

# ***Internal Audit Report 2017/2018***

## **Fraud Risk Review**

***I4B Holdings Ltd***

*31 May 2018*

*Final draft*



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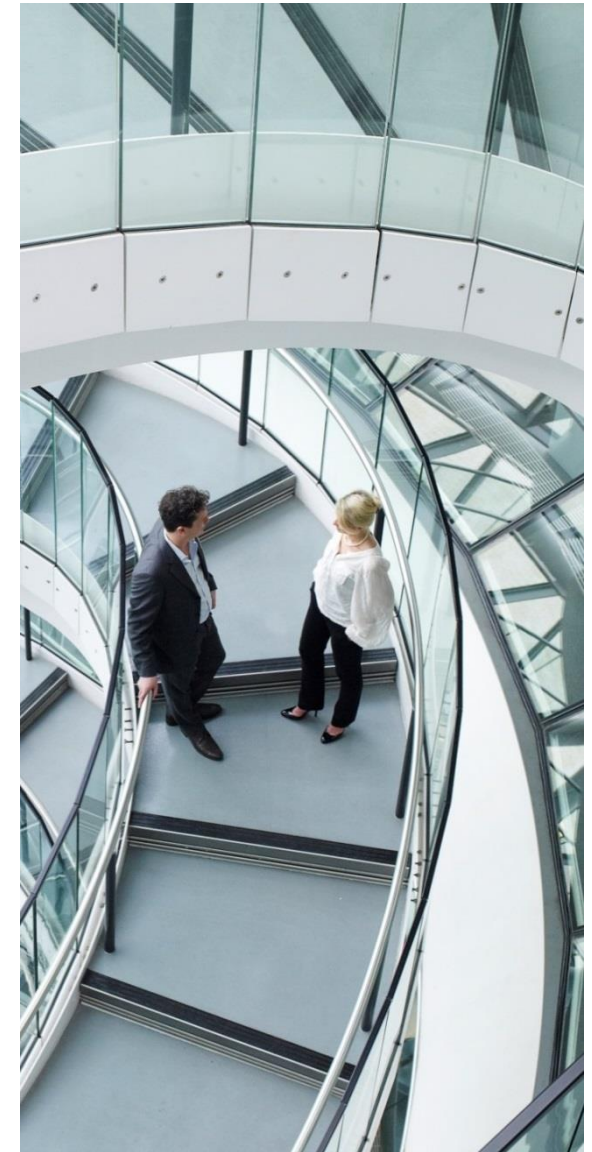
### Distribution list

#### For action:

Martin Smith, I4B Board Chair  
 Chris Brown, Programme Manager (i4B Holdings Ltd)  
 Sadie East, Head of Transformation (Brent Council)  
 Paul Keegan, Interim Head of Commercial Finance (Brent Council)

#### For information:

Councillor George Crane, Director (I4B Holdings Ltd)  
 Peter Gadson, Director (I4B Holdings Ltd)  
 Gail Tolley, Director (I4B Holdings Ltd)  
 Michael Bradley, Head of Internal Audit (Brent Council)  
 Aina Uduehi, Audit Manager (Brent Council)  
 Michael Cassel - Investigations Manager (Brent Council)



## ***Executive summary (1 of 2)***

### ***Introduction***

I4B is a wholly owned subsidiary of Brent Council, incorporated in December 2016. It has been set up to reduce the number of Brent families living in temporary accommodation by providing good quality affordable homes. Over the past 12 months Brent Council has purchased a number of residential properties and are in the process of transferring these to I4B. Moving forward I4B will purchase properties directly in order to expand its portfolio.

These activities create inherent internal and external fraud risks for I4B, particularly when large value payments are to be made to purchase properties and external parties are to be engaged to source and manage properties. Fraudulent activity could result in financial losses and reputational damage to I4B. It is therefore important for I4B to take a pro-active approach to identifying, assessing and responding to fraud risks and ensure that there are robustly designed controls in place to treat these risks in accordance with risk appetite.

