



Northumberland County Council

AUDIT COMMITTEE

DATE: 22 MARCH 2019

INTERNAL AUDIT REPORT RELATING TO GOVERNANCE MATTERS WITHIN THE
COUNTY COUNCIL'S ACCOUNTING GROUP BOUNDARY

Report of the Chief Internal Auditor

Purpose of report

The purpose of this report is to present to Audit Committee the final report from Internal Audit's review of the former Arch Group of Companies, which were wholly owned by Northumberland County Council and within the County Council's 'accounting group boundary', prior to a restructuring of the group which took place in 2018.

Recommendations

It is recommended that:

- Audit Committee considers the findings from the Internal Audit review of the Arch group of Companies (October 2017) as part of Audit Committee's remit in reviewing the County Council's framework of governance, risk management and control (including the effect on this framework from other entities within the accounting group boundary)
- Audit Committee seek a position statement on progress made by the companies' interim management on implementing the actions in the schedule of recommendations issued by Internal Audit, related to the findings in the report, in October 2017
- Notes that the Arch Group of companies has now been replaced with a new company structure (Advance Northumberland).

Link to Corporate Plan

The work of Internal Audit and the Audit Committee contributes to the achievement of all priorities in the Council's Corporate Plan.

Key issues

In June 2017 a review of five specific governance areas of the County Council's wholly owned group of companies, Arch, was jointly commissioned by the (then) Interim Chief Executive of Arch and the (then) Interim Chief Executive of Northumberland County Council who acted as joint clients for this assignment. The work was performed by Internal Audit, and was reported in October 2017.

Internal Audit's report has until this point been embargoed from publication at the request of Northumbria Police. Northumbria Police formally advised in February 2019 that this embargo was lifted. The County Council has sought confirmation from Northumbria Police in February and March 2019 that they would not object to the report's disclosure. This confirmation has been received and the Internal Audit's work can now be reported and subjected to appropriate disclosure as required by legal processes.

Internal Audit's report is therefore now presented to Audit Committee, in order that Audit Committee can be aware of the findings from the review and consider these as part of the ongoing overview of the framework of governance, risk management and control of those entities within the 'accounting group boundary' of Northumberland County Council.

Background

Arch Corporate Holdings Ltd was a group of companies wholly owned by Northumberland County Council. Much of the activity of the group was predicated on the acquisition, building and rental of property (both residential and commercial).

In June 2017, Internal Audit was asked to undertake a review of five main governance areas within the Arch Group. Specific objectives for this review were provided to Internal Audit and are reproduced in full at **Annex A**. The objectives covered the following areas:

- Consultants and Contractors
- Employees
- Property Portfolio
- Hospitality and Gifts
- Awards of Major Contracts.

Internal Audit's main fieldwork work was performed between July and October 2017, with findings recorded in the report attached at **Annex B**. For completeness, an example of the interim reporting format (used to advise the client of emerging findings) is attached at **Annex C**.

Key governance matters / themes arising from Internal Audit's work are summarised below:

Consultants and Contractors

- There was not evidence of a robust competitive process in the appointment of consultants / contractors. This did not assure Arch as to the value for money gained from contracts let (and paid at what was often a high daily rate); and lacked

transparency at that time. It was therefore recommended that all consultancy contracts were reviewed.

- The appointment process surrounding one consultant / contractor in particular raised questions of appropriateness and control. The circumstances of the consultant's appointment and nature of duties to be performed were unclear, but it appeared that the consultant had commenced work on the contract before the closing date on the advert for the contract had been reached. The remuneration for this consultancy was not well documented but appeared to include a disproportionately generous package of benefits including provision of a house and car by Arch to the contractor in addition to a high daily rate (see also 'property portfolio' below). The consultant appeared to have been allowed to bespoke the finish of the property to his own specification, at an added cost which was borne by Arch. No rent was ever paid by this consultant to Arch.
- Performance management of work outputs from this consultant was not in evidence and no staff within Arch could provide a clear account of any work which he had performed. The payments and benefits offered to this consultant may also have had taxation implications for Arch and due to the lack of detail held, it is not known whether these were accounted for correctly.

Employees

- Personnel records were found to be variable in their completeness and quality. Whilst some appointment had followed a competitive selection process, others seemed to have been made without a competitive process.
- Certain adhoc payments had been made to staff without a suitable decision making or authorisation trail. A number of pay enhancements were unusual. The absence of a salary scale at the time of the audit made it difficult to ensure parity for roles of comparative levels of responsibility.
- Some expenditure on items such as Christmas parties for staff and contractors could be judged as ill advised given that the company was a wholly owned local authority company.

