented in leases. **Recommendation 4 addresses this issue.**

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

Positive steps have been taken to develop and document procedures for the tenancy application process. Process maps covering applications for tenancy and the payment recovery process have been developed, however they could be further enhanced by including responsible officers and including more detailed steps such as lease approvals, identification verification, Heads of Terms and rent deposits. **Recommendation 5 addresses this issue.**

All potential tenants are required to complete and sign a tenancy application form. Of the ten units sampled by Internal Audit, only 50% had completed and signed an application form. Should there be more than one applicant for a vacant unit, the tenancy would be offered by the OEP Manager based on his judgement, taking into account that the Council is encouraging new/start-up businesses. If an unsuccessful tenant was to raise a dispute over a tenancy application, the Council would not have a sufficient audit trail to justify their decision. **Recommendation 6 addresses this issue.**

Pre-tenancy checks such as the verification of tenant identity, performing credit checks and checking trade references had not been conducted for any of the ten units in the selected sample. Internal Audit recognise that steps have been put in place to ensure that credit checks and trade references are carried out going forward, however it is also important to confirm the identity of all tenants to reduce the risk of money laundering and potential fraud. **Recommendation 7 addresses this issue.**

It is considered best practice for Officers involved in the management of commercial lettings to be suitably training in fraud awareness as well as bribery and corruption and money laundering. Counter fraud awareness has been covered in the Corporate Induction since 2013; however the OEP Business Manager has not received this training. Whilst the Council has a documented money laundering protocol, it is currently not mandatory to read the document and there has been no awareness training on money laundering or bribery and corruption in recent years. **Recommendation 8 addresses this issue.**

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

OEP tenants are invoiced one month in advance for rental and service charge payments. Nine units within a sample of ten were invoiced accurately for the 2015/16 rental period and in accordance with lease agreements. A lease agreement could not be provided for one unit in the sample (Unit 11a) and therefore Internal Audit was unable to verify that the rent charged was accurate.

The recovery of rental income is carried out in accordance with the Council's Financial Procedure Rules. Overdue debt is discussed monthly between the Exchequer Team Leader and the OEP Business Manager. At the time of the audit, fifteen accounts were overdue, totalling £22,421. Appropriate action is being taken to recover the debt and payment plans have been put into place where appropriate.

Suitable segregation of duties exists between the setting of rent, creation of leases and collection of income, however it was highlighted during the audit that on rare occasions, cash is accepted by staff at the OEP site office rather than the customer taking the cash directly to customer services. This practice together with the lack of audit trail for rent deposits creates a significant fraud risk to the Council. Internal Audit note that where it could be seen that cash was accepted on site, a receipt was later emailed to the tenant and cash was posted to the correct tenant account. **Recommendation 9 addresses this issue.**

Rental deposits were not consistently requested from earlier tenants, however this is now considered to be a requirement going forward. Of the ten units sampled by Internal Audit, eight units were charged a deposit according to an electronic record held by the OEP Business Manager. Receipts could be found for seven deposits and six payments were correctly charged to the Council's holding account (BZ534) within the Council's finance system (Agresso). One payment for £1,000 had been incorrectly posted to account R9322 and has now been transferred to the correct account. A receipt or finance entry could not be found for a deposit payment of £521 for unit 11a. In this instance there was also no lease agreement or rental deposit deed available for review, therefore it is unclear as to whether a deposit was actually charged or received. Such lack of audit trail puts the Council at greater risk of potential fraud. **Recommendation 4 addresses this issue.**

### **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.

This audit did not include a review of the management and funding of the OEP project or health and safety legislation compliance for commercial properties and communal areas.