The purpose of this review was to identify through a workshop the key inherent fraud risks facing I4B from internal and external sources based on its current and planned business activities, along with a consideration of the key controls in place that would treat these risks and suggestions for next steps. This will enable management to understand the key fraud risk they face and consequently assess whether controls are appropriately designed and fit-for-purpose in advance of I4B expanding its portfolio and the level of its operations.

### ***Fraud risk workshop***

A fraud risk workshop was delivered on 12 April 2018 to I4B. This was attended by:

- James Cook - Head of Commercial Finance (Brent Council)
- Chris Brown - Programme Manager (i4B Holdings Ltd)
- Sadie East – Head of Transformation (Brent Council)
- Peter Gadsdon - Director of Performance, Policy and Partnerships (Brent Council)
- Michael Cassel - Investigations Manager (Brent Council)
- Charlotte Moore - National Management Trainee (Brent Council)

During the workshop, a facilitated discussion was held on the current and future fraud risks facing I4B, which all attendees contributed to. Controls in relation to current fraud risks were also discussed.

## Executive summary (2 of 2)

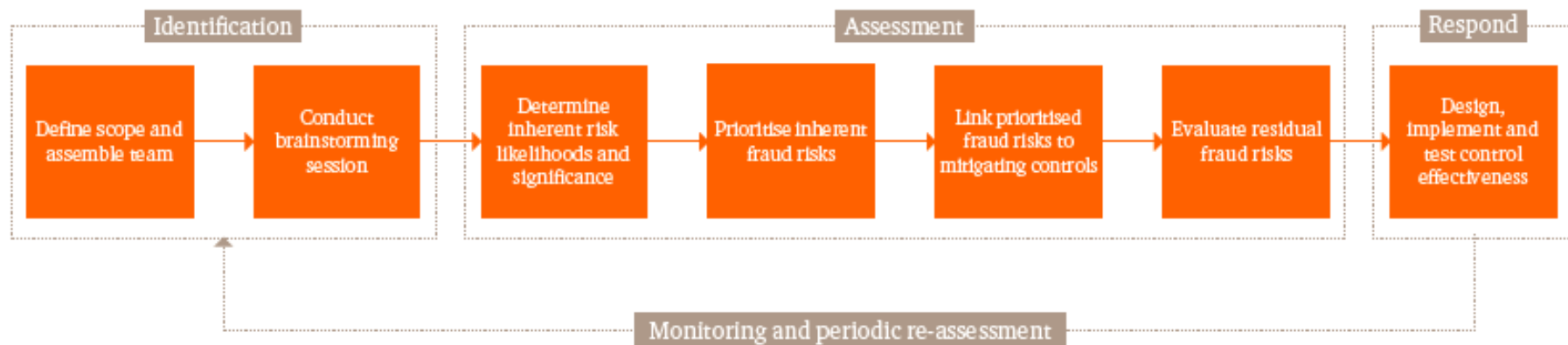
### Fraud risk identification

A listing of the fraud risks identified and discussed during the workshop are set out on the following pages. These are grouped by:

- Fraud risks arising from current business activities, i.e. purchase of built properties, rental of properties to tenants nominated by the Council, and property management. Potential mitigating controls are also captured based on information provided by delegates at the workshop. No assessment has been performed by audit to confirm that the controls are in place and operating effectively, or whether they are adequate to mitigate the stated fraud risks
- Fraud risks arising from future business activities as set out in the current I4B business plan, i.e. strategic investments, purchase of land, and joint venture partnerships to develop properties.

### Next steps

The identified fraud risks identified during the workshop are designed to form an initial starting point for I4B to understand their fraud risk profile. It is important that I4B take this forward and adopt a pro-active approach in managing the fraud risks that they face to minimise the risk of financial and reputational losses going forward. This can be achieved by developing and embed an ongoing fraud risk assessment process. A fraud risk assessment allows organisations to obtain an overall view of all the fraud risks that they face and assess, based on actual controls, whether residual risks are consistent with the organisation's risk appetite. A suggested framework is set out in the diagram below. In addition, it is important that I4B have in place a set of fraud and ethics policies to set the tone at the top, such as a counter fraud policy, a fraud response plan, code of conduct for board members, and a whistleblowing policy. Either equivalent Council policies could be adopted, or I4B could develop their own, though the former is likely to be more appropriate given the current entity size.



