



**Chief Internal Auditor
Jill Stacey**

Audit Committee
Tuesday 28 May 2019
Item No: 5.1

Auditor: Amber Ahmed

Final Internal Audit Report

to

**Chief Executive
All Directors
All Heads of Service
Financial Services Manager
Legal Services Manager
Planning Manager
Resource Manager
Senior Accountant Projects & Treasury
Lead Officer Planning Obligations**

on

Follow-Up review of Developer Contributions

19 April 2019

1 Introduction

- 1.1 In March 2016, an Internal Audit report was presented to the Audit Committee on the controls in place over Developer Contributions. In total 11 recommendations were made in the report to improve controls within this area focusing on Governance, Monitoring and Procedures. The Audit Committee requested that Internal Audit follow up on the monitoring recommendations raised in the Internal Audit report.
- 1.2 A Follow-Up review was reported to the Audit Committee in June 2016 which highlighted Management were making steady progress in improving the controls operating over the Developer Contributions system, however expected completion dates for a number of actions had not yet been reached. It was agreed that a fuller report would be brought to the Audit Committee on the recording and monitoring of Developer Contributions once the Compliance Officer and the new database is in place.

2 Audit Scope

- 2.1 As set out in the Internal Audit Annual Plan 2018/19, we have reviewed the recommendations raised in the Developer Contributions March 2016 report, which were all signed off as complete on the Pentana Performance system by Management, to ensure they had been adequately completed and that there was evidence of improvement.

3 Management Summary

- 3.1 Midlothian Council is currently experiencing high levels of growth and investment with further significant levels of development proposed in the Council's adopted and proposed development plans. As the population of Midlothian increases there are increasing demands placed on the existing infrastructure and services. Developer Contributions are used by the Council as a means of mitigating the impact of new development on the Council's existing infrastructure and for the provision of new facilities. Contributions are used to fund education provision, road infrastructure improvements, community facilities, town centre improvements, delivery of affordable housing, and other infrastructure which is required as a consequential impact of development. The infrastructure requirements are identified during the preparation and adoption of the Local Development Plan and associated Supplementary Planning Guidance.
- 3.2 Contributions are secured as part of the planning process where the developer and the Council sign an agreement under Section 75 of the Town and Country Planning (Scotland) Act 1997 (as amended by the Planning etc. (Scotland) Act 2006) or under S69 of the Local Government (Scotland) Act 1973. This commits the developer to make a contribution to the Council linked to the progress of completion of the development. In return the Council commits to procuring the required infrastructure within a specified time limit.
- 3.3 The Council currently has 230 Planning Agreements and contributions have been allocated to 91 infrastructure projects. The Developer Contribution balance as at 31/03/2019 was anticipated to be £35,915,904 which is committed to fund future expenditure. In 2018/19, the amount of contributions receipted was £9,795,463, and 1 late penalty fee was applied to a Developer.
- 3.4 A new Exacom database system has been implemented which is used to record all of the developments and stages of completion. The finance spreadsheet demonstrates when the Council has receipted the contribution and the year it was receipted which allows officers to determine the expiry date of the contribution. The finance spreadsheet and the Uniform system provides a good foundation for the Exacom database system.

- 3.5 From the 11 recommendations reviewed, **5** were found to have been completed satisfactorily, and **6** were partially complete. Internal Audit have noted improvements such as: a decision was taken to implement the new Exacom database system, Planning service have been proactive in instructing Finance to calculate and raise invoices for contributions that have reached their trigger points; Legal, Planning and Finance Services work closely together over the developer contribution process and have a shared file location; 3 reports on specific infrastructure projects in relation to developers contributions have been presented to the Capital Plan and Asset Management Board; Finance and Education services have been consulted on costings to be included in the new Supplementary Guidance and have been have been working together with Planning service to perform an in-depth analysis of contributions received and their allocation to capital infrastructure for school projects.
- 3.6 Issues noted are: the Exacom database system is not fully populated; there has been no summary reports on the developer contributions which highlights the total agreements signed during the year reporting the value and number of units, agreements completed during the year with the value of contribution received, developer contribution allocated to specific projects, a breakdown of the balance held by the project and a summary of contributions which are due to expiry; a Compliance Officer was appointed in 2017 to assist with monitoring the level of completion of developments but left the Council in November 2018 and has not been replaced (the Lead Officer Planning Obligations is currently monitoring the trigger points in the agreements); and although significant improvements have been made to the finance spreadsheet, there needs to be a clearer audit trail of the schedule of estimated future payments to establish how future forecast payments have been determined and calculated.
- 3.7 Management have advised that their main priority is to ensure the data is fully accurate and input into the Exacom database system which is now approximately 75% complete. The system will improve the monitoring and reporting of the contributions being receipted, allocated and spent which will provide an efficient reporting functionality. It has been advised that over the next 12 months, Planning Service are scheduling to roll out the Exacom database system across the Council which will also allow Services to monitor contributions allocated and spent in their area.
- 3.8 As is standard Internal Audit practice, we have not rated this review since it is a follow-up of previously raised Internal Audit recommendations. We have however noted **6** Internal Audit recommendations which are incomplete as stated in the Findings section. Actions remaining from this review, with realistic completion dates, are stated in the Recommendations section noting that some related remaining actions have been integrated for ease of Management implementation thus 5 Recommendations in total.
- 3.9 The Internal Audit function conforms with the professional standards as set out in the Public Sector Internal Audit Standards (2017), including the production of this report to communicate the results of the review.
- 3.10 We would like to thank those officers who assisted us during our review.

