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Annex 1: Review of Financial Management Relating to CPO Fraud

Findings and lessons learned

18 September 2018

Contents

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18 September 2018

Dear Kevin

Support in relation to fraud investigation

We have pleasure in enclosing Annex 1 to our report (the 'Report') containing the findings of our engagement to provide support in relation to a fraud investigation ('the Project') on behalf Barnet Council ('the Council').

Scope of work and limitations

The scope of this project was agreed in Grant Thornton UK LLP's contract with the Council dated 22 January 2018 ('the Terms of Engagement') and the variation letter dated 19 February 2018. This Report is a short summary of our findings to date. Our review of the affairs of the Council and its partner organisations does not constitute an audit in accordance with Auditing Standards and no verification work has been carried out by us; consequently we do not express an opinion on the figures included in the report. At your behest it has been shared with Capita representatives of Re and CSG Finance and is updated to reflect our consideration of their detailed comments.

Limitation of liability

We draw the Council's attention to the limitation of liability clauses in paragraphs under section 18 in the Terms of Engagement.

Disclosure and reliance

We agree that the Council may disclose our Report to its professional advisers directly involved in the Project, and also to officers and members of the Council solely in relation to the Project, or as required by law or regulation, court or supervisory, regulatory, governmental or judicial authority without our prior written consent but in each case strictly on the basis that prior to disclosure you inform us that (i) disclosure by them is not permitted without our prior written consent, and (ii) we accept no duty of care nor assume responsibility to any to any person other than the Council.

The Report should not be used, reproduced or circulated for any other purpose, in whole or in part, without our prior written consent, such consent will only be given after full consideration of the circumstances at the time. These requirements do not apply to any information, which is, or becomes, publicly available or is shown to have been made so available (otherwise than through a breach of a confidentiality obligation).

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Council for our work, our Report and other communications, or for any opinions we have formed. We do not accept any responsibility for any loss or damages arising out of the use of the report by the Council for any purpose other than in connection with the Project.

Whilst the information in the Report has been prepared in good faith, it does not purport to be comprehensive or to have been independently verified. The recipient's attention is drawn to the fact that no representation, warranty or undertaking has been received by Grant Thornton in respect of the accuracy of the information provided to us. Grant Thornton does not accept any responsibility for the fairness, accuracy or completeness of the information so provided and shall not be liable for any loss or damage arising as a result of reliance on the Report or on any subsequent communication, save as provided for under the Terms of Engagement.

Forms of report
For the Council's convenience, this Report may have been made available to the Council in electronic as well as hard copy format, multiple copies and versions of this Report may therefore exist in different media and in the case of any discrepancy the final signed hard copy should be regarded as definitive.

Confidentiality

This work is confidential. No information relating in any way to our work, is to be disclosed to any third party (other than those the Council has confirmed are assisting it in connection with this investigation) without the Council's prior written consent.

General
The Report is issued on the understanding that the management of the Council have drawn our attention to all matters, financial or otherwise, of which they are aware which may have an impact on our Report up to the date of signature of this report. Events and circumstances occurring after the date of our report will, in due course, render our report out of date and, accordingly, we will not accept a duty of care nor assume a responsibility for decisions and actions which are based upon such an out of date report. Additionally, we have no responsibility to update this report for events and circumstances occurring after this date.

Notwithstanding the scope of this engagement, responsibility for management decisions will remain solely with the Council and not Grant Thornton UK LLP. The Council's management team should perform a credible review of the recommendations in order to determine which to implement following our advice.

We understand this advice is being sought for the purpose of enabling the Council to receive legal advice in respect of the fraud investigation and the actions the Council should take as a result.

We would like to thank the Council's officers and those of the other key partners for making themselves available during the course of the project.

Guy Clifton

Head of Local Government Advisory
For Grant Thornton UK LLP

Paul Dossett

Head of Local Government
For Grant Thornton UK LLP

1. Introduction

Introduction to Annex 1

This annex provides a detailed supplementary information to the report entitled 'Review of Financial Management Relating to CPO Fraud - Findings and lessons learned' and should not be read in isolation. The purpose of this document is to provide further detail on the findings presented in the main report.

Glossary of key terms

To help the reader of this report we set out below a glossary of the key technical terms used in the report.

BACS	Bankers Automated Clearing Service – automated payment service used for the majority of Council transactions.
Bankline	The electronic application through which CHAPS and BACS payments are made.
CHAPS	Clearing House Automated Payment System - automated payment service used to make same day payments at short notice.
CIL	Community Infrastructure Levy – a planning charge paid to the local authority by developers.
Control Account	A ledger account used to record balances of a number of subsidiary accounts, that may contain debit or credit entries that net off.
Cost Centre	A section of the Council's financial ledger (Integra) which to which costs may be allocated for accounting purposes.
CPO	Compulsory Purchase Order – Legal function allowing local authorities to obtain land or property without the consent of the owner.
CSG	Customer Support Group – The organisation that provides back office services, including financial management (CSG Finance) to the Council under contract with Capita (formerly the New Support Customer Organisation (NSCSO).
GROB	Growth and Regeneration Operations Board – Council Governance body that oversees the progress and cost of development schemes
Integra	The IT system run by Capita that houses the Council's financial ledger system.
Journal	A record of financial transactions recorded on a financial ledger, including the movement of cost or revenue from one cost centre to another.
PDA	Principal Development Agreement – The overarching legal agreement between the Council and a development partner (i.e. a developer), that underpins a regeneration scheme.
POB	Partnership Operations Board – Council Governance body that oversees performance against contract terms for both Re and CSG.
PTA	Private Treaty Agreement – A means of buying a privately owned property whereby the Council negotiates terms with the owner via an agent, as an alternative to compulsory purchase.
Re	Regional Enterprise Limited – The arms length organisation that delivers the Council's development and regulatory services, a joint venture between Capita and the Council under the Development and Regulatory Services (DRS) contract.
Section 106 (S106)	Section 106 of the Town and Country Planning Act 1990 governing payments to the Council from the Developer to help mitigate the impact of any proposed development.

2. Background to the review

Background to the review

Background to the fraud

The Council and Re were alerted to the fraud by CSG Finance following contact from the Individual's Bank on 18th December 2017 to query an unusual transaction. The Council's CAFT team were alerted and immediately commenced a criminal investigation. The Individual responsible was suspended from duties by Re within 24 hours of notification.

The investigation identified 62 fraudulent transactions with a value exceeding £2 million which relate to the activity of an employee of Regional Enterprise (Re) Limited, a joint venture between the Council and Capita.

The first fraudulent transaction identified dates from 2016/17, and the Individual seems to have increased the size of the fraudulent transactions over time. The fraud appears to have been committed, in some cases, by obtaining letter headed paper of various legal firms and then adding details relating to fictitious Compulsory Purchase Orders (CPOs) for property in the borough with each letter including the Individual's personal bank details.

Payments to the Individual's bank accounts were made via the Clearing House Automated Payment System (CHAPS); and, in each case, in the form of an e-mail request to the Treasury Management Team, that was duly processed.

Performance and Governance Review

When the current Chief Executive took up his post in February 2017 he commissioned a Performance Governance Review which had 4 objectives as follows:

1. improve the clarity of roles and responsibilities in respect of the management of key strategic contracts;
2. ensure that internal governance arrangements are fit for purpose;
3. further develop the performance reporting and monitoring framework to ensure that it drives improvement; and
4. update contract management arrangements to take into account the outcomes of the recent reviews of the Re and CSG contracts.

The review was ongoing during the period of the fraud and was not fully implemented by the time the fraud was discovered in December 2017.

In our view, this review demonstrates that the Council had an awareness of the shortcomings of the overall framework for contract management of the Re and CSG contracts and were in the process of taking steps to rectify this during the period of the fraud. However, the work was not completed in time to influence the fraud or to begin to identify and address the specific control weaknesses identified in this report.

Background to the review (cont'd)

Updated treasury payment procedures for CHAPS

We note that in response to the initial discovery of the fraud immediate steps were taken by the Council, CSG Finance and Re to address the control weaknesses and a new Treasury Management Procedure Note, dated 25 January 2018, was drafted.

In our Phase 1 recommendations, we identified specific cases where these procedures could be strengthened further. We have reviewed the updated procedure and are satisfied that the following elements should help prevent and/or detect any potential fraud/error on CHAPS payments, providing that they are applied robustly. The key controls that were put in place are as follows:

- All Urgent Payment Request forms sent to treasury must be authorised by two persons who are either (1) shown on Integra as having authority on the relevant cost centre with a monetary limit in excess of the proposed payment, or (2) specified individuals listed in the Treasury Management Procedure Note.
- The payment request form must be accompanied by the supporting paperwork e.g. invoice, contracts or equivalent and evidence of the third party bank account. Original (not emailed copies) documentation must be delivered to the Treasury Team.
- The Treasury Team will check that the two persons approving the payment are authorised for the cost centre on Integra or a senior executive above for the appropriate cost centre and to the appropriate value. Treasury Team Print and append Integra cost centre approval or a copy of the authority letter.
- The Treasury Team will call one of the payment approvers to check the payment details.
- The Treasury Team will contact the recipient to confirm the payment details, including bank account.
- If the payment relates to a property transaction, the Treasury Team will confirm the payment details with Legal Services.

The procedure includes a checklist that needs to be completed by the inputter on Bankline and requires sign off by a second signatory. Again in our view, the checklist provides a robust control, if applied effectively. The checklist details the following tasks:

- Initiating documentation must be hard copy
- Form signed by two authorised signatories
- The reason for urgency has been completed and supported by evidence and is reasonable.
- Confirmed payment with most senior authoriser
- Original documentation in respect of recipient details and bank details viewed
- Treasury call recipient to confirm expectation of payment and bank details
- Property transactions (i.e. CPO and / or compensation for CPO) need to be confirmed by Legal department i.e. HB Public Law
- Person authorising payment is shown on Integra as authorised to approve expenditure or has been authorised for that cost centre by a chief officer
- The payment has been added to the treasury payment spreadsheet

Background to the review (cont'd)

The Bankline release has also been strengthened with the dual release process now re-installed. Overall, our view is that the process significantly strengthens the controls over Bankline payments providing that it is applied effectively. In the previous section we have commented and made recommendations where we believe the process could be strengthened.

Two authorised persons can release all payment types and values using pin cards and passwords. Paperwork relating to each proposed payment will be provided to the authorised person. Before releasing the payment the authorised persons must each sign off the releasers checklist by scrutinising the paperwork and checking that the above processes have been followed.

The procedure includes a checklist that needs to be completed by the releasers on Bankline and requires sign off by a second signatory. The checklist details the following tasks

- The Treasury checklist has been completed and signed as required
- Initiating documentation is hard copy
- Two authorised signatories on payment request form
- Evidence is provided that the persons authorising the payment have authority
- Original documentation in respect of recipient bank details or on separate approved listing
- Treasury will use 'best endeavours' to ensure that for each release, one person from the Council and another from CSG Finance is be used.

3. Overview of financial arrangements for regeneration projects

Our understanding of the CPO process

Key stages of the PTA / CPO process – high level overview

Our understanding of the outline process for the acquisition of properties under regeneration projects, and the payments made in this regard, has been developed from our discussions with senior employees from Re and an example documented process provided by Re. This outline is not definitive, as all regeneration projects have a different specification. However, the following outline is intended to provide a useful background for the findings of this report, in the context of the fraud.

In order for the Council to progress regeneration proposals across the borough, a programme of land and property acquisition is required. In most cases, this can be achieved through Private Treaty Agreements (PTA) under which the Council and developer are able to negotiate a mutual agreement with the property owner. Where this cannot be achieved, Compulsory Purchase Orders (CPOs) for privately owned property, are sometimes required to provide certainty to the delivery of the works programme.

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In the case of CPO, property owners will be entitled to compensation for the value of the property, and various other statutory payments such as home loss and disturbance. In the majority of cases where CPO powers are used, the Council can offer an advance payment of compensation. A person whose land or property has been compulsorily acquired should be no worse off or better off than they were before the CPO, but they will need to demonstrate losses in order to claim for them. The way these compensation payments are calculated is set out in legislation. In the event that compensation cannot be agreed the Lands Chamber of the Upper Tribunal is an independent body which decides the right compensation to be made.

The fraud was based on CPO payments raised on a real regeneration project and a real CPO cost centre, but for fraudulent addresses that did not form part of the actual regeneration scheme.