## Background and scope

### Background

I4B is a wholly owned subsidiary of Brent Council, incorporated in December 2016. It has been set up to reduce the number of Brent families living in temporary accommodation by providing good quality affordable homes.

Brent has one of the highest numbers of households in temporary accommodation in England, with at least 2,895 households living in temporary accommodation. In response to this challenge on 14 March 2016, Cabinet approved the council's Temporary Accommodation Reform Plan. One of the main measures outlined in the Plan is for Brent to acquire a large portfolio of Private Rented Sector (PRS) accommodation, which would be professionally managed by external agencies with costs protected against rental inflation.

As a wholly owned, Local Authority Company, I4B has been setup to operate at 'arm's length' from Brent, with the remit of providing affordable Private Rented Accommodation to households for which Brent has a responsibility. I4B is governed by a Board which is chaired by an independent voting Director in addition to a Councillor, the Brent Council Strategic Director of Community Wellbeing, and the Brent Council Director of Policy, Partnerships, and Performance. I4B is operating in accordance with a business plan approved in November 2016. Whilst I4B itself has no direct staff, it purchases a range of services from Brent Council under an SLA and can purchase a range of other services as may be required to deliver the business plan.

Over the past 12 months Brent Council has purchased a number of residential properties and are in the process of transferring these to I4B. Moving forward I4B will purchase properties directly in order to expand its portfolio.

These activities create inherent internal and external fraud risks for I4B, particularly when large value payments are to be made to purchase properties and external parties are to be engaged to source identifying and manage properties. Fraudulent activity could result in financial losses and reputational damage to I4B. It is therefore important for I4B to take a pro-active approach to, assessing and responding to fraud risks and ensure that there are robustly designed controls in place to treat these risks in accordance with risk appetite.

The purpose of this review was therefore to identify through a workshop the key inherent fraud risks facing I4B from internal and external sources based on its current and planned business activities, along with a consideration of the key controls in place that would treat these risks and suggestions for next steps. This will enable management to understand the key fraud risk they face and consequently assess whether controls are appropriately designed and fit-for-purpose in advance of I4B expanding its portfolio and the level of its operations.

## ***Background and scope continued***

### ***Scope and approach***

In order to perform the review we will facilitate a workshop with management (key contacts set out below) in order to:

- Identify the key inherent fraud risks that I4B are likely to face based on their current business plan. This will be based on current fraud trends impacting on organisations of a similar nature to I4B and local government in general, along with the views of the attendees.
- Identify key controls for mitigating the identified risk (this may include follow up contact with process owners to obtain an accurate and holistic view)

The outputs will be used to produce a summary report, which will contain:

- A summary and analysis of the key risks and controls identified
- A suggested framework for managing fraud risks through a fraud risk assessment strategy

### ***Limitations of scope***

Our work will be limited to the scope outlined in the table above.

We will not be testing operative effectiveness of any controls in place to prevent or detect fraud, and so will therefore not be providing assurance over these.

Our scope will not include designing a likelihood and impact scoring mechanism or defining fraud risk appetite for I4B. Therefore, identified risks will not be scored or ranked, nor will risk responses be recommended.

The identified risks are based on current fraud trends in the sector along with those identified by delegates at the workshop. It cannot be guaranteed that all fraud risks have been identified.

The controls captured in the table are based on information provided by delegates at the workshop. No assessment has been performed by audit to confirm that the controls are in place and operating effectively, or whether they are adequate to mitigate the stated fraud risks.

