



Internal Audit Report 2018/2019

Fraud Risk Review

First Wave Housing Ltd

August 2018

Final Report

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Contents

Executive summary

1

Background and scope

2

Risks and responsibilities

3

Appendices

- A. Basis of our classifications
- B. Limitations and responsibilities

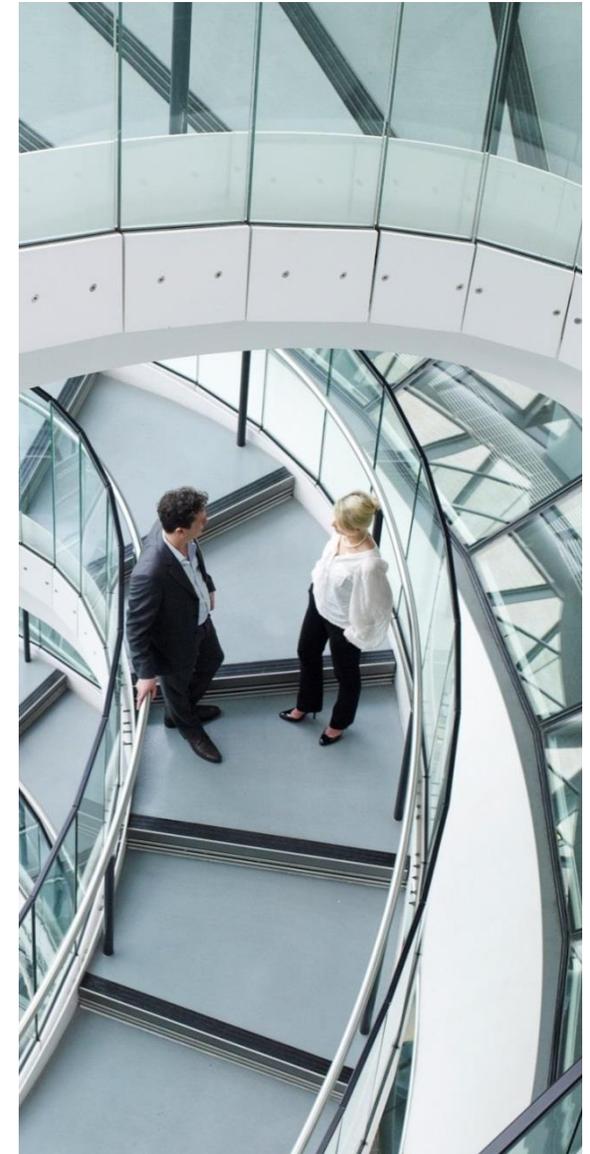
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Michael Cassel - Investigations Manager (Brent Council)





Executive summary (1 of 2)

Introduction and purpose

First Wave Housing Limited (the 'Company' or 'FWH'), formerly Brent Housing Partnership ('BHP') is a local authority owned company of the London Borough of Brent ('LBB'), and is limited by guarantee. The Company's primary activities are to manage its stock of 332 properties (as at 31 March 2018) and to contribute to Brent's housing strategy. It is a registered housing provider with the Homes and Community Agency (HCA).

LBB decided to terminate the Management Agreement with BHP, in relation to the council housing stock, with effect from 30 September 2017. The majority of BHP's property stock was owned by the Council and the management of these was brought back into the council with the creation of a new Brent Housing Management department. The Council set up FWH to manage the remaining properties that were owned by BHP. The Council has since begun providing services to FWH under a Services Agreement with a value of £1.4million per year. These include services to support the Company structure / Governance functions, such as Board administration, business planning and business modelling, and procurement and administering of the FWH's Housing Management and Repairs functions

During the year all eleven of the remaining BHP Board Members resigned and were replaced by the FWH Board, which currently comprises of 5 members, made up of two independent representatives (one of which is Chair of the Board), and three representatives from Brent Council (one councillor and two officers).

Like all social housing providers, FWH faces a number of inherent internal and external fraud risks, which could result in financial losses and reputational damage. These include rent collection, payments for repairs and maintenance, and unauthorised letting and sub-letting. It is therefore important for the FWH board to take a pro-active approach to understand the risks faced, and ensuring that it receives adequate assurance that these risks are mitigated.

The purpose of this review is therefore to confirm understanding through a workshop the key inherent fraud risks facing FWH from internal and external sources based on its current business activities. The workshop will also assess whether the FWH board has adequate oversight of how key inherent fraud risks are managed.