It is difficult to predict exactly how long the CPO procedure takes to complete because the type and number of properties involved in each stage of the process can vary. It can take up to two years or more to implement the CPO and prepare possession orders, and the settlement of compensation can take longer in exceptional cases.

4. Our understanding of how the fraud took place

Our understanding of how the fraud took place

Our work confirms the Council's understanding of the fraud. In our view there were specific circumstances related to the nature of CPO payments that enabled the fraud to take place and help explain why it was not detected or prevented through financial management and internal controls.

We note the work undertaken by the Council and Capita in January 2018 to strengthen controls around CSG Finance Treasury CHAPS transactions. From our enquiries, the indications are that, if properly implemented, it is likely that the new controls would mitigate against the same fraud taking place in future.

Our detailed work on regeneration related financial processes has confirmed that there are other significant weaknesses in financial controls operated by Re and CSG, in addition to the CHAPS payment process which, had they been identified and addressed earlier, are likely to have resulted in detection or prevention of the fraud.

The Individual had budget holder access rights on the Integra financial system, which meant that they were able to request payments to be made in regard to the cost centres they controlled.

On the balance of the evidence reviewed, it is highly unlikely that the Individual's role within Re justified having control of cost centres related to Regeneration projects. In particular, the Cost Centre 1 CPO control account, which we would expect to be under the control of the Regeneration Manager with responsibility for that project. There appears to have been a lack of rigour in the approval process for requests for changing access rights to Integra.

There was no detailed scheme of financial delegation or equivalent, against which the access to financial systems and duties of Re managers could be justified, checked and clearly understood. The Individual would not have been able to raise CHAPS payment requests had they not been set up as a budget holder on the Integra system.

Our understanding is that the fraud occurred by the Individual initiated the CPO payment process by emailing a CHAPS Treasury Management Urgent Payment Request form to various officers in the Treasury Management Team.

The email was accompanied, in some instances, by a completion statement drafted on apparently fraudulent letter headed paper of various legal firms in the borough. These letters (when provided) included the Individual's personal bank details. In some cases the Treasury Management Urgent Payment Request form (which also has the Individuals bank account details) was the only information sent across to the Treasury Management Team.

There were no written down procedures within Treasury Management to explain to the team the processes and checks to guide them through the CHAPS payment process. The lack of procedures meant that officers within the Treasury Management Team did not understand what checks they should be undertaking. This was compounded by a lack of procedures and knowledge amongst Treasury Management staff on what paperwork was considered appropriate to support a CPO payment.

In some instances there was no supporting documentation provided supporting the Treasury Management Urgent Payment Request form and the Treasury Management Team still released the payment.

The Treasury Management Team did not confirm with the recipient of the funds that the bank account numbers were correct. This control would have been key to preventing the fraud.

We note that key controls over Treasury Management, including CHAPS payments, had been reviewed by the Council's Internal Audit team during the period of the fraud and these control weaknesses were not detected. This issue is explored further on page 38 of this report.

Our understanding of how the fraud took place (cont'd)

The Individual was employed by the Council before being transferred to Capita's CSG Finance team in 2013. They then moved to Re in circa 2015. The Individual was a well respected, trusted member of staff and knew the key officers involved in the process across all organisations well, professionally and some personally. Having moved around all the relevant organisations, the Individual was able to identify the lack of controls in respect to CPOs across all organisations. Their previous role as a finance business partner/management accountant was particularly relevant in this regard.

The Individual had significant knowledge and experience of the general ledger system (Integra) and his roles and responsibilities included preparing budget monitoring information on behalf of Re, that was used for monitoring financial performance within the wider governance structure.

This meant that the Individual had the capability and the opportunity to conceal fraudulent payments from those charged with governance and oversight. This included the use of regular, smaller payments below the budget holder approval limits in place on Integra, that would make the individual transactions difficult to detect. This was enabled by the absence of adequate review controls executed by CSG finance business partners or through the budget holder hierarchy within the Re management structure, who should have been in a position to review individual payments and challenge balances accumulating on control accounts for which the Individual was responsible.

Summary budgetary performance information on regeneration budgets was provided to a number of governance platforms within the Council. However, the Council's Growth and Regeneration Operations Board (GROB) are responsible for the oversight of regeneration scheme delivery. Although the terms of reference do not specifically refer to budget management, it would not be unreasonable to expect a level of oversight. Nonetheless, revenue and capital budgets were provided at scheme level to GROB but balances accumulating on control accounts were not monitored as part of the standard information provided by finance business partners.

In addition, the Individual was able to conceal the accumulated fraudulent costs on their cost centres, by moving amounts to different cost centres and making use of unmatched receipts to net off costs, through journal adjustments. Segregation of duties was in place in regard to journals, but again, the transactions were not adequately challenged by finance business partners and others as part of the journal review and approval controls. Had controls been stronger, the Individual would not have found it easy to conceal fraudulent costs and they are likely to have been detected and queried during the year end financial closure process.

The budget monitoring process adopted by CSG in relation to Regeneration related transactions was not detailed enough to be relied upon to identify the fraud. There were errors in CSG Finance business partnering and allocating unmatched income, and in regard to Re management scrutiny at the level below the key governance bodies. This meant that as a result of the fraud Re and CSG, and consequently GROB, were misled into believing that CPO transactions were legitimate and were not alerted to the presence of unusual and erroneous transactions as they should have been.

The way that some of the capital projects are managed, specifically in regard to CPO transactions, means they are effectively outside of the normal budgetary control system and are managed via control accounts. As the budgets are expected to net off to nil (or a small surplus), less attention appears to have been given to their control and monitoring. Finance business partners conducted a reconciliation process, intermittently initially, but monthly by the end of the period of the fraud. The level of rigour applied to understanding the transactions was not sufficient to identify a significant number of unusual payments linked to the fraud. This led to the Individual being able to circumnavigate the normal budgetary control mechanisms and effectively move funds around the organisation before ultimately transferring them to their own bank account via the method outlined above.

5. Financial Controls Analysis

Introduction

Context

This section of our work focuses on the wider processes and financial controls relevant to the fraud.

As part of the Council's response to dealing with the fraud, we were asked to review the key controls surrounding the financial management of Regeneration projects, with a particular focus on the areas of operation affected. This process crossed the areas of responsibility for Re, CSG Finance and the Council.

The objective was to understand the processes and control deficiencies that led to the fraud being able to occur and make recommendations to improve controls to prevent similar issues from occurring in future. The controls work builds on the evidence gathered from the forensic accounting review that took place in parallel.

Our approach to reviewing controls

We were asked to review the following aspects of the Regeneration management process:

- The end to end process and key controls within Re for managing regeneration projects, including the management of CPOs/Private Treaty Agreements and reclaiming costs from developers, with a focus on the Cost Centre 1 and Cost Centre 2 Regeneration programmes.
- Controls relating to capital budget monitoring of Re cost centres and control accounts, including the potential impact that absences or resourcing challenges within the CSG Finance team supporting regeneration may have had on the effectiveness of controls.
- Journal controls managed by CSG Finance, focusing on transactions related to the fraud.
- System administration and access controls on the Integra system during the period of the fraud managed by CSG Finance.

We also considered the following areas:

- Compliance with Council Financial Regulations and Scheme of Delegation (and the scheme of financial authorisation for non council employees).
- The responsibilities of each organisation (the Council, Re and CSG Finance), including how delegated authority passes between the parties.
- The extent to which financial controls inherited by CSG Finance from the Council have been weakened, maintained or strengthened.

We obtained relevant documents and other information and met with key personnel in the Council, CSG Finance and Re to gain a deeper understanding of issues which led to the fraud and to assess the financial control environment.

Control themes relevant to the fraud – 5 Pillars

We have identified five broad themes to describe aspects of financial control that relate to the management of regeneration schemes, and the related finance support services provided by CSG – the Five Pillars. In our view, if any one of these control pillars were functioning effectively during the period, it should not have been possible for the Individual to perpetrate the fraud for such an extended period of time through prevention of the means and opportunity, or through detection or deterrence.

Key control themes – 5 Pillars

Pillar I	Pillar II	Pillar III	Pillar IV	Pillar V
Delegated authority and control over access to systems (CSG Finance Treasury, CSG Finance, the Council) A lack of clarity over the lines of delegated authority and a lack of control over system access, created the opportunity to access cost centres for inappropriate use.	**Control over the processing of transactions** (CSG Finance) A lack of robust review and challenge in the authorisation of payments and a lack of reconciliation to amounts due back from developers, allowed fraudulent payments to be made.	**Control over journals within the Integra ledger** (CSG Finance) A lack of robust challenge and review in the authorisation of journals that enabled fraudulent transactions to be disguised.	**Budgetary control and financial reporting** (CSG Finance, the Council, Re) A lack of robust challenge from CSG finance business partners and a lack of scrutiny at transactional level resulted in a lost opportunity to identify and question unusual payments.	**The financial control environment for regeneration projects** (CSG Finance, Re, the Council) Insufficient review and professional scepticism by managers in CSG Finance and Re, contributed to significant financial control weaknesses in relation to regeneration projects. Many of these weaknesses persisted over a long period of time and should have been identified and mitigated as part of routine management activity. There was also insufficient oversight by the Council.

Further detail on the findings under each pillar are provided on the following pages of this report:

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Pillar 1 - Delegated authority and control over access to systems

The Council's Scheme of Financial Delegation

There was a lack of clarity about both the role of the budget holder and the allocation of budget holder responsibility between Re, CSG Finance and the Council, in respect of regeneration projects and related financial management activity.

The Council delegates functions to council officers through a scheme of delegation which is divided into separate documents for each area, under the responsibility of the respective Council Chief Officers. The Regeneration Service is delivered through a contract with Re as set out below, and was not therefore included in the Growth and Development scheme. However, as Re employees had direct access to the council's financial system, there should have been a detailed equivalent scheme giving clarity over financial responsibilities and authorisations for non-council employees.

The basis for delegating financial authority

Re's responsibilities for regeneration schemes are set out in the DRS Partnering Contract and the Output Specification for Regeneration Services (referred to in Clause 5 of the Contract). The Output Specification includes responsibility for managing the schemes and associated budgets (REGEN015, REGEN089), raising invoices (REGEN016), maintaining effective financial records of scheme costs, both historic and current, and to ensure that expenditure from managed budgets have authority approval (REGEN017). This includes CPO compensation and payments to third parties.

Clause 5.5 of the DRS Partnering Contract, refers to the service provider's responsibility to forward 3rd party invoices to the Council for approval.

Schedule 35 of the Partnering Contract (Managing Agent Protocol) states that subject to clause 5.5 of the Agreement, the Service Provider "shall be responsible for paying third party contractors in accordance with the terms of the relevant third party contract".

We note that the Council's understanding was, that the authority of officers within Re (employed by Capita) to initiate payments to suppliers from the Council's budget was determined by the Council's Policy and Resources Committee when approving the relevant Regeneration Schemes. The contractual obligation for Re to take on these responsibilities was passed through the DRS Partnering Contract to Re, in order for them to deliver services in accordance with the PDA (the agreement with the 3rd party developer).

Absence of a scheme of financial delegation/ authorisation

In order to provide effective control over financial responsibilities within the Council, the Council's Scheme of Delegation for Growth and Regeneration should have been supported by a documented Scheme of Financial Delegation or a Scheme of Financial Authorisation for non-Council employees. This should have defined how the contractual arrangements described above, would function in terms of the transfer of financial authority from the Council to Re budget holders and should have been revised following any mutually agreed decision to alter governance as anticipated in the DRS Contract.

Pillar 1 - Delegated authority and control over access to systems (cont'd)

However, we found that no such detailed scheme was in place, during the period of the fraud. This means that the requirement in Para 2.1.2 of the Financial Regulations was not being fulfilled.

- The Financial Regulations are supporting documents to the Council Constitution and paragraph 2.1.2 states that "each Chief Officer is required to maintain a scheme of financial delegation… which accords to the financial limits included within the overall scheme of delegation and contract rules."
- The Council's Constitution (Article 9, Para 9.1) defines the role of Chief Officer. Current Chief Officers include the Deputy Chief Executive responsible for Growth, Development and Regeneration, and the Director of Resources (Chief Finance Officer) responsible for the finance function. We note that over the period of the fraud Council management structure has been subject to change.