## Fraud risks arising from current business activities (1 of 3)

Area/process	Fraud risks	Controls – initial assessment
Property purchases	<ul style="list-style-type: none"> <li>Collusion between staff/board members and estate agents in relation to finders fees and commissions</li> <li>Collusion between staff/board members and vendors to inflate purchase prices and share the additional amount</li> </ul>	<p>I4B purchase properties are sourced either by one of three external agents (who have gone through a Council procurement process and receive a fixed fee per property) or a Council team. The Council team may use estate agencies, however no fees are paid to them by the Council, which should eliminate the risk of manipulated finders fees.</p> <p>All properties must be approved by a Council/I4B panel, which takes into account a number of factors including market value. Perception that collusion between a vendor and Council staff would be difficult to detect if the purchase price was around market value.</p>
	<ul style="list-style-type: none"> <li>Staff making payments for fictitious property purchases to themselves</li> </ul>	<p>Payments for property purchases are processed by the Council through either:</p> <ul style="list-style-type: none"> <li>BACS – Authorised by a Council officer and processes to an existing supplier set up on the procure-to-pay system.</li> <li>CHAPS – Processed by Treasury as an online money transfer.</li> </ul> <p>Perception that BACS would be more difficult to manipulate, as there are additional controls in place around supplier set up and bank account amendments. However there could be an increased risk with CHAPS, as the lead purchaser would be responsible for instructing Treasury to process a one-off payment. The potential for invalid payments was reflected in a recent incident whereby a property purchase payment was processed in duplicate by the Council and was only detected through recipients (solicitors) informing the Council.</p> <p>This could represent an unmanaged risk for I4B and warrants further review of controls.</p>
Asset disposals	<ul style="list-style-type: none"> <li>Collusion between staff/ board members and buyers to dispose of properties at under market value</li> <li>Undeclared conflicts of interest between staff/board members and buyers</li> </ul>	<p>No properties have yet been disposed of by I4B and so process and controls are unclear. However the Council would be required to authorise any sale.</p>

## Fraud risks arising from current business activities (2 of 3)

Area/process	Fraud risks	Controls – initial assessment
Accounts Payable	<ul style="list-style-type: none"> <li>Set up of invalid/fictitious suppliers by staff for personal gain</li> <li>Invalid amendments to supplier bank details to divert payments, either by external parties making fraudulent requests or by staff making amendments for personal gain.</li> <li>Payments to third parties for goods/services not recieved</li> </ul>	<p>I4B has its own bank account independent of the Council. However the Council maintains the supplier master data and processes payments on behalf of I4B based on I4B's instruction. Payments from I4B's account are currently limited to:</p> <ul style="list-style-type: none"> <li>property purchase payments made to the relevant solicitors.</li> <li>low level payments made to two external property managing agents.</li> </ul> <p>Excluding high value payments for property purchases (see separate risk), the potential for payments fraud is currently low, however the risk is likely to increase in the future as business activities increase.</p>
Accounts Receivable	<ul style="list-style-type: none"> <li>Diversion of tenant rent payments by staff</li> <li>Collusion between tenants and staff to write off rent arrears.</li> <li>Deliberate overpayment of rent by tenants using proceeds of crime and then requesting a refund.</li> </ul>	<p>Management of the I4B's property portfolio is split across three parties; the Council, Mears and Pinnacle. I4B calculate the expected monthly rent income to be collected by each party based on the volume of properties and rates, and then reconcile against the actual amount received.</p> <p>It is understood that no arrears have yet been written off. However in practice this would need to be authorised by both I4B and the Council.</p> <p>Management of the I4B's property portfolio is split across three parties; the Council, Mears and Pinnacle, who each operate policies in relation to overpayments and rent refunds.</p>



## Fraud risks arising from current business activities (3 of 3)

Area/process	Fraud risks	Controls – initial assessment
Rental/voids	<ul style="list-style-type: none"> <li>Subletting of properties by tenants</li> <li>Letting of properties by Council or maintenance staff for personal gain during a void period.</li> </ul>	<p>Management of I4B's property portfolio is split across three parties; the Council, Mears and Pinnacle. Each of these parties conduct periodic tenancy audit visits for the properties which they manage to confirm the identity of those residing in the property.</p> <p>It is understood that no voids have occurred in relation to I4B properties as of yet and so formal controls have not yet been developed by I4B. It was perceived that void properties would be monitored by the Council teams and that it is unlikely a long term sublet could occur. However the risk is more pertinent for short term voids during a maintenance period, as repairs staff would have control of the keys and could theoretically sublet through a portal such as AirBNB.</p> <p>This could represent an unmanaged risk for I4B and warrants further review of controls.</p>
Property maintenance	<ul style="list-style-type: none"> <li>Repairs/maintenance/major works – overcharging or charging for fictitious works</li> </ul>	<p>Management of I4B's property portfolio is split across three parties; the Council, Mears and Pinnacle. Each of these parties are responsible for arranging repairs, however the Council is responsible for ensuring that works have been performed through inspections and obtaining tenant confirmation.</p>