4 Findings

No	Original Recommendation (2016)	Original Priority	New Findings and Conclusion (2019)
1	<p>The Developer Contribution Steering Group should be re-established with a specific terms of reference developed that clearly identifies the responsibilities of each service involved in the process and its reporting line, meet regularly and provide periodic reporting to CMT.</p> <p>Management should implement regular reporting to the Developer Contribution Steering Group of: agreements signed during the year reporting the value and number of units; agreements completed during the year with the value of contributions received.</p> <p>The infrastructure projects funded during the year and value of funding allocated; a breakdown of the balance held by agreement and infrastructure project; and highlight reports showing contributions that are approaching expiry.</p>	High	<p>The Capital Plan Asset Management Board which has a terms of reference has replaced the Developer Contribution Steering Group. 13 meetings have been held since the new Board was established.</p> <p>3 reports were presented to the Capital Plan Asset Management Board in relation to specific infrastructure projects but there has been no summary reports on the developer contributions which highlights the total agreements signed during the year reporting value and number of units, agreements completed during the year with the value of contribution received, developer contribution allocated to specific projects, a breakdown of the balance held by the project and a summary of contributions which are due to expiry. It was advised that the new Exacom database system has a reporting functionality but input of the data on the system is only 75% complete and therefore no summary reports on Developer Contributions have been presented to the Capital Plan Asset Management Board. Reports will be presented when all of the Developer Contribution data is registered on the system.</p> <p>Conclusion: Partially Satisfied – New Recommendation 5.1 and 5.2</p>
2	<p>Management should review the current risk score and develop a series of actions to reduce the risk level to within the Council's risk appetite.</p>	High	<p>The Lead Officer Planning Obligations maintains an operational risk register for developer contributions but this has not been entered into the Pentana Performance system and we noted that the risk register was last updated in August 2018.</p> <p>Conclusion: Partially Satisfied – New Recommendation 5.3</p>

No	Original Recommendation (2016)	Original Priority	New Findings and Conclusion (2019)
3	<p>In the short term Management should:</p> <ul style="list-style-type: none"> a) update the finance spreadsheet recording developer contributions received with the planning reference number and the expiry date of each contribution; b) review the developer contribution balance and analyse it by agreement and infrastructure project; c) examine the individual contributions and identify any that may have expired and those that are nearing expiry; and d) more fully develop the schedule of estimated future payments for all signed agreements to enhance capital planning. 	High	<p>Financial services maintain a spreadsheet which records the developer contribution balance and how it has been allocated to the infrastructure projects. Currently, officers have to analyse a significant number of columns and rows to check the developer contribution balance and when it is due to expire. This needs to be summarised at a higher level which the Exacom system will be able to do when the data is fully populated.</p> <p>It has been advised that until the data is fully populated in the new Exacom database system, the Council has to rely on officers to monitor and track the expiry date of each contribution. The main priority is to ensure the data is accurate and input into the system which will improve monitoring of the payments being receipted, how they are allocated to projects and how they are spent. The system will provide an efficient reporting function.</p> <p>Although there is an established schedule of estimated future payments recorded on the spreadsheet, there is not a clear audit trail of how future forecast payments have been determined and calculated.</p> <p>Conclusion: Partially Satisfied – New Recommendation 5.4</p>

No	Original Recommendation (2016)	Original Priority	New Findings and Conclusion (2019)
4	<p>The Developer Contribution Steering Group should review any contributions which have passed or are approaching their contractual date to ensure that there is a clear audit trail from the contribution to the infrastructure.</p>	High	<p>As mentioned above, the Capital Plan Asset Management Board has replaced the Developer Contribution Steering Group. 3 reports were presented to the Capital Plan Asset Management Board in relation to specific infrastructure projects and one of these reflected on a contribution which was due to expiry. Appropriate actions were taken and noted.</p> <p>For the agreements that are currently registered on the system, the payments collected are recorded and allocated to a project and once allocated they are available for spending. This has reduced the risk of contributions passing their due date as there is an audit trail of the contribution to the infrastructure on the Exacom database system. There is also a strong audit trail