Responsibility to maintain an updated scheme

The Scheme of Delegation is a Council owned document and the nominated Council Chief Officer is ultimately responsible for it. The Constitution as written defines the Chief Officer responsible for the Growth and Development Scheme as the Council's Deputy Chief Executive. Not withstanding the Council's ultimate responsibility for the scheme, CSG as professional service provider should have been in a position to flag this issue and ensure that it was rectified.

CSG Finance have a contractual obligation to "review, maintain, and update" on an on-going basis, the Council's scheme of delegation, which in order to comply with the Council's Financial Regulations should include a scheme of financial delegation (or financial authorisation for non-Council employees), as part of their responsibility to ensure an effective system of internal financial control (FIN001).

In the case of Re, it has a general contractual responsibility to perform the contract in accordance with Good Industry Practice, and must warn the Authority of anything likely to prejudice the quality or purpose of the Services and must ensure the Services are performed by appropriately qualified and trained personnel (Clause 5.2.1).

Re were not able to provide a separate detailed scheme of financial authority that set out the specific delegated financial powers for employees within the Regeneration Team in relation to the management of Council budgets.

Importance of clear delegated authority to financial control

We noted as part of our review, that due to the lack of a formal scheme of financial authorisation, the CSG Finance Treasury Team could not check that the officer requesting a CHAPS payment for a CPO was an appropriate person to do so. There was a check by CSG Finance Treasury Team against the approval levels for the recorded on Integra, but this was not an adequate check in the absence of a formal scheme on which Integra authorisations should have been based.

Recommendation 1 - We recommend that the Scheme of Financial Authorisation for Growth and Development is updated to reflect current role descriptions and specifically to include Regeneration Team members currently omitted. Current definitions of financial roles and responsibilities across the organisations should be revisited, to make sure they remain fit for purpose and provide for robust governance.

Pillar 1 - Delegated authority and control over access to systems (cont'd)

User access to request / approve transactions on Integra

We noted that the Individual was designated as a budget holder for two cost centres that were used for the fraud. Re were unable to adequately explain why the Individual was a budget holder for these Regeneration related accounts – in particular Cost Centre 1 which was a CPO Control account used to perpetrate the fraud. Budget holder authority over this account did not seem to be consistent with the Individual's role, and it would have been more appropriate for this cost centre to have sat with the Regeneration Manager responsible for that project.

There is an authorised users database within Integra that is used to control payment requests from budget holders (including Re managers) and sets authorisation permissions and levels. This database does not refer to an approved definitive scheme of financial authorisation because such a scheme does not currently exist in the appropriate level of detail.

Our findings indicate that the Integra schedules are not reliable as the system does not always reflect an up to date list of the appropriate officers that control the corresponding budget.

Recommendation 2 - We recommend that the listed budget holder authorisers on the Integra system be reviewed and controls put in place to ensure the list is kept up to date.

The process for setting up user access on Integra

As part of our review, we requested to review a selection of Integra User Set-up forms used for Re managers since the Integra system was implemented in 2013. We found that for the sample of recent user access requests during 2017, user set-up forms had been used, and a partial audit trail of e-mails had been retained, to demonstrate that the appropriate system access approvals had been obtained. The process was such that the person requiring the access filled in the form, their line manager approved it, and the finance business partners reviewed and authorised it. However, we note that in each case there was a lack of narrative to record why the access was required and how it linked to the person's role, to enable the change request to be properly considered and authorised prior to processing.

Access to the control account that was central to the fraud (Cost Centre 1) pre-dated the process outlined above. The only evidence that was provided was an e-mail from the Individual to an Integra-Finance e-mail account requesting that they become the budget holder. This e-mail was dated 11 November 2016 and it is unclear how the Individual was able to request a number of fraudulent payments that were processed on this cost centre prior to this date. We noted that the most recent user profile set up for the Individual was as budget holder for Cost Centre 18, which again appears to have been initiated by the Individual themselves in March 2017. The reason the Individual gave was that an urgent payment needed to be made from this cost centre and that the current budget holder was not clearly identified.

Approval by e-mail was given by the Individual's line manager on the Integra system for Cost Centre 18. A second approval was given by the senior business partner responsible for regeneration. However, there is no evidence on the e-mail trail of a clear rationale for the Individual to be the budget holder or confirmation that it was appropriate for their role.

Pillar 1 - Delegated authority and control over access to systems (cont'd)

IT system controls have been set up on Integra and supporting systems such as Bankline, that determine the level of access that individual users can have to financial systems and the ability to authorise transactions. These permissions have also historically been referred to for manual processes, such as a CHAPs payment request, to determine if the individual is the budget holder. The effectiveness of these controls is dependent on systems being be kept up to date for starters/ leavers and transfers. A failure in this control could lead to inappropriate individuals having control of budgets and permission to request or authorise journals and payments.

Recommendation 4 - We noted a potential weakness in controls to ensure that any changes made to access rights and authorisation levels for IT systems, are appropriate to the individuals role, e.g. following a change in role or for starters and leavers. We recommend that additional controls be introduced to mitigate this risk.

Authorisation limits on Integra

The Integra system currently operates only three authorisation levels for transactions, for individuals with budget holder / requester and authoriser status. The levels are £25k, £173k and £99.9m. We understand that the Individual's authorisation level was £173k.

We note that a revised schedule of financial limits was recommended by Internal Audit following a Re JV governance review. It does not appear that these new limits had been applied to the Integra system by CSG Finance and was not in general use. For example, this scheme limits the authorisation limit for Cost/Profit Centre Managers to £100k.

Recommendation 3 - It is not clear that budget holders with authority to request payments held on the Integra General Ledger system, have been set authorisation limits for the value of transactions that are fully consistent with their role. This could lead to individuals being able to authorise payment for inappropriately large sums. We recommend that the list of individual authorisation levels for the value of transactions, be reviewed for appropriateness.

Pillar 2 – Control over the processing of transactions

Testing of new CHAPS process

During the period of the fraud, there were no CHAPS procedures or task checklists in place for those working in CSG Finance Treasury to guide them through the CHAPS approval process. This resulted in the officers loading bank details onto Bankline and authorising and releasing payments who were unclear on their checking and verification responsibilities. We note that this has been rectified in the new Treasury Payment Procedure that has been put in place. Historically, the only control relating to TPA/CPO CHAPS payments is whether the person requesting the CHAPS payment was authorised to do so on Integra. Under the new process set out in the Treasury Payment Procedure note, there is a check to ensure the bank details included within the CHAPS memorandum and any paperwork agreed to the bank details on Bankline and that the details belong to a genuine third party.

Recommendation 5 - We recommend that the new Treasury Payment Procedure be tested for compliance after a suitable period.

Recommendation 6 - We note that the process for the Cost Centre 2 regeneration project indicates that the instruction to make the CHAPS payment should come directly from the solicitors to the Barnet CSG Treasury Team. In some cases these requests appear to have been forwarded by the Regeneration Manager. We recommend that this separation of duties be considered for all CPO transactions.

Recommendation 7 - We recommend the development of a guidance note or checklist for Re managers, to help them ensure that the required evidence is included with a CHAPS payment request.

Use of control accounts

We identified that general ledger 'control account' cost centres have been used to account for transactions relating to Private Treaty Agreements and Compulsory Purchase Orders, including those for the Cost Centre 1 and Cost Centre 2 relating to regeneration projects.

We looked specifically at account codes Cost Centre 1 and Cost Centre 2 as they were the principle ledger accounts used to perpetrate the fraud. In general terms, control accounts differ from a conventional general ledger code, as they are used to net off costs accumulated against income recovered, and it is the balance that is posted to the general ledger.

These control accounts are used where costs incurred by the Council in purchasing properties and making compensation payments to owners are to be recovered directly from developers under an Indemnity Agreement, which is associated with the overall Principle Development Agreement (PDA). Usually a cost centre will record either costs or income as separate balances with no netting off and with an associated annual budget.

Pillar 2 – Control over the processing of transactions (cont'd)

It is generally accepted accounting practice that control accounts have no budget, as the expectation is that all costs will be recovered from developers and balances will net to zero at year end.

Two types of control accounts are employed for regeneration projects:

(1) Recovery of PDA administration costs such as regeneration manager time and other fees which are generally capped as part of the PDA, and

(2) PTA/CPO control accounts which are not capped, and are instead subject to an indemnity agreement – the control accounts noted above fall into this latter category.

Recommendation 25 - The policy of using of control accounts for recording PTA/CPO transactions should be reviewed. We recognise that this can be a legitimate and useful method of accounting in some circumstances, but there is a risk that comparatively large income and expenditure transactions are not accounted for with sufficient transparency, particularly in regard to the recoverability of amounts treated as debtors, due to the netting off process. The lack of a specific budget against which accumulated costs and income can be measured can also serve to reduce the organisation's ability to monitor transactions.

Accounting for regeneration transactions (balance sheet)

We noted an additional risk associated with the use of control accounts for PTA/CPO costs in regard to capital accounting. We have not carried out a review of technical accounting treatment for balances passing through the PTA/CPO control accounts for Cost Centre 2 and Cost Centre 1. However, we noted that the nature of the transactions resemble capital purchases and other costs which in other circumstances we would expect to be capitalised – in particular, payments made to property owners in order to acquire land and buildings, and for which title passes to the Council.

We recognise that this is a potentially complex accounting issue in regard to which entity controls the asset under a PDA, the accounting implications of an indemnity agreement and the issue of the impairment of assets purchased for demolition.

Recommendation 13 - The accounting implications of PTA/CPO transactions managed through regeneration related control accounts should be reviewed to ensure that transactions associated with PTA/CPO purchases are appropriately accounted for in the Council's financial statements, particularly in regard to capital accounting and the balance sheet. In addition, we recommend the CSG Finance team reconciles the Authority's Asset Register with the Atrium valuation system to ensure all acquired assets have been accounted for in line with the recommended value where title has passed to the Authority.

Pillar 2 – Control over the processing of transactions (cont'd)

Reconciliation to a schedule of expected payments

During our work, we asked in meetings with Re managers whether there was a master list of TPA/CPO transactions in process, that would enable CSG Finance managers to monitor and plan for TPA/CPOs likely to require payment in the short to medium term – e.g. list of properties that require a TPA/CPO split out by each regeneration project.

We have seen some evidence to suggest that Re managers retain such a list in order to track the progress of CPOs through the process. We found that schedules of expected property acquisitions did appear to be held by Regeneration Managers, in some form although this tended to be on non-standardised spreadsheets. Finance officers we interviewed in CSG Finance Treasury and the Business Partner team were not aware of the existence or potential application of these schedules, which could help them monitor the value and timings of large payments, including through the CHAPS process. We would expect lists such as these to be to be used to cross check spending on regeneration cost centres as part of the budget monitoring process.

Recommendation 10 - Re should provide evidence that a master schedule of CPOs is in place for all regeneration projects, which should be used for cross checking payments made.

Checks by Re prior to the issue of payment requests

Our initial review indicates that the Re manager responsible for a specific project has authority to raise a CHAPs memo up to a limit set for that project, without further review or checking by Re senior management. It also appears that no check takes place by Re to ensure that payment authorisation levels have been checked prior to signing off the memorandum. These payments can be large (the largest fraudulent payment being £124,750) so we would expect that a further manager in Re signs the CHAPS Memorandum confirming that they have checked the paperwork. This could be put in place alongside a suitable level, below which payments could be issued without review.

Recommendation 8 - We recommend that appropriate supervisory checks be put in place by Re for all projects, prior to the issue of requests for payment by CHAPs being issued to the CSG Treasury Team.

Pillar 2 – Control over the processing of transactions (cont'd)

Control over the set up of new suppliers

Where payments were processed via CHAPS there has been no direct verification with the supplier/vender (e.g. by telephone) to confirm the bank details are correct. The payee's bank details were not checked against independent information. This control alone would have prevented the fraud. We note that the new Treasury Payment Procedure now includes this control for CHAPS payments. We also note that the supplier masterfile process supporting BACS payments includes a New Vendor form which requires verification of bank details with the Vendor to take place.

Recommendation 16 - The Masterfile supporting the BACS payment process does not automatically identify and flag payments made to different suppliers/recipients that had the same bank account number. There was also no manual control in place to identify BACS and CHAPS payments made to different suppliers which had the same bank accounts. We recommend that this control be considered as an addition to the new Treasury Payment Procedure.