## ACTION PLAN

Rec No.	ISSUE	RECOMMENDATION	Management Comments	Priority	Officer Responsible	Due date
1	A clear audit trail for lease review and approvals could not be found for all units within the audit sample.	<p>The Property Manager should ensure that all lease agreements for the Oakham Enterprise Park are independently reviewed by the Estates Surveyor prior to signing to ensure there are no errors and they are commercially viable.</p> <p>A suitable audit trail for the review process should be kept on file.</p>	In place	Low	Director - Places (D & E)	Complete
2	<p>Of the units reviewed during the audit, 90% did not have a Heads of Terms document.</p> <p>Whilst heads of terms are not a legal requirement, they set out the key commercial terms for a lease and could minimise the risk of errors and disputes, particularly for longer lease agreements.</p>	<p>The Council should determine under what circumstances a Heads of Terms should be required depending on the size/type of unit that is being let</p> <p>This should be documented within the OEP process maps.</p> <p>Copies of all Heads of Terms should be saved in the appropriate unit folder on the shared network for reference and audit purposes.</p>	In place	Low	Director - Places (D & E)	Complete

Rec No.	ISSUE	RECOMMENDATION	Management Comments	Priority	Officer Responsible	Due date
3	<p>From a sample of ten units, internal audit identified the following:</p> <ul style="list-style-type: none"> <li>- 30% of the leases were not signed and sealed by the Council or copies were not available for review.</li> <li>- One lease agreement (Unit 11a) was not available for review during the audit. Further review highlighted that a lease was also not available for Unit 1 which is occupied by the same tenant.</li> </ul> <p>Without a signed lease it could be more difficult to resolve any tenant/landlord disputes.</p>	<p>The OEP Business Manager should work with the legal department to ensure that there is a signed lease agreement on file for all currently let units within the Oakham Enterprise Park.</p> <p>Originals should be held in the Council safe and certified copies scanned on to the Council network and saved in the appropriate folder.</p>	In place	Low	Director - Places (D & E)	Complete
4	<p>Rent review arrangements and rent deposits are not clearly stated in lease agreements.</p> <p>From a sample of ten units, the following was highlighted:</p> <ul style="list-style-type: none"> <li>- Two leases referred to a schedule 5 for rent reviews, however a schedule 5 did not exist and one lease did not state any rent review arrangements.</li> <li>- Five leases did not state arrangements for rent deposits, despite the tenant being charged a deposit.</li> <li>- It was unclear whether one deposit with a value of £521 had been charged or received due to an insufficient audit trail.</li> </ul> <p>Unclear landlord and tenant roles and responsibilities, can lead to potential disputes, reputational damage and a lack of audit trail leaves the process open to abuse and risk of fraud.</p>	<p>Rental deposits and rent review arrangements should be detailed in all lease agreements.</p> <p>A rent deposit deed should be completed for all deposits and evidence should be retained on file.</p> <p>The Council should consider developing a checklist to ensure that all tenancy documentation has been obtained and saved on file.</p>	<p>All future leases will have a clear statement and/or procedure regarding rent reviews</p> <p>A checklist will be developed to ensure that all relevant documentation is included within the property file</p>	High	Director - Places (D & E)	<p>01/11/15</p> <p>31/03/16</p>

Rec No.	ISSUE	RECOMMENDATION	Management Comments	Priority	Officer Responsible	Due date
5	<p>Whilst current process maps outline the steps the Council will take regarding tenancy applications and income collection, it does not provide details on who will carry out these tasks and some key steps in the processes are missing.</p> <p>There is a risk that key controls are not followed and staff do not know how to perform their roles and responsibilities leading to non-compliance and inconsistencies in working practices.</p>	<p>The current process maps for the tenancy application process and payment recovery should be revised to include details of responsible officers and also to include controls over lease reviews, ID checks and Heads of Terms.</p>	Process map to be developed	Low	Director - Places (D & E)	31/03/16
6	<p>A Tenancy Application Form was not completed for 50% of tenants in the audit sample. Furthermore, a formal, documented, transparent selection process for multiple tenants does not currently exist.</p> <p>The Council would not be able to demonstrate how a tenant was selected if a tenancy was disputed.</p>	<p>Formal criteria for receiving, assessing and selecting tenancy applications should be determined.</p> <p>A signed application form must be completed for all prospective tenants as it gives the tenant's consent for the Council to carry out credit searches and records permanently the tenant's declaration as to identity, accommodation, references and personal details</p>	A process will be developed	High	Director - Places (D & E)	31/3/16
7	<p>Current processes outline that credit checks and trade references should be carried out on new tenants however out of the ten units reviewed by Internal audit, none of the tenants had been subject to such checks. Furthermore, it is not current procedure to verify identification of the tenants.</p> <p>Without the processes in place to carry out appropriate tenant checks, the Council is at risk of potential fraudulent activities which could result in financial and/or reputational damage.</p>	<p>Pre tenancy checks should be carried out on all prospective tenants at the OEP.</p> <p>Checks should include but not be limited to the following:</p> <ul style="list-style-type: none"> <li>• ID verification</li> <li>• Credit checks</li> <li>• Trade references</li> </ul> <p>Documentary evidence of these checks should be retained on file.</p>	<p>This will be introduced as part of the standard procedure</p>	High	Director - Places (D & E)	29/1/16