Property Portfolio

- Substantial property acquisitions had been made by the Group. Inaccuracies were found in a number of conveyancing transactions associated with property purchases. This resulted in a lack of confidence in the overall internal processes for checking conveyancing fees and concern over the accuracy of very substantial payments for properties purchased by Arch.
- A specific surveying firm had received payments under what appeared an exclusive contract with an extremely generous fee structure which did not assure value for money for the Arch group.

- At the time of the review, procedures for monitoring rental income were disjointed with Arch's in-house team monitoring private rental sector and affordable homes, and the surveying firm mentioned above monitoring the 'executive property portfolio'. Review of rental statements showed high levels of arrears in some executive properties, suggesting that monitoring was not as robust as would have been expected. There were weaknesses in the end to end processes for all rental income monitoring.
- Errors were identified in land registration details for properties which is of particular concern.
- Two property transactions raised specific issues of governance and control:
 - The purchase of the former Arch Chief Executive's home, by Arch, was at a price which appears to have been unable to deliver unrealistically high expected rental income yields
 - The provision of a house to the contractor referred to above, in respect of which the contractor paid no rent, and regarding which the contractor appeared to have been allowed to 'bespoke' the interior specification for his own benefit at added cost to Arch.

Hospitality and Gifts

- A number of examples of Arch sponsorship and provision of hospitality were noted. In the early years of the company, it appeared that such opportunities were reported and debated by the Board, with follow up reports on outcomes / benefit gained by Arch from the sponsorship. In the later years of Arch this appeared to have waned and there was a lack of strategy and reporting. This meant it was unclear what value was being gained from the expenditure incurred, or what the rationale for hosting certain events was. There was therefore a risk that expenditure may be incurred that did not contribute towards the objectives of the company.
- Registers of hospitality held within Arch were informal documents which lacked detail, gave no business reason for acceptance and did not provide for prior authorisation of any proposal to accept hospitality.
- Annual declarations by Board members appeared incomplete.
- Credit card bills showed extensive evidence of entertaining and meals / alcoholic drinks but the beneficiaries of this expenditure or benefit to Arch was not known.

Award of Major Contracts

(This work overlapped with Consultants / Contractors Summarised above)

- Exclusivity arrangements to a specific firm in relation to the executive homes portfolio did not appear to comply with Arch's Financial Regulations and may not have been in Arch's best interests
- Other major contracts had similarly not complied with thresholds in Arch's Financial Regulations

- Correspondence between senior officers within Arch and some major contractors appeared to show a level of relationship which went beyond a normal business contract. No declarations of interest were however located on file. In the interests of transparency, any friendships or family relationships between those officers involved in awarding contracts and contractors should be expressly declared and reviewed at Board level.

Schedule of Recommendations

At the time of the review a number of recommendations were made to Arch interim management, summarised at **Annex D**. Audit Committee may wish to enquire of Advance Northumberland as to actions taken in preparation for establishment of the new company and the extent to which the control issues identified have been addressed.

Implications

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| Policy | The framework of governance, risk management and control supports all corporate and policy objectives of the Authority. |
| Finance and value for money | Contained within the main body of this report. |
| Legal | Contained within the main body of this report. |
| Procurement | Contained within the main body of this report. |
| Human Resources | Contained within the main body of this report. |
| Property | Contained within the main body of this report. |
| Equalities (Impact Assessment attached) Yes <input type="checkbox"/> No <input type="checkbox"/> N/A <input type="checkbox"/> | None |
| Risk Assessment | Contained within the main body of this report. |
| Crime & Disorder | Contained within the main body of this report. |
| Customer Considerations | The work to be performed was discussed and agreed with the joint audit clients for this assignment and was codified in a Terms of Reference. |
| Carbon reduction | None |
| Wards | All |

Consultation

The work to be performed was discussed and agreed with the joint audit clients for this assignment and was codified in a Terms of Reference..

Background papers:

- Terms of Reference
- Internal Audit Final Report – Review of Arch Arrangements (October 2017)
- Example of interim reporting format
- Schedule of Recommendations

Report sign off.

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| Finance Officer | N/A |
| Monitoring Officer/Legal | N/A |
| Human Resources | N/A |
| Procurement | N/A |
| I.T. | N/A |
| Chief Executive | N/A |
| Portfolio Holder(s) | N/A |

Author and Contact Details

Allison Mitchell, Chief Internal Auditor
0191 643 5720
Allison.Mitchell@northumberland.gov.uk