Approval of CHAPS payments – dual signatories

We identified that the list of approved Bankline Authorisers included a mixture of the CSG Finance team and current Council employees. Prior to the new Treasury Payment Procedure being introduced, it was not possible to determine if this was a deliberate policy, or whether it was a result of the delegated financial authority not being clearly defined and updated to reflect movements of officers between these separate organisations.

We also identified that historically, the authorisation of Bankline Payments use a rota system, meaning that payments are authorised by a mixture of employees of CSG Finance and the Council, as has been the case with some of the fraudulent transactions identified. This also indicates a historic lack of clarity over the specific roles and responsibilities of the CSG Finance and the Council, in regard to the processing and approval of payments and a lack of control over authorisation levels in the event of a change in employment.

Recommendation 9 - Under the new Treasury Payment Procedure the approved authorisers have been reviewed and defined, however we note that the new requirement for a dual signature for all Payments includes provision that 'best endeavour' will be made to make sure that there is one signatory from each of Barnet Council and CSG. In our view, this creates uncertainty which could undermine the control and it may be better to base this requirement on specific authorisation levels for all payments.

Pillar 2 – Control over the processing of transactions (cont'd)

Process for reclaiming costs from developers

We discussed the process for recovering costs from developers with Regeneration managers responsible for current projects. These discussions indicated that where control accounts are used to recover PDA and PTA/CPO costs, it is the responsibility of regeneration managers to monitor the accumulation of costs and to invoice the developer at regular intervals. Billing to developers is reported monthly to the Council's Growth and Development Operations Board (GROB) meeting.

We reviewed the Regeneration project highlight reports for October, November and December 2017. We found that the frequency of invoicing was variable, significant balances could accumulate over a period of months without being billed and this was not generally bound to a set timescale that could be monitored effectively by GROB members.

Recommendation 11 - We recommend that Re are asked to provide explanation of the process for reclaiming the cost of CPO payments from developers and matching these to payments made.

We looked at the PTA/CPO control accounts for Cost Centre 1 and Cost Centre 2 to see evidence of regular invoicing:

- We noted that Cost Centre 2 PTA/CPO control account was last billed in April and May 2017, but by month 10 of the current year (Jan 2018) it was still carrying a balance of £1.5m unbilled, which was being carried in the Council's accounting system as a long term debtor from the developer, according to the monthly control account reconciliation. Subject to the completion of the forensic accounting review, there is a risk that this included balances related to the fraudulent transactions identified.
- We noted that the Cost Centre 1 control account at month 10 (Jan 2018) indicated that £937k of costs had accumulated on the code since October 2017, of which the majority relates to the fraudulent transactions previously identified. We note that £668k appears to have been raised as an invoice to developers on 27 December 2017 and posted to the general ledger on 2 Jan 2018.

Recommendation 12 - There is a risk that invoices raised to developers from Cost Centre 2 and Cost Centre 1 include costs that are associated with the fraudulent transactions identified. We recommend a detailed investigation of these cost centres to ascertain if inappropriate amounts have been invoiced and potentially reimbursed by developers.

Pillar 3 – Control over journals within the Integra ledger

Review and authorisation of journals

We found that the Individual was able to use journal entries to move costs accumulated on the Cost Centre 1 control account, during the 2016/17 year end financial closure process (Feb to April 2017). This appears to have enabled fraudulent transactions to be concealed in other account codes to avoid detection, notably the Cost Centre 2 control account. In addition the Individual was able to appropriate unmatched receipts, using journals to transfer income in order to net off accumulated costs. It is likely that it was necessary to clear the Cost Centre 1 control account at this point, as questions may have been asked about the accumulation of CPO costs by the financial closure team, particularly as this phase of the project was thought to be substantially complete.

We reviewed examples of supporting documentation for journals associated with the fraud (Journal 4 and Journal 5). In both cases a standard Integra Journal template records the processor and approver of the journal. In both cases the supporting documentation provided in support of the journals is incomplete and not of sufficient detail to enable robust review and challenge, with insufficient information to explain the nature of the transaction. In particular, we would expect to see confirmation from the budget holder receiving the transfer, e.g. for the £272k moving from the Cost Centre 1 to Cost Centre 2 relating to Journal 5. In both cases their Journals should have been reviewed by the CSG Finance business partner and their direct line manager, the Senior Business Partner, prior to their posting to Integra.

The Journal documentation does include a screen print to demonstrate approval by the CSG Finance business partner team – we understand that this is a system control within Integra that ensures that the person processing the journal cannot post it to the system unless it has been approved by the authoriser, in this case the relevant business partner or their direct line manager in the business partnering team.

Our stakeholder meetings with finance business partners indicated that the likely process for raising these journals at that time was that the journals were requested by the Individual as budget holder, working with the business partner and approved by the senior business partner.

A more robust review and challenge of the Journals at this stage could have raised questions over the validity of the transactions and either prevented them from taking place or raised further questions. This in turn could have led to the detection of the fraud.

We established in our stakeholder meetings that the staff involved were not aware of comprehensive documented procedures for the processing of journals being in place, other than the instructions in the template. We understand that since 2017 journal processing, review and approval within CSG Finance has been centralised and is no longer undertaken by the devolved business partnering team. This should have improved the segregation of duties between the budget holder requesting the journal, the business partner reviewing it and the journal processing team who will check that the journal is supported by sufficient documentation and evidence of review. However, the effectiveness of the control continues to rely on robust review of the supporting documentation by the journal authoriser and the central processing team.

Recommendation 17 - We recommend that the development of a process note for Journal processing and its dissemination to staff. This should include a checklist for the officer processing the journal, to ensure that adequate explanation for the journal has been provided along with robust, preferably supporting evidence, preferably from 3rd parties.

Recommendation 18 - We recommend that journal processing be reviewed further to ensure that Integra journal request templates are properly completed and that there is evidence of a robust review and approval process.

Pillar 4 – Budgetary control and financial reporting

The monthly and quarterly budget monitoring process

Regeneration projects are subject to a regular management reporting process. Monthly monitoring is performed by the CSG finance business partners allocated to Re, working with budget holders to monitor and report on variances against revenue and capital budgets. It is the budget holders responsibility to provide monthly summary budget information. This information is compiled for each regeneration scheme and performance for the month and is reported to GROB (Chaired by the Council's Strategic Lead for Regeneration and Development). In our view the Council's GROB was the key governance forum in regard to monitoring Regeneration budgets. Although scrutiny of financial information for accuracy and completeness was not part of the Terms of Reference, it did review expenditure on CPO and cost recovery at scheme level as part of its strategic role to monitor the delivery of regeneration projects.

In parallel to reporting to GROB, financial performance information is also reported to the Partnership Operations Board (PoB), who are responsible for monitoring Re performance outputs in regard to contractual requirements and report to the Council's Performance and Contract Management Committee. This includes a high level analysis and commentary on revenue and capital budgets for Re managed budgets. The financial information is also used to compile reports for the wider governance structure around Council services, including the Re Board of Directors and the Council's Strategic Commissioning Board. Due to the nature of the transactions and the scale of regeneration budgets as a whole, it is unlikely that unusual variances could be detected without being flagged by Re budget holders and CSG finance business partners.

We believe it reasonable that GROB (and other governance platforms) relied upon the data presented by CSG Finance and Re management in order for them to make decisions concerning Regeneration.

There were errors in CSG Finance business partnering, including checking that transactions were valid and posted to the correct code, and in regard to Re management budget scrutiny at the level below the key governance bodies. This meant that as a result of the fraud Re and CSG, and consequently GROB, were misled into believing that CPO transactions were legitimate and were not alerted to the presence of unusual and erroneous transactions as they should have been.

Discussion with the CSG finance business partners responsible for regeneration related cost centres indicated that the emphasis for budget monitoring of both revenue and capital was actual or forecast overspends against the budgets for relevant cost centres. It was in these instances that explanation was required from budget holders to explain variances, and that these are then reflected in the highlight report to GROB. The progress and emerging risks for each scheme were reported as separate sections in the highlight report.

The budget monitoring process for large capital schemes does not currently provide an effective control that would enable even relatively significant frauds to be detected as a budget variance. Budgets are not profiled month by month, and forecast financial underspends are not generally investigated or challenged by finance business partners.

Recommendation 20 - We recommend that the budget monitoring process for capital schemes be reviewed to determine if additional and proportionate review controls could be implemented to improve the ability of finance business partners and senior management to detect unexpected variations.

Pillar 4 – Budgetary control and financial reporting (cont'd)

The Council and CSG have agreed that it is not practical to implement the profiling of capital budgets on a monthly basis in order to measure progress on planned expenditure on regeneration projects. The Council and CSG should therefore consider alternative arrangements to ensure that the monthly monitoring of expenditure on capital budgets is meaningful and provides an appropriate method of identifying potential adverse variances, including forecast spend in excess of budget.

As part of the monthly monitoring process, commentary on variances should be provided by budget holders to explain variances, and the business partner should challenge this on the basis of their independent understanding of the project. Significant or problematic variances should be highlighted to GROB.

Quality of capital budget monitoring reports

During the course of our review, we were informed by CSG that capital budgets are not held on the Integra general ledger system, but reside on separate Excel spreadsheets, which is where spend is monitored against budgets.

There were consistent comments from our meetings with capital budget holders in the regeneration team that the capital monitoring reports they received contained information that was not consistent with their understanding off the capital budgets assigned to them and did not assist them in identifying costs incorrectly coded to their budget. These reports are currently provided by CSG finance business partners.

We noted that due to this lack of understanding, support had often been sought from the Individual this was because they had previously worked as a finance business partner and had an understanding of the process. It is likely that at least two Regeneration Managers relied on the Individual to help them interpret and respond to the capital budget monitoring report. It is likely that this informal workaround, opened further opportunity for the Individual to control the flow of information that may otherwise have identified transactions relating to the fraud.

Recommendation 21 - We recommend that all capital budgets are recorded on the Integra general ledger system and that opportunities are explored to use the BDM system to improve the ability of budget holders to access up to date information on capital budgets.

Recommendation 22 - We recommend that more regular and detailed capital monitoring reports be made available to budget holders to improve their ability to detect unexpected variances.

Recommendation 23 - We recommend that the respective responsibilities of Re, CSG and Barnet Council in regard to Capital budget monitoring are reviewed and more clearly defined.

Pillar 4 – Budgetary control and financial reporting

The role of Finance Business Partners

In the cases of reporting to both GROB and the Performance and Contract Management Committee, the information is relatively high level and therefore significant onus is placed on CSG finance business partners to challenge the narrative on budget variances provided by budget holders, for the cost centres they are responsible for.

In the absence of this detailed understanding of Re transactions, CSG finance business partners will be unable to effectively challenge the narrative provided by the regeneration manager, weakening the review control that could identify error or fraud. As CSG Finance act on behalf of the Council in this capacity, this in turn exposes the Council to significant risk.

In the case of the fraud, the review control was not sufficiently robust to detect unusual transactions – for example, knowledge of the Cost Centre 1 project should have identified that there was a mismatch between the budget holder for the Cost Centre 1 control account (the Individual) and the Re regeneration manager responsible for the project and that the project was nearing completion, so that significant transactions on the CPO account should have stood out as unusual, as the CPO process should have been completed by 2016.

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We note that there had been some changes to the business partner allocated to Cost Centre 1 and Cost Centre 2, which coincided with the latter phase of the fraud. A significant control weakness arises where an individual initiating the payments for CPO transactions on the costs centres for which they were budget holder, also being also being responsible for providing explanatory narrative for the transactions which the business partner is not in a position to challenge.

Recommendation 19 - We found that in a number of cases, finance business partners supporting Re had not challenged a number of unusual balances on control accounts and movements on cost centres. This could be due to the level of knowledge they had around the service and the activity that was being reviewed, for example, new costs accumulating on the control account for a project that was substantially complete. We recommend that finance business partners be equipped to take a more active role in confirming that movements on budgets and control accounts are consistent with the underlying activity, ensuring that appropriate monthly monitoring reports are being sent to budget holders.

Pillar 4 – Budgetary control and financial reporting (cont'd)

Balances carried forward on control accounts – CPO/PTA

The reconciliation of control accounts is a key financial control in any organisation. Reconciliation, in this context, means understanding and being able to explain all the transactions which are posted to a specific account to check for error or unusual transactions, as well as ensuring that developers are being regularly billed for cost accumulated in the case of regeneration related control accounts.