Rec No.	ISSUE	RECOMMENDATION	Management Comments	Priority	Officer Responsible	Due date
8	<p>The Business Manager for OEP has not received awareness training on fraud, bribery and corruption or money laundering in recent years.</p> <p>Staff involved in the management of commercial lettings may not have the skills and information to detect and prevent potential fraudulent activities.</p>	<p>Awareness training on fraud, bribery, corruption and money laundering should be considered for all employees involved in the management of commercial lettings.</p> <p>.</p>	<p>The Council's HR team have advised this training is not yet available. However, the Governance team are working on some online training to be available soon.</p>	Low	Director - Places (D & E)	31/3/16

Rec No.	ISSUE	RECOMMENDATION	Management Comments	Priority	Officer Responsible	Due date
9	<p>It was identified during the audit that occasionally cash or cheque payments from tenants are received at the Oakham Enterprise Park site and taken to customer services by the OEP Manager.</p> <p>This leaves the Council vulnerable to fraud risk and open to abuse.</p>	<p>Cash or cheques should not be accepted at the Oakham Enterprise Park. Tenants should be advised to take all cash and cheque payments to Customer Services.</p> <p>If the Council chose to accept cash and cheque payments on site the following controls must be implemented:</p> <ul style="list-style-type: none"> <li>- Policies and procedures for the handling of cash should be documented,</li> <li>- All cash should be held in a secure safe with restricted access,</li> <li>- The maximum amount of cash held on site must be covered by the Council's insurance policy,</li> <li>- All income received must be recorded and reconciled to the income received,</li> <li>- The person receiving income must not be the OEP Business Manager,</li> <li>- Receipts should be issued for all income received and a suitable audit trail retained.</li> </ul>	<p>No cash payments will be taken for rent going forwards. However, it is reasonable to be expected to accept cash for sundry item sales via the Council's EBAY account (the Council cannot accept PayPal payments which is the default &amp; preferred EBAY payment method). Due to the long distances often travelled by buyers, items are often collected out of hours or at weekends when the Council offices are not open. A numbered cash receipt book is now located within the site office and will be used going forwards.</p>	High	Director - Places (D & E)	Complete

## 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 table below explains what the opinions mean.

Level	Design of Control Framework	Compliance with Controls
<b>SUBSTANTIAL</b>	There is a robust framework of controls making it likely that service objectives will be delivered.	Controls are applied continuously and consistently with only infrequent minor lapses.
<b>SUFFICIENT</b>	The control framework includes key controls that promote the delivery of service objectives.	Controls are applied but there are lapses and/or inconsistencies.
<b>LIMITED</b>	There is a risk that objectives will not be achieved due to the absence of key internal controls.	There have been significant and extensive breakdowns in the application of key controls.
<b>NO</b>	There is an absence of basic controls which results in inability to deliver service objectives.	The fundamental controls are not being operated or complied with.

### 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
<b>HIGH</b>	Management action is imperative to ensure that the objectives for the area under review are met.
<b>MEDIUM</b>	Management action is required to avoid significant risks to the achievement of objectives.
<b>LOW</b>	Management action will enhance controls or improve operational efficiency.