Fraud risk workshop

A fraud risk workshop was delivered on 10 August 2018 to FWH. This was attended by:

- Chris Brown - i4B and First Wave Programme Manager
- Sadie East – Head of Transformation (Brent Council)
- Peter Gadsdon – First Wave Housing Board Member
- Deep Shah – Senior Finance Analyst (Brent Council)
- Dawn Martin – Income and Sustainment Manager (Brent Council)
- Michael Cassel - Investigations Manager (Brent Council)
- Charlotte Moore - National Management Trainee (Brent Council)
- Joe Castagnetti – Counter Fraud Officer (Brent Council)

During the workshop, a facilitated discussion was held on the current and future fraud risks facing FWH, which all attendees contributed to. Board roles and responsibilities around counter fraud and the level of oversight was also discussed.



Executive summary (2 of 2)

Overview of key findings

Our key findings from the workshop are set out on the following pages, which are comprised of:

- A listing of the fraud risks identified and discussed during the workshop, which includes areas such as right to buy, rental income, voids and property maintenance.
- Board responsibilities around counter fraud and an assessment of how these are being met, which include:
 - Identification and oversight of fraud risk
 - Oversee implementation of anti-fraud measures
 - Creation of appropriate tone at the top
 - To investigate any alleged/suspected instances of fraud

Next steps

The identified fraud risks identified during the workshop are designed to help the FWH Board to understand the organisation's fraud risk profile. It is important that the FWH Board take this forward and adopt a pro-active approach in managing the fraud risks that they face in order to minimise the risk of financial and reputational losses. As set out in recommendation 1, this can be achieved by developing and embedding a fraud risk assessment process. This will allow the board 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. As set out in recommendation 2, we have also identified some opportunities for the FWH Board to enhance their oversight of counter fraud activities, such as including a specific a section on counter fraud measures and activities in board papers to contain details of fraud risk assessment activity, full details of anti-subletting initiatives, including outcomes, and details of the outcomes of any investigations into suspected fraud or other anomalies/error where there could be a suggestion of fraud. The Board should also assess whether any further counter fraud activities should be performed or existing initiatives strengthened, which may be determined by future company activities.

Inherent fraud risks arising from current business activities (1 of 2)

| Area/process | Fraud risks | Initial assessment of likelihood based on workshop discussions |
|----------------------|--|--|
| Right to buy (RTB) | <ul style="list-style-type: none"> • Tenants misrepresenting their circumstances during the eligibility assessment process. • Proceeds of crime being used to purchase properties | A small number of FWH tenants are eligible for RTB, however no such transactions have occurred during the past year. |
| Accounts Payable | <ul style="list-style-type: none"> • Set up of invalid/fictitious suppliers by staff for personal gain • Invalid amendments to supplier bank details to divert payments, either by external parties making fraudulent requests or by staff making amendments for personal gain. • Payments to third parties for goods/services not received | Currently FWH makes minimal payments to third party suppliers. FWH pays the Council a fixed amount for service provision, and any payments are made by the Council on its behalf. |
| Accounts Receivable | <ul style="list-style-type: none"> • Diversion of tenant rent payments by staff • Collusion between tenants and staff to write off rent arrears. • Deliberate overpayment of rent by tenants using proceeds of crime and then requesting a refund. | Rent collection rates are monitored by the FWH board and are understood to be above target at present. Perception is also that areas such as refunds and write-offs are highly controlled. |
| Rental/voids | <ul style="list-style-type: none"> • Subletting of properties by tenants • Letting of properties by Council or maintenance staff for personal gain during a void period | Perception that the risk is prevalent in properties that are rented out at social housing rent rates and less prevalent in properties that are rented out at full market rates. |
| Property maintenance | <ul style="list-style-type: none"> • Repairs/maintenance/major works – overcharging or charging for fictitious works | FWH pays the Council a fixed amount regardless of repairs volume, and so considers that the risk of fraud has been largely transferred to the Council. |

Summary of Board responsibilities for counter fraud oversight (2 of 2)

| Area | Current status |
|---|--|
| Identification and oversight of fraud risk | <p>Whilst the Board demonstrated a good awareness of fraud risk profile and exposure, a formal fraud risk assessment exercise has not been performed. 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 within the organisation's risk appetite. The risks identified and discussed during the workshop are an initial starting point for a such an assessment. It is important that this is completed and documented by the board and that control assessments are performed.</p> |
| Oversee implementation of anti-fraud measures | <p>The key anti-fraud exercises being performed are tenancy verification visits, which is reported to the Board. The Board also monitors rent collections and repair volumes through KPIs, though these are not specific anti-fraud measures. The next page sets out some suggestions for enabling enhanced oversight of counter fraud activities by the board.</p> |
| Creation of appropriate tone at the top | <p>The Board has adopted a code of conduct, which includes policies on expected behaviours, conflicts of interest and gifts and hospitality. There is also a standing board meetings agenda item on declaring interests.</p> |
| To investigate any alleged/suspected instances of fraud | <p>There have been no suspected instances of fraud since the formation of the FWH for further investigation. The board were made aware of incident whereby a property remained void for 14 months, which was attributed to an administrative error. There does not appear to have been a formal investigation report that sets out the root cause and gives assurance that there are no further cases. The matter was also not reported to the counter fraud team.</p> |