Control account reconciliations relating to the Cost Centre 1 and Cost Centre 2 accounts were performed intermittently over the period of the fraud, but CSG Finance could not demonstrate that this had been a monthly process on a consistent basis, prior to 2017/18 month 6 (September 2017). We note that the reconciliation process for both control accounts adopted a standardised template from 2017/18 Month 7 onwards that included an outline of the process required. Prior to this the documentation of the reconciliation was inconsistent and it is not clear that an effective reconciliation process was in place for the early phase of the fraud, up to September 2017.

We reviewed control account reconciliations carried out after September 2017 in regard to the Cost Centre 1 and Cost Centre 2 control accounts. Reconciliation activity carried out appears to have been limited to agreeing that the net total recorded on the control account matched the net total recorded on Integra General Ledger. The reconciliation templates do not provide evidence of robust review, eg. to provide assurance that the transactions were accurate and complete.

We note that Internal Audit had reported on this as an area of weakness in their General Ledger Testing undertaken in January 2017 and that CSG had accepted an action to provide evidence of review of control account reconciliations by the Senior Business Partner (Internal Audit Report: Key Financial Controls Phase 1 2016/17).

We confirmed with finance business partners that balances carried forward are not reported as part of the Monthly budget monitoring reported to GROB, despite the balances carried on the Cost Centre 1 and Cost Centre 2 control accounts carrying significant cost balances at intervals during the year. Although control accounts do not have allocated budgets against which financial performance can be measured, the expectation is that the accounts should net to zero at the end of every month.

The lack of reporting on control account balances effectively removed the ability of GROB members to identify and challenge accumulated balances month by month, which reflected amounts that should have been billed to developers. As we noted in our analysis of the process for reclaiming costs from developers, significant unbilled balances of between £900K and £1.5m had accumulated on these codes at intervals during 2017/18. It is likely that a more rigorous reporting to GROB members of control account balances carried as debtors, and more rigorous challenge provided by finance business partners on these balances, could have led to the detection of the fraudulent transactions identified.

Recommendation 24 - We recommend that balances held on control accounts under the indemnity agreements, are included in the budget monitoring information and in the GROB highlight report. This should include narrative on variances against a zero budget provided by budget holders and validated by business partners.

Pillar 4 – Budgetary control and financial reporting (cont'd).

Balances carried forward on control accounts – PDA

Regeneration Managers are the revenue cost centre managers, and for a number of schemes they have to spend to agreed caps, for costs which do not fall under an Indemnity agreement for CPO/TPA transactions. This is stipulated in the Partnership Development Agreements (PDA) for their schemes. If their spending exceeds their cap, the Council will absorb the cost.

According to the Council's Financial Regulations, Chief Officers must ensure that their revenue cost centre managers do not enter into commitments before satisfying themselves there is sufficient approved budget provision. Chief Officers do not have the power to over-spend or under-recover income.

We noted that CSG Finance budget monitoring does not monitor against these caps. During our stakeholder meetings, we were informed that the Area 2 regeneration project had regularly overspent against their PDA cap in recent years and was likely to re-negotiate, for a second time, the annual PDA cap with the developer. Furthermore, in the quarters in which the project overspent, the Council has had to absorb the cost.

In our view the GROB were not provided with sufficient information on variance against PDA net expenditure caps.

Recommendation 26 - In order to manage the risk of accumulating unbudgeted liabilities on Regeneration cost centres, we recommend that expenditure against the PDA cap is reflected in the budget monitoring process for relevant cost centres, and forecast overspends against the cap are reported to finance business partners as part of the monthly cycle, and to GROB if the balances become significant an may require an adjustment to the budget.

Pillar 5 - The financial control environment for regeneration projects

Documented procedures and knowledge transfer

We found that documented financial processes either did not exist or staff were not aware of them. This was a common theme in a number of meetings with Re and CSG Finance stakeholders. In particular, during the period of the fraud there were no detailed documented procedures for key parts in the process, including the process for requesting and authorising CHAPS payments. This lack of procedural documentation has contributed to inconsistency of practice as there was no set process documented for new staff to be able to follow or to form the basis of training.

In our view, a lack of documented procedures coupled with staff turnover in key positions such as Business Partner, contributed to a lack of clarity and mutual understanding of the roles and responsibilities of each of the key stakeholders involved in exercising financial control. This created uncertainty over who is responsible for what areas of the process and helped create 'grey areas' where responsibilities overlapped.

For example, in our meetings with stakeholders we heard that staff in CSG Finance Treasury assumed that staff in Re and the finance business partners were carrying out checks of validity, which was not always the case.

Recommendation 27 - Clarification should be sought and evidence provided from Re management on the existence of:

a) Formal documented processes and controls that apply to all regeneration projects (including but not limited to CPO related aspects), and the extent to which these vary for each project.

b) Evidence that training of staff in regard to these procedures has taken place.

c) Ongoing CPD and risk management and the means by which they ensure that project managers are adhering to the agreed processes.

Pillar 5 - The financial control environment for regeneration projects (cont'd).

Supervision of Re Managers

We noted that Re Managers responsible for Regeneration Projects and supporting processes heave been subject to limited supervision, in terms of oversight by a senior manager with appropriate detailed knowledge of all the current regeneration schemes. In our view, such an individual may have been in a position to challenge transactions on Re cost centres and in particular, the way that the cost centre 1 was being used by the Individual.

- The current Business Director for Regeneration, with overall responsibility for regeneration projects, had only nine months experience of regeneration and was not directly involved in reviewing the financial management activity of his managers or the Individual, in regard to regeneration budgets and related ledger codes. In its current form this role is geared more towards commercial account management, focusing on the contractual relationship with the Council and not with detailed functional and technical oversight of the projects themselves.
- The Individual's nominated direct line manager within Re was identified as being the Head of Strategic Planning within Re. On the Integra system, we note that a third senior manager – identified as Property Director - from Capita was identified on Integra as the Individual's superior budget holder in the system hierarchy for payments in excess of the budget holders limit (e.g. 173k). This individual had also been the approver for granting Integra systems access to the Individual early in 2017.

This also raises a business continuity risk - should the Regeneration manager leave their post suddenly significant emphasis would be placed on the junior Regeneration Officer assigned to the project to provide this.

Recommendation 28 - We recommend that Re take steps to ensure that Regeneration Managers are subject to closer supervision within Re to ensure that projects are being properly executed and to provide assurance on business continuity. Specifically, we recommend that Re re-reinstates a Head of Regeneration Role in line with the contract, or a satisfactory equivalent, to whom all regeneration managers report, and who has overall responsibility for all regeneration schemes within Re.

Pillar 5 - The financial control environment for regeneration projects (cont'd).

Management behaviours & professional scepticism

While we recognise that the following observations are anecdotal, we raise them as they are indicative of pockets of business culture within Re and CSG that do not react quickly and effectively to address potential risks.

There has clearly been an over reliance on key people and the Individual concerned has variously been described as "The Go To" person for Integra, "the acknowledged expert on capital expenditure" and the person with the most detailed knowledge of a number of the capital schemes. It was clear from our meetings with regeneration managers that they relied heavily on the Individual's knowledge and experience to help them manage their budgets.

A number of officers in CSG Finance and Re commented during our meetings that they were aware of control weaknesses (for example, through Internal Audit findings or their own observations) or recognised in hindsight that control weaknesses should have been identified and addressed. This report describes several situations where a higher level of professional scepticism and rigour on the part of senior managers within Re and CSG Finance, could be reasonably expected to have identified and challenged unusual and potentially suspicious transactions – notwithstanding weaknesses in formal controls and CSG Finance when approving journals, payments and system access, and when reviewing budgetary performance. Some of this may be attributable to the turnover of personnel in key roles and the lack of effective knowledge transfer.

These management practices may help explain why control weaknesses that should have been anticipated and addressed by senior/experienced managers, have not been addressed since the new contracts were set into operation in 2013.

Recommendation 29 - We recommend that key lessons learned from this review be communicated to relevant staff involved in financial processing across Re, CSG and Barnet Council and incorporated into existing training programmes. This should emphasise the importance of meeting standards of professional ethics and behaviour set out by the professional accountancy bodies, particularly in regard to fraud prevention and cover financial skills for budget holders.

Oversight by the Council

In our view, there has also been insufficiently close scrutiny and client side management on the part of the Council and the Chief Officers coupled with an over reliance on the limited scope and frequency of work carried out by the Internal Audit service, to highlight issues. This is likely to have contributed to the lack of focus on effective controls. We note that the Council commissioned a Performance Governance Review in February 2017 but this occurred too late to influence the outcome of the fraud.

There are a number of governance platforms at which financial and management issues arising from Re and CSG service delivery are monitored by the Council, including:

- Partnership Operations Board (PoB), responsible for monitoring Re performance in regard to contractual requirements and reporting to the Council's Performance and Contract Management Committee.
- Growth and Development Operations Board (GROB) responsible for the oversight of regeneration scheme delivery and the associated budgets managed by Re.

Pillar 5 - The financial control environment for regeneration projects (cont'd)

- The Strategic Commissioning Board at which Chief Officers report on service delivery to the Council Chief Executive.
- The Re Board, which monitors the performance of the Joint Venture between the Council and Capita.

In our view Chief Officers and other Council representatives attending these governance platforms could have been more proactive in challenging the speed of progress in addressing known issues (such as clarity of roles and responsibilities and matters raised by internal audit).

Assurance from Internal Audit

In our stakeholder meetings, we observed a number of comments from CSG Finance and the Council, that they had taken assurance from work done by Internal Audit which had influenced their approach to maintaining a secure financial control environment.

We note that the operation of various aspects of the Regeneration Service within Re had been reviewed by Internal Audit on a number of occasions, and recommendations had been raised and accepted.

Re have been subject to a Review of Operations (Phase 1) in 2016/17 where there were findings relating to the completeness and use of documented procedures, including over regeneration. In 2017/18, benefits realisation from regeneration schemes and the management of CIL S106 expenditure were reviewed by Internal Audit and given Limited Assurance with findings reported to the Audit Committee.

The operation of CSG Finance had been reviewed more frequently including the annual review of core financial procedures, and we note that recommendations had been raised relating to the Scheme of Delegation (and financial authorisation) and General Ledger (Control Accounts). Evidence from our review indicates that these were not implemented effectively by CSG at the time of the fraud. While the Council had a responsibility to work with CSG in implementing changes around the Scheme of Delegation, in our view the onus was on CSG to work with Re ensure the Scheme of Delegation and financial delegation/authorisation was fit for purpose under its contractual obligation to maintain the scheme.

We have been advised by Internal Audit that they were not satisfied with the level and timeliness of implementation of findings generally, and the target of 90% implementation of high priority recommendations had not been met since 2013/14, and on follow up audits Internal Audit have also found that in some cases medium priority recommendations had not been implemented.

We noted that a recent Internal Audit of Treasury Management that covered CHAPs payments within CSG Finance Treasury did not identify significant control weaknesses or risks for CHAPS payments, including TPA/CPO transactions and as a result follow up has not been completed outside planned audit work.

Following the identification of the fraud in December 2017, the internal audit testing was re-performed by the Internal Audit service in more detail following the highlighting of the fraud and a number of deficiencies were found in regard to CHAPS payment authorisation.

Our review of the Internal Audit retesting relevant exercise is reported on the subsequent pages of this report.

Pillar 5 – Review of Internal Audit work on CHAPS payments

Retesting of Internal Audit work on CHAPS

The Council's Internal Audit service jointly covers the Council, Re and CSG Finance. As part of the testing around Treasury Management within CSG Finance, Internal Audit undertook a review in February 2017 of a sample of 20 CHAPS payments using a scope that had been agreed with the in house Internal Audit service, delivered through an in house team plus a contract with a provider and senior managers from Barnet Council's Commissioning Group and CSG Finance. The control being tested was limited and found no deficiencies.

In January 2018, the same sample was reviewed again following the anomalous payments being identified. This review was conducted by a more senior member of the Internal Audit service (who was not involved in the original testing). The Council have advised us that the scope for this second review was the same. However, the Council asked the Internal Audit Manager (who was not part of the original testing) to write down every detail on what they saw for the sample and to note any wider improvement points to inform this review - 12 deficiencies from the sample of 20 were identified.