## ***Fraud risks arising from future business activities (1 of 1)***

Area/process	Fraud risks
Land acquisitions	<ul style="list-style-type: none"><li>• Collusion between staff/board members/agents and vendors to inflate purchase prices and share the additional amount.</li><li>• False representation by vendors in relation to land ownership or suitability for development</li></ul>
Strategic investments	<ul style="list-style-type: none"><li>• Organisations misrepresenting their financial viability/performance to make them more attractive as an acquisition</li></ul>
Joint Venture Partnerships	<ul style="list-style-type: none"><li>• Contractor inflating or falsifying development costs, resulting in I4B's portion of expenditure being increased</li></ul>
Board ethical conduct	<ul style="list-style-type: none"><li>• Falsification of financial position by I4B to secure additional Council funding</li><li>• Nepotism in recruitment and procurement processes, including bribery</li><li>• Invalid or overly ostentatious expenses, for example for entertainment purposes</li><li>• Facilitation of income tax avoidance</li></ul>

## Current year findings (1 of 1)

### Fraud risk assessment

#### Control design and operating effectiveness

1

#### Finding rating

Rating

Medium

#### Finding and root cause

I4B's current and future proposed business activities as set out in their business plan create inherent internal and external fraud risks for the organisation. Fraudulent activity could result in financial losses and reputational damage to I4B. It is therefore important for I4B to take a pro-active approach to identifying, assessing and responding to fraud risks and ensure that there are robustly designed controls in place to treat these risks in accordance with risk appetite. A fraud risk assessment allows organisations to obtain an overall view of all the fraud risks that they face and assess, based on actual controls, whether residual risks are consistent with the organisation's risk appetite. This has not yet been developed and embedded by I4B.

#### Risk

I4B may not have a holistic overview of the key fraud risks that they are facing or are likely to face in the future, resulting in losses to fraud as a result of risks not being appropriately treated.

#### Recommendations

I4B should use the findings from the fraud risk workshop to perform a fraud risk assessment. This should capture the key fraud risks and include an assessment of mitigating controls so that residual risks are understood. Given that I4B's business activities are likely to expand in the future as per their business plan, the fraud risk assessment should be refreshed at least bi-annually.

I4B should also ensure that they have in place a set of fraud and ethics policies to set the tone at the top, such as a counter fraud policy, a fraud response plan, code of conduct for board members, and a whistleblowing policy. Either the Council's policies could be adopted, or I4B could develop their own.

## Current year findings (1 of 1 continued)

### Fraud risk assessment

Control design and operating effectiveness

1

#### Finding rating

Rating

Medium

#### Management responses

Accepted.

*The company will undertake an anti-fraud risk workshop. This will be done following the anti-fraud measures audit planned for First Wave Housing (as agreed at the First Wave board meeting on 21 March 2018) in order that work can be aligned on fraud risk across both companies.*

*i4B will review Brent Council's fraud and ethic policies with the aim of adopting these for i4B and will add an additional clause to the SLA agreement when it is next updated to strengthen the company's overview of fraud risks.*

#### Responsible person/title:

Martin Smith, I4B Board Chair

#### Target date:

1 September 2018

#### Reference number:

1718FRA-1

## Appendix A: Basis of our classifications

### Individual finding ratings

#### Critical

A finding that could have a:

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

#### High

A finding that could have a:

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

#### Medium

A finding that could have a:

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

## Appendix A: Basis of our classifications

### Individual finding ratings

#### Low

A finding that could have a:

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

#### Advisory

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

## Appendix B: Limitations and responsibilities

### *Limitations inherent to the internal auditor's work*

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

#### *Internal control*

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

#### *Future periods*

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

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

### *Responsibilities of management and internal auditors*

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

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

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