Current year findings (1 of 2)

Fraud risk assessment

Control design

1

Finding rating

Rating

Medium

Finding and root cause

As identified during the workshop, FWH face a number of inherent internal and external fraud risks. Fraudulent activity could result in financial losses and reputational damage. It is therefore important for FWH to take a proactive 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. Whilst the board demonstrated a good awareness of fraud risk profile and exposure, a formal fraud risk assessment exercise has not been performed and documented. The risks identified and discussed during the workshop are an initial starting point for a such an assessment. It is noted that that FWH relies on the controls executed by the Council to mitigate a number of risks, and so it is important that the reliability of these have been assessed by the board.

Risk

FWH 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

FWH should use the findings from the fraud risk workshop to document a fraud risk assessment. This should capture the key fraud risks and include an assessment of mitigating controls so that residual risks are understood.

Current year findings (1 of 2)

Fraud risk assessment

Control design

1

Finding rating

Rating

Medium

Management responses

Accepted.

First Wave will engage Board members and officers in documenting a fraud risk assessment using the findings from the fraud workshop. The assessment will capture the key fraud risks to the Company and an assessment of the mitigating controls.

Responsible person/title:

Chris Brown, i4B and First Wave Programme Manager

Sadie East, Head of Transformation (Brent Council)

Target date:

30 November 2018

Reference number:

1819FRA-1

Current year findings (2 of 2)

Board oversight of counter fraud activities

Control design

2

Finding rating

Rating**Medium**

Finding and root cause

A Board's responsibilities in relation to counter fraud typically include:

- Identification and oversight of fraud risk
- Oversee implementation of anti-fraud measures
- Creation of appropriate tone at the top
- To investigate any alleged/suspected instances of fraud

Our review of FWH Board meeting minutes and packs identified some examples of oversight of counter fraud activities by the Board. For example, updates on tenancy verification visits in order to target sub-letting, and KPI reporting targeting processes where there is an inherent fraud risk, such as rent collections, voids and repairs. However we also noted:

- Further to finding 1, there is no formal reporting on fraud risk assessment activity
- The tenancy visit programme does not appear to be risk-based to target properties with an increased likelihood of subletting due to location. Also the updates on tenancy verification visits do not set out the holistic position, i.e. the total number of FHW properties checked from the overall stock, along with outcomes.
- We noted a case where a property had remained empty for 14 months, which was attributed to an administrative error during a data migration process. It is unclear whether this was referred to the Council's counter fraud team to assess whether there was any fraudulent activity involved. Also there was no formal investigation report made to the Board that set out the root cause and any remedial actions required to prevent reoccurrence.

Risk

The FWH Board may not have a comprehensive oversight of all counter fraud measures and activities, resulting in losses to fraud going undetected.

Current year findings (2 of 2)

Board oversight of counter fraud activities

Control design

2

Finding rating

Rating

Medium

Recommendations

Board reports should contain a section on counter fraud measures and activities, including:

- Fraud risk assessment exercise, in order to demonstrate that key fraud risks have been identified and mitigated
- Full details of anti-subletting initiatives, including outcomes
- Details of the outcomes of any investigations into suspected fraud or other anomalies/error where there could be a suggestion of fraud. This includes follow up investigation into any anomalies identified through KPI reporting in relation to rental income, voids and repairs.

The Board should also assess whether any further counter fraud activities should be performed or existing initiatives strengthened, which may be determined by future company activities, for example:

- Adopting a targeted approach to tenancy verification visits based on risk factors, such as location and rent rates
- Screening of any future right to buy applications

Current year findings (5 of 5)

Board oversight of counter fraud activities

Control design

2

Finding rating

Rating

Medium

Management responses

Accepted.

First Wave will engage Board members and officers in a fraud risk assessment using the findings from this fraud workshop.

The outcome of this review will influence regular future fraud awareness items on Board agendas.

As part of the review, the tenant verification processes will be enhanced to prioritise verifications where risks of sub-letting may be greater.

Responsible person/title:

Chris Brown, i4B and First Wave Programme Manager

Sadie East, Head of Transformation (Brent Council)

Target date:

30 November 2018

Reference number:

1819FRA-2

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.