We were asked to review the re-testing exercise performed by Internal Audit and to comment on the extent to which the revised findings were valid and the broader implications for Internal Audit work in future.

Internal Audit tested emergency CHAPS payments under the key system Treasury Management.

According to the original Terms of Reference ("ToR"), Internal Audit were required to "perform sample testing of key controls within each of these systems to provide assurance over their operating effectiveness" and the "design of the key controls will be assessed and any findings related to control design will be included in the report". Therefore, Internal Audit were expected to consider the operating effectiveness of the controls and assess the controls' design.

Furthermore, the audit would "focus on the key objectives, risks and controls listed for each system." The ToR for this review identified the following with respect to emergency CHAPS transactions:

- **Key objective**: Only valid emergency transactions are made via the CHAPS system
- **Key Risk:** CHAPS transfers are made for the incorrect amount or to the incorrect recipient due to human error or fraud
- **Control:** Emergency CHAPS transactions should be requested by an individual as per the signatory listing and in their authorisation limits. The payment should then be authorised by the Deputy/Head of Treasury before payment.

Pillar 5 – Review of Internal Audit work on CHAPS payments (cont'd)

Internal Audit scope of work for CHAPS testing

Before the issuance of the original ToR, the Council's Internal Audit service, CSG Finance and the relevant Council officers agreed what the key controls over the Treasury Management processes were, of which the emergency CHAPS payment process was one. Moreover, for the Council's Internal Audit service to fulfil their aim of assessing the design of key controls, a better understanding of those controls would have been necessary.

Based on our review of the re-performance testing, it is clear that the controls identified in the original ToR did not reflect a full understanding of the process:

- The role of 'requester' was not clearly defined in terms of whether this was the initiator or the approver of the payment and/or the budget holder.
- There is no definitive 'signatory' list, to clearly set out who are permitted to initiate requests (e.g. budget holders), those who can authorise payments (e.g. finance managers/ business partners), those who can process payments and those who certify or release payments (senior managers in Treasury Management, and those approved on Bankline).
- The payment authoriser did not need to be the Deputy or Head of Treasury, rather, the authoriser should be on the 'Treasury Management Authorised Approvers list', dated 22 January 2014, e.g. the Asst. Director of Finance was not on this list but also had the authority to authorise payments.
- There was limited consideration by the Internal Audit service, CSG Finance and the relevant Council officers of the level of information attached to the CHAPS payment request in the scope.

  This was acknowledged in the method statement for the original testing, but there was no clear expectation of what level of documentation was required and it was not followed through. This was key to the ability of the authoriser and approver to determine if the request was valid, and hence the effectiveness of the control.

- The validation of bank details attached the CHAPs payment request was not considered as a key control as this was covered by another audit of Accounts Payable (AP). The controls tested did not include any checks on payee details – their accuracy or the consistency of payee details given by the requester compared to Treasury Management records. If such controls were in place, it does not appear that they were tested. If they were not in place, Internal Audit did not identify this as a design deficiency to be reported as this was part of another audit scope (AP).

The Council's Internal Audit service, the CSG Finance Treasury Team and the Section 151 Officer, therefore did not effectively identify and clarify the key controls that should have been in place. The definition of the controls to be tested in the original testing and the re-performance are compared in **Appendix C**.

There is also the issue of whether the controls identified in the ToR and those tested in the re-performed testing adequately mitigated the identified risk. The risk identified in the ToR was two-fold:

(1) transfers made for the incorrect amount

(2) transfers made to the incorrect recipient.

Pillar 5 – Review of Internal Audit work on CHAPS payments (cont'd)

In our view the controls identified in the original ToR did not adequately cover either risk. It is possible that a relevant requester, within their requisition limit, could request a payment for an incorrect amount that then went to the wrong recipient, but was still 'authorised'. This would depend on what the Council's Internal Audit service understood 'authorisation' to mean – i.e. to check that it was sufficient that the requester was on the relevant list and within their requisition limit for a payment to be authorised.

Recommendation 30 - We recommend that during the stakeholder engagement to develop the Terms of Reference (ToR) for the Key Financial Systems review, greater rigour should be applied to:

- **making sure that all required stakeholders engage fully in the process**
- **understanding the process to be tested, in order to identify key risks**
- **ensuring that the design of controls mitigates all key risks identified**
- **ensuring that planned audit tests adequately interrogate the controls**

Sample selection for Internal Audit work on CHAPS

We recognise that the sample of 20 items used in the testing was unlikely to pick up a the relatively small number of fraudulent payments, as it was selected from a full list of all types of CHAPS payments in the period. We also recognise that it is not always necessary to test a large number of payments in order to establish whether controls are working.

We noted that within the test sample, 10 items related to payments raised within the Treasury Team, primarily relating to investments. While four deficiencies were noted, the updating of the signatory list mitigated three and the remaining deficiency was a relatively minor documentation point.

Therefore this type of transaction is relatively low risk, compared the eight deficiencies found out of eight sampled, for payment requests from other service departments and further forensic testing should therefore focus on the transactions posing the greater risk.

Recommendation 31 - We recommend that, during internal audit sample selection, greater consideration is given to weighting the sample towards those transactions that are potentially higher risk, either inherently (such as unusual or high value items) or as a result of a more complex process, for example, CHAPs payments requested from outside of the Treasury Team.

Observations on re-performed Internal Audit CHAPS testing

The retesting demonstrated a more thorough and detailed understanding of the processes and controls that the Council and the CSG Finance Treasury Team had in place. This produced deficiencies for twelve sample items.

The recurring deficiencies found in the re-performance testing were:

- Insufficient evidence to support the need for an emergency payment or to determine that the payment is reasonable
- Approver and/or initiator acting outside their requisition limits
- Neither initiator nor approver having the authority to request the payment (not being the budget holder)
- Authorisation lists not up to date, or the authoriser not on the list

Pillar 5 – Review of Internal Audit work on CHAPS payments (cont'd)

The rigour of control testing in the re-performance work, specifically, the detailed review of sufficient supporting documentation, better mitigated the risk of transfers made for the incorrect amount. For example, in the re-performance, Internal Audit thoroughly reviewed the supporting documentation held for each of the payments tested and made clear judgements on its sufficiency.

Of the 12 sample items for which deficiencies were found in the retesting, four of them were deemed to have insufficient supporting evidence to confirm their validity. These included, for example, a lack of completion statements or solicitor letters for legal payments. This control, in particular, could identify if payment requests had been made for the incorrect amount, through paperwork inconsistencies, for instance. However, the controls did less to mitigate the risk of payments made to the wrong recipient.

We found that that 10 of the 20 items tested related to payments raised from within the Treasury Team (primarily relating to Treasury investments), rather than as requests from other service areas. Although four deficiencies were noted, three were due to the hard copy certifier signatory list not being up to date, although the signatory was shown to be valid. The other deficiency related to an incorrect document retained to evidence payment through Bankline, although the payment was found to have been made.

Three of the deficiencies have been addressed via an updated signatory list implemented from February 2017 list, or were relatively minor in the case of the final deficiency. Therefore these items are considered to be relatively low risk, in regard to the need for further forensic review. This does raise the issue we identified earlier in this report around how approved signatories are reviewed and managed across multiple manual lists as well as recorded on the Integra system.

We note that two items were not CHAPS transactions, and should not have been included in the original sample.

The remaining eight cases related to other forms of emergency payment requested by other service areas. Deficiencies were noted with all eight items, indicating significant weakness in the controls. In our view, further work Internal audit work should focus on CHAPs payments based on requests from other departments.

The deficiencies found in the re-performance testing are reproduced in **Appendix D**.

Our conclusion on the retesting of Internal Audit work

In our view, the results of the re-performance testing drew findings where the original testing did not, because the process and controls to be tested, were better understood, with the benefit of hindsight and a knowledge of the control weaknesses that had been exposed. The testing was also executed with greater focus and robustness.

In our view, there was a need for a better understanding of the CHAPS process and the areas of risk at the planning stage for the original review, before the key controls for testing could be defined with confidence. There were weaknesses in the execution of the original testing but also insufficient consideration of the design of controls in order to mitigate the risks identified.

We note that a sample of 20 items for testing was unlikely to detect a relatively small number of fraudulent transactions within a much larger population. However a greater focus on the level of supporting information and validation of bank details could have resulted in control weaknesses being identified and recommendations made, that were relevant to preventing a fraud of this kind.

Pillar 5 - Maintenance of effective controls over time

Maintenance of effective controls over time

We have considered the extent to which financial controls reviewed in the scope of this review have declined, improved or been maintained since operations were delegated to Re and CSG Finance in 2013/14. We note that the contracts for both arrangements include method statements and service specifications, but these do not necessarily reflect the detailed financial procedure inherited from the Council at the point of handover. We have therefore focused on the changes that have taken place and how these have affected the financial control environment.

Delegated authority and Systems Access

Prior to the Integra system being implemented, we could see little evidence of effective control over the way that individuals were given access to the ledger system.

We note that new system administration procedures were introduced when Integra was implemented to replace the old ledger system. From this point forms were used to authorise requestor and authoriser/budget-holder access. However, our work indicated that the authorisation process has not been robust in the absence of a clear scheme of financial authorisation within Re against which suitability of requested to role could be checked – therefore the control has been maintained at a low level of effectiveness.

Control over the processing of transactions

In regard to the processing of financial transactions for Regeneration projects, the use of control accounts and the approach to billing developers appears to have been inherited from Council practices, although this cannot be confirmed to original documentation. We did note however, that the Cost Centre 1 regeneration project has been handed over to a new Regeneration manager in 2015 and that during this transition the new Regeneration Manager did not become the budget holder for the Cost Centre 1. Budget holder status was subsequently taken up by the Individual for reasons which are unclear. The lack of effective handover meant that the Regeneration Manager was not aware of a key cost centre relating to the project, and this reflects a deterioration in the level of control due to the overreliance on knowledge vested in individuals rather than documented systems and processes.

There has been some turnover of key officers in the CSG Finance Treasury Team, notably the Head of Treasury. It is conceivable that this contributed to the fact that the notable increase in CPO payments for Cost Centre 1, and the increase in the total quantum of CHAPs requests passing through Treasury, particularly in the latter part of 2017 was not questioned as unusual. Again, this reflected a likely over reliance on the knowledge of individuals rather than sound processes and controls, to challenge unusual transactions.

We note that significant weaknesses in the CHAPS payment process were allowed to continue without remedy, and improvements to the process were only triggered in response to the detection of the fraud.

Pillar 5 - Maintenance of effective controls over time (cont'd)

Journals

A new journal form was introduced when the Integra system was implemented, which reflects a process for request and sign off. However, we identified that, prior to 2017, journals from the regeneration team were processed and authorised within the CSG Finance Business Partner team, where segregation of duties was also maintained. We note that the processing of journals has now passed from finance business partners, to a centralised team within CSG Finance. The further separation of the personnel approving and processing should reflect a slight strengthening of the process. However, the inconsistent levels of supporting documentation and explanation to validate journal requests was a consistent weakness over the periods 2016/17 and 2017/18, based on the journal documentation we reviewed in relation to the fraud.

Budgetary control

The lack of detailed analysis and challenge by finance business partners as part of the budgetary control process seems to have been consistent from the start of the Re and CSG Finance contracts, and reflects the Council's focus on reporting forecast overspends as a means of managing budgets, rather than unusual or unexpected transactions (which matches the approach described in the Financial Regulations).

Consideration of staff turnover within CSG Finance

Turnover of finance business partners, and changes made to the way that the service was organised, has generated mixed results. The bulk of fraudulent transactions on regeneration control accounts took place under the old system, under the review of a business partner and senior business partner who had been in post for a significant period of time. During this period questionable journals and system access requests were approved, and control account reconciliations appear to have not taken place monthly. Under the new arrangements and personnel, control account reconciliations for regeneration control accounts have been conducted monthly although the rigour with which unusual transactions have been challenged has remained consistently weak.

Financial control environment

The issues we have raised in regard to the overall financial control environment and culture appear to have been fairly consistent over the period of review. We have not observed any specific shift in culture of approach during the period, and these issues appear to have been accumulating for some time. This observation applies primarily to the transaction level processes and first tier of review by management and finance business partners, and is therefore applicable to Re and CSG. However, through the reporting of its Internal Audit Service and the recognition of weaknesses in the governance of Re and CSG reflected by the Performance Governance Review initiated in 2017, the Council also had a role in making sure known issues were addressed promptly and effectively and in holding both providers to account.

Pillar 5 - Compliance with Financial Regulations

Compliance with Financial Regulations

The Council's Financial Regulations are supporting documents to the Council's Constitution and were updated in July 2017. These govern the way that the Council undertakes financial forward planning, annual budget setting, budget monitoring and the closing of the accounts.

We note that the Regulations only detail the Chief Officer's financial responsibilities. The Chief Officers are defined by the Councils Constitution as members of the Council's senior management team. Under this definition, the Chief Officer for regeneration is the Deputy Chief Executive and the Chief Officer for finance is the Director of Resources (Section 151 Officer).

Clause 2.4 notes that, where applicable, consultants or agencies acting for the Council will be bound by these procedures and it is a condition of their engagement that they do so. Therefore, this obligation extends to both Re and CSG Finance. We note that the financial regulations only detail the budgetary responsibilities of Chief Officers of the Council.

In this section, we have framed the findings of this report in the context of the Council's Financial Regulations and identified the following areas that may constitute non-compliance on the part of service providers Re and CSG Finance and the Council.

All the key findings of this report potentially have a bearing on the application of the Financial Regulations, however we noted four areas in particular where Financial Regulations may not have been applied - these are listed on the following page.

Pillar 5 - Compliance with Financial Regulations (cont'd)

- **Pillar 1 – Maintaining a Scheme of Financial Delegation.** The Financial Regulations (Para 2.1.2) state that "each Chief Officer is required to maintain a scheme of financial delegation… which accords to the financial limits included within the overall scheme of delegation and contract rules." This was not in place for the Re Regeneration team in the form of a Scheme of Financial Authority, but contractually, Re and CSG had a duty to maintain the scheme and should have alerted the Council to any deficiencies.
- **Pillar 2 – Reclaiming costs from developers.** According to the Council's Financial Regulations, Chief Officers must ensure that their revenue cost centre managers do not enter into commitments before satisfying themselves there is sufficient approved budget provision. Chief Officers do not have the power to over-spend or under-recover income and must report potential overspends to the Chief Finance Officer. Our review found balances on control accounts to record CPO payments and potential PDA costs accumulated in excess of contractual cap that could give rise to a significant unreported liability to the Council. Reporting to Chief Officers has not highlighted significant cost balances accumulating, that may not be recoverable - in particular the £2m value of fraudulent payments.
- **Pillar 2 – Accounting for CPO/PDA control account balances.** Chief Finance Officer has overall responsibility for preparing accounts in accordance with the CIPFA Code of Accounting Practice, and the Chief Officers have a responsibility to meet the requirements set by them. The use of revenue control accounts to account for transactions that resemble capital acquisitions of property, raises the risk that capital accounting standards (IFRS) are not being adhered to in regard to the recording of land and buildings, and potentially in regard to other aspects of the balance sheet such as long term debtors. Our work did not find definitive evidence of error, however we have raised a recommendation to establish how accumulated CPO costs have been accounted for at year end.
- **Pillar 2 - Initiation of payments for CPO and PTA liabilities.** The Council adopts the key recommendations made by CIPFA, including the Standard of Professional Practices on Treasury Management, to be reflected in Treasury management practices maintained by the Section 151 Officer. It is likely that acknowledged weaknesses in the CHAPS payment process operated by the CSG Finance Treasury management team has not enabled the Chief Finance Officer to fully discharge this responsibility in the period 2016/17 and 2017/18.
- **Pillar 4 – Budget Monitoring.** The Financial Regulations stipulate that the Chief Finance Officer is responsible for reporting to the Performance and Contract Management Committee, any cost centres that are projecting net overspends of over £50k, where the budget is less than £1m. Again, the lack of transparency over fraudulent balances accumulating on Regeneration control account cost centres, has prevented this from being disclosed in the period 2016/17 and 2017/18.

Other areas of potential concern that are outside of scope

CIL & S106

We understand that the Individual was also involved with the processes for matching income and expenditure for Community Infrastructure Levy and Section 106 payments. An Officer explained to us that the processes used to manage funds associated with Community Infrastructure Levy and Section 106 payments was inconsistent and was previously managed using a series of spreadsheets.

Recommendation 14 - We recommend that the process for processing CIL, S106 payments and Private Treaty Agreements be reviewed for the adequacy of controls and the prevention of fraud, including scrutiny of specific transactions.

Bank Details for E-form payments

We noted from stakeholder meetings that for E-form payments that are not subject to purchase order new vendor controls, it was not clear if the bank details of new suppliers were verified directly with the supplier, prior to being input on the system and that controls over these payments may be less rigorous than for normal BACS transactions.

Recommendation 15 - We recommend that the BACS process be reviewed for the adequacy of controls over new suppliers where there is no purchase order (such as E-form payments).

6. Forensic Fraud and Accounting Analysis

Introduction

Context

This section of our work focuses on the wider processes and financial controls relevant to the fraud.

The Council's Corporate Anti-Fraud Team (CAFT) has identified 62 fraudulent payments during the 2016/2017 (Year 1) and 2017/2018 (Year 2) financial years.

Regeneration Managers and CSG finance colleagues refer to Cost Centre 1 and Cost Centre 2 as "control accounts". We have been informed that control accounts associated with Cost Centre 1 and Cost Centre 2 should be used simply to account for the:

- cost of purchasing properties to develop schemes, and
- recovery of these costs from developers

Over the lifetime of the scheme, the balance on these control accounts should add to nil (and without the need for journals to re-allocate costs, for example).

The Council has requested that in this report we anonymise any references to locations or addresses that may be identifiable.

Our approach to reviewing transactions

Our work has been on the following two agreed key areas of focus:

- Where does the £2 million of fraudulent payments currently reside in the Council's books and records?
- A detailed review of the Cost Centre 2 control account for evidence of a lack of contract compliance relating to the Council's contracts with Re and/or CSG Finance.

In order to address these questions we have used the conclusions reached by CAFT as the starting point for our work in order to consider how the fraudulent payments were initially accounted for.

We have worked closely with CSG in order to address the two topics listed above. In order to do so, we have asked CSG to locate and provide us with accounting records which we have reviewed.

CSG has also undertaken work in response to recommendations which we have made. We have reviewed the work undertaken by CSG and sought further information in order to confirm our understanding of the work undertaken by CSG and to address further lines of enquiry.

How the fraudulent transactions were accounted for

Overview

As shown in Table 1 below, fraudulent payments were made and accounted for in both 2016/17 (Year 1) and 2017/18 (Year 2).

CSG anticipated that the cost centres initially used to account for the fraudulent payments would have nil balances at a financial year end. So, in order to avoid detection, it was necessary for the Individual to make accounting adjustments to bring the balances on the cost centres initially used to account for the fraudulent payments to nil by the financial year end.

However, because the fraud was discovered part way through 2017/18 and prior to the start of the year end accounting process, the Individual had not had the opportunity to attempt to conceal the balances at the time the fraud was discovered, part way through Year 2.

The way in which the fraud was accounted for in Year 1 was, therefore, much more complicated in Year 1 than it was in Year 2.

Causing fraudulent payments to be made from Council bank accounts created debit balances on the control accounts which needed to be hidden from sight within the Integra Ledger at year end. Our work and that of CSG has demonstrated that the Individual took advantage of book-keeping errors which generated erroneous, but in themselves not fraudulent, credit balances. These could then be offset or incorrectly matched against fraudulent debit balances, therefore part of the accumulated fraudulent balance was netted off against unmatched income and other balances and was effectively written down to zero at the end of Year 1.

However, our work and that of CSG has also shown that some of the fraudulent debit balances were transferred to the Council's balance sheet at the end of Year 1, prior to the discovery of the fraud.

The accumulated balances at the end of Year 2 remained on the cost centre to which they were originally posted, with minimal adjustment.

Table 1 – Originating cost centres that fraudulent transactions were posted to

Cost Centre	1		2		3		4		5		Total	
	£	No	£	No	£	No	£	No	£	No	£	No
Year 1	660,522	40	-	-	-	-	-		160,500	6	821,022	46
Year 2	880,350	12	-	-	237,850	3	124,750	1	-		1,242,950	16
Total	**1,540,872**	**52**	**-**	**-**	**237,850**	**3**	**124,750**	**1**	**160,500**	**6**	**2,063,972**	**62**

Accounting in Year 1

Year 1

In year 1, CAFT identified fraudulent payments totalling £821,022. These were initially recorded in Cost Centres 1 and 5, as summarised here:

- Cost centre 1: £660,522
- Cost centre 5: £160,500

Our work has shown that £44,357 of the fraudulent transactions which were initially recorded in Cost Centre 5 were ultimately transferred to Cost Centre 1 via a series of accounting adjustments known as “journals”.

The balance on Cost Centres 1 and 5 was nil at the end of Year 1. The following table summarises how the fraudulent payments were accounted for in Year 1 and how Cost Centres 1 and 5 came to have nil balances at the end of Year 1.

Table 2 – Accounting in Year 1

Cost centre	1	2	3	4	5	Total
Fraudulent transactions identified by CAFT	660,522	-	-	-	160,500	821,022
Net transfers from c/c 5 to c/c 1	44,357	-	-	-	(44,357)	-
Net transfers from c/c 1 to c/c 2	(481,257)	481,257	-	-		-
Subtotal	**223,622**	**481,257**	**-**	**-**	**116,143**	**821,022**
Revenue understated	183,212	210,508	-	-	(87,393)	306,327
Balance sheet overstated	0	270,750	-	-	-	270,750
Capital overstated	40,410	-	-	-	203,536	243,946
Total	**223,622**	**481,258**	**-**	**-**	**116,143**	**821,022**

Accounting in Year 1 (Cont'd)

Cost Centre 1

We understand from CSG that Cost Centre 1 is a control account which would have been expected to have a nil balance at the end of the financial year. Had it not had a nil balance it is likely that it would have been subject to greater scrutiny than some other cost centres increasing the likelihood that the fraud would have been identified.

In order to have a nil balance at the end of Year 1, after transferring £44,357 from Cost Centre 5, it was necessary to hide a fraudulent debit balance of £704,879 (£660,522 + £44,357).

This was achieved by making use of erroneous postings which had already been made to Cost Centre 1 and by making transfers to other cost centres.

Other erroneous postings

Our work has shown that net credit balances had been recorded within Cost Centre 1. Our work has shown that these balances should not have accrued within Cost Centre 1.

The creation of these erroneous credit balances meant that some of the fraudulent payments which were recorded in Cost Centre 1 reduced the accumulated debit balance caused by the fraudulent payments. This helped to bring the overall balance in Cost Centre 1 to nil by the end of Year 1.

Transfers from Cost Centre 1

After allowing for the erroneous credit balances in Cost Centre 1 and the transfer from Cost Centre 5, this left fraudulent transactions totalling £547,735 which needed to be hidden or masked (£704,879 minus £55,453 and £101,691). Of this, £481,257 was transferred to Cost Centre 2, discussed below, leaving a further £66,478 which is discussed here.

The £66,478 was transferred to a combination of revenue and capital accounts. In doing so, ad-hoc or one off credit balances seem to have been used to offset fraudulent transactions. For example:

- £8,012 was transferred from Cost Centre 1 to a capital Cost Centre (Cost Centre 3). Cost Centre 3 which had an otherwise unmatched credit balance following a refund for stamp duty which had arisen from a timing difference (i.e. stamp duty paid in 2015/2016 but refunded in 2016/2017).

Overall, the transfer of £66,478 is likely to have resulted in capital being understated by £40,410 and revenue by £26,068.

With reference to the "capital" items, based on the information we have seen, £32,398 was transferred to assets under construction at the end of Year 1 (the remaining £8,012 is described above).

With reference to the "assets under construction", information provided by CSG indicates that these were written off in Year 2. We understand that these transactions were initially accounted for as revenue expenditure before a decision was taken to fund these costs using the New Homes Bonus Reserve.

Accounting in Year 1 (Cont'd)

Cost centre 2

We understand from CSG that Cost Centre 2 is a control account (like Cost Centre 1) which would have been expected to have a nil balance at the end of the financial year. As explained above, £481,257 was transferred at the end of the financial year from Cost Centre 1 to Cost Centre 2. This seems to have been concealed with reference to four groups of accounting entries.

Cost Centre 2 Entry 1 (£82,238)

This relates to £81,504 of costs incurred during the previous financial year plus a further £734 of costs incurred during Year 1. These costs were not transferred to Cost Centre 2 prior to the end of Year 1.

As such, when a credit entry was posted to recognise repayment in Year 1, there was no debit balance against which the credit could be offset. Instead, this provided an opportunity to offset a debit balance created by the fraudulent payments against the vacant credit balance.

This is likely to have resulted in revenue being understated in Year 1. This is because of instead of transferring the unmatched credit to revenue it was offset against the anomalous debit balance created by the fraudulent payments, some part of which were later transferred to Cost Centre 2.

Cost Centre 2 Entry 2 (£21,066)

Cost Centre 2 is a control account which should have been used to match expenditure with receipts from one particular development.

CSG's analysis has shown that in some instances developers have:

- Paid for costs which were not recorded in Cost Centre 2; and
- In other instances there are costs recorded in Cost Centre 2 which have not been paid for by developers or the payments have not been accounted for in Cost Centre 2.

Overall, this resulted in a net credit balance of £21,066 (i.e. in value terms there are more payments from developers accounted for in Cost Centre 2 than there are costs). This resulted in an opportunity to offset some of the fraudulent payments against this otherwise unmatched group of credit balances.

Cost Centre 2 Entry 3 (£107,203)

We understand from information provided by CSG that this represents a credit for accrued income. We understand from CSG that the costs were invoiced and paid by the corresponding developer in the following financial year (being Year 2). However, the information available to us suggests that the costs passed on to the developer were not transferred to Cost Centre 2. The absence of debit entries (i.e. costs incurred by Re) in Cost Centre 2 meant that there was an unallocated credit balance against which some of the fraudulent payments could be offset.

It is likely to have meant that revenue in Year 1 was understated because it was offset against part of the fraudulent payments.

Accounting in Year 1 (Cont’d)

Cost Centre 2 Entry 4: £270,750

After transferring £481,257 to Cost Centre 2 and offsetting this against entries 1, 2 and 3, this left a residual balance of £270,750 (£481,257 - £82,238 - £21,067 - £107,203).

The final accounting entry of Year 1, which was recorded in Cost Centre 2, reduced the balance to nil and transferred £270,750 from Cost Centre 2 to the Council’s debtors. This meant that the Council’s balance sheet was overstated at the end of Year 1 by £270,750.

This transfer was reversed in Year 2.

Cost centre 5

In order to have a nil balance at the end of Year 1 in Cost Centre 5, after transferring £44,357 of the fraudulent balance to Cost Centre 1, it was necessary to make other adjustments of £116,143 (£160,500 - £44,357).

Cost Centre 5 had a nil balance at the end of Year following two accounting entries.

Cost Centre 5 Entry 1: £28,750

This accounting entry resulted in five adjustments of £5,750 being made to five capital accounts. Based on information provided by CSG, the balance of £28,750 was transferred to assets under construction at the end of Year 1.

Information provided by CSG indicates that these “assets” were written off in Year 2. We understand from CSG that they were initially accounted for as revenue expenditure before a decision was taken to fund these costs using the New Homes Bonus Reserve.

Cost Centre 5 Entry 2: £87,393

The final adjustment which was made to reduce the balance in Cost Centre 5 to nil at the end of Year 1 (other than an adjustment of £0.49) resulted in:

- One capital balance (Cost Centre 12) being increased (debited) by £174,786; and
- A second revenue (Cost Centre 14) being reduced (i.e. credited) by £87,393.

With reference to the adjustment to revenue, this is likely to have resulted in revenue being inflated during Year 1.

With reference to the capital balance (£174,786), information provided by CSG indicates that this was transferred to assets under construction at the end of Year 1. We understand from CSG that this remains capitalised.

Overview of Year 1

In overview, this work has shown that the Cost Centres used to account for the fraudulent payments in Year 1 were not subject to effective scrutiny.

In order to hide or mask the fraudulent payments, the Individual took account of weaknesses in the control environment, such as a lack of effective control over manual accounting adjustments known as journals and the failure to identify erroneous postings (credit entries or net credit entries) which could be offset against debit balances caused by fraudulent payments.

Accounting in Year 2 and the ongoing impact

Year 2

In year 2, CAFT identified fraudulent payments totalling £1,242,950. These were initially recorded in Cost Centres 1, 3 and 4, as summarised here:

- Cost centre 1: £880,350
- Cost centre 3: £237,850
- Cost centre 4: £124,750.

The fraud was identified prior to the end of Year 2. As such the Individual did not need to hide the fraudulent payments before the year end in Year 2. CSG have informed us that these balances were ultimately transferred to a central expenses cost centre.

As explained above, £270,750 which was posted from Cost Centre 2 to debtors at the end of Year 1 was reversed in Year 2. This resulted in £270,500 of the fraudulent payments from Year 1 being carried forward in Cost Centre 2 at the beginning of Year 2. We understand from CSG that this balance was also transferred to the same central expenses cost centre during Year 2.

The fraudulent payments from Years 1 and 2 totalled £2,063,972. Information provided by CSG shows that adjustments were made in Year 2 to account for this sum as accrued income.

Ongoing impact

CAFT identified fraudulent payments which totalled £2,063,972.

Although we have not specifically been instructed to investigate the possibility that there have been other, unidentified, fraudulent payments, our work has not identified any other fraudulent payments.

Most of these fraudulent payments have resulted in the Council's revenue being under-stated. This has arisen because fraudulent payments have been offset against revenue items. Or, the fraudulent payments have been re-classified as capital items which have subsequently been written off resulting in a reduction in revenue.

We understand that Re (underwritten by Capita) has reimbursed the Council in full (£2,063,972) for the fraudulent payments. In that sense, the Council has been compensated in respect of the fraudulent payments themselves. However, the fraudulent payments have left a legacy which has resulted in an ongoing misstatement to the Council's balance sheet and capital position, as summarised here:

Table 3 – Accounting in Year 2

Balance sheet and capital misstatement	Balance sheet	Capital
Likely misstatement at end of Year 1	270,750	243,946
Reversed in Year 2	(270,750)	-
Transfer to New Homes Bonus Reserve	**-**	**(61,148)**
Ongoing impact on balance sheet/capital	**-**	**182,798**

Recommended next steps

The level of comfort obtained

During the 2016/2017 and 2017/2018 financial years, costs were incurred by the Council as a result of regeneration schemes accounted for in Cost Centres 2 and 3. During the 2016/2017 financial year, the sale of a property was also accounted for in Cost Centre 1.

The explanation for the way in which the fraud was accounted for has been provided to us by CSG. We have conducted analysis based on the evidence provided by CSG and used this to challenge the explanation provided. We conclude that the narrative is logical and fits with the evidence provided.

Aside from the 62 fraudulent transactions identified, we have seen no direct evidence to suggest that other transactions and journals posted to the control accounts for the three schemes over the period of the fraud, are themselves fraudulent. However, our review has uncovered mis-posting and other weak accounting practices that enabled these other transactions to be used to conceal the fraud in the accounting system.

Recommendation 32 - We recommend that further final review of the cost centres relevant to the fraud (cost centres 1,2 and 3) is undertaken, including a review of year end reconciliations for 2016/17 (Year 1) and 2017/18 (Year 2).

The purpose of this additional review is to ensure completeness and to confirm that the mis-postings and other transactions that contributed to the fraud being concealed, have been correctly accounted for (noting that we have seen no direct evidence to suggest that these transactions are themselves fraudulent). The review should ensure that:

- **All costs are reconciled to invoices addressed to the associated development partners and, if applicable, with costs written off as revenue expenditure.**
- **All costs, revenue and receipts are reconciled with entries on the Integra general ledger.**
- **Corrections are made to the Integra general ledger if required**

Appendices

Appendix A and B - Included in the summary report entitled ‘Review of Financial Management Relating to CPO Fraud - Findings and lessons learned’

Appendix C - Internal Audit Re-performance testing approach

Appendix D - Results of Re-performance testing

Appendix C - Internal Audit Re-performance testing approach

Internal Audit considered the following processes and tested the following controls in the re-performance:

Process	Process Details recorded (Original testing)	Controls Tested (Re-performance)
Approval & Initiation	Details of the transaction's initiator Details of the transaction's approver	- The initiator or authoriser is the budget holder for the cost code. - The initiator or the authoriser is within their requisition limits, as per Integra if applicable - The initiation and authorisation agrees with the Scheme of Delegation
Supporting Evidence for transaction collated	Whether the Treasury management dealing ticket template was completed Whether the standard stamp showing the names of all personnel involved in the approval process was used	- Sufficient necessary supporting information had been obtained to provide a reasonable explanation for the payment
Input	Details of who input the payment details into Bankline	- The inputter is on the Treasury Management authorised dealers list
Authorisation	Details of who authorised the payment	- The authoriser is on the Treasury Management cash flow and deal ticket authoriser signatory list (dated June 2016)
Certification for Payment	Details of certifier	- The certifier is on the Treasury Management authorised approvers list (dated Jan 2014)
Payment	Details of payment: release date, CHAPS reference number	- Amount recorded on the Bankline acceptance document agrees to CHAPS request documents

Appendix D - Results of Internal Audit Re-performance testing

Of the 20 transactions selected, two were not CHAPS payments so not tested. Of the remaining 18, Internal Audit identified 12 deficiencies:

Sample No.	Payment Description	Raised by	Deficiency identified
1	Investment dealing	Treasury Team	Payment certifier not on the Jan-2014 Treasury management approver list; however, certifier was on the Bankline signatory permissions list (this list had not been identified as part of the key controls)
3	Amendment to monthly funding for November & December	Schools	1. Treasury management template not used 2. Insufficient information provided to determine whether initiator was the budget holder 3. Insufficient evidence to support the use of emergency CHAPS as payment method 4. Authoriser not on the Treasury Management cash flow and deal ticket authoriser signatory list (dated June 2016)
6	Investment dealing	Treasury Team	Payment certifier not on the Jan-2014 Treasury management approver list; however, certifier was on the Bankline signatory permissions list (this list had not been identified as part of the key controls)
8	Investment dealing	Treasury Team	Bankline acceptance document not retained with the supporting evidence on file.
11	Loan interest payment	Treasury Team	Payment certifier not on the Jan-2014 Treasury management approver list; however, certifier was on the Bankline signatory permissions list (this list had not been identified as part of the key controls)

Appendix D - Results of Internal Audit Re-performance testing (cont'd)

Sample No.	Payment Description	Raised by	Deficiency identified
12	Completion funds for the acquisition of Address 6	Regeneration Team (Re)	The authoriser was the relevant budget holder, but the payment requested exceeded their requisition limit, as per Integra
13	Clearance of debt on account	Street Scene	Neither initiator nor approver was the budget holder and no evidence that the budget holder was involved in the transaction
15	Purchase of Address 7	Regeneration Team (Re)	1. No solicitor's letter or completion statement held 2. authoriser was the relevant budget holder, but the payment requested exceeded their requisition limit, as per Integra 3. No record of who input details into Bankline
17	Mayoral CIL Barnet interest charged	CIL/ Regeneration Team (Re)	Authoriser not on the Treasury Management cash flow and deal ticket authoriser signatory list (dated June 2016), though they should have been. Authoriser was the Assistant DoF
18	Payment of deposit for advance buyback	Regeneration Team (Re)	1. Insufficient supporting evidence: no solicitors' letter or completion statement 2. The authoriser was the relevant budget holder, but the payment requested exceeded their requisition limit, as per Integra
19	Completion of purchase for pram sheds forming part of Address 8 and 9	Regeneration Team (Re)	1. Insufficient supporting evidence: no solicitors' letter 2. Neither the approver nor initiator was the relevant budget holder and no evidence that the budget holder was involved in the process 3. Approver was not a LBB officer, with no authority over the budget 4. Authoriser not on the Treasury Management cash flow and deal ticket authoriser signatory list (dated June 2016), though they should have been. Authoriser was the Assistant DoF
20	Completion of purchase of Address 10	Regeneration Team (Re)	1. Neither the approver nor initiator was the relevant budget holder and no evidence that the budget holder was involved in the process 2. Approver was not a LBB officer, with no authority over the budget 3. No record of who input details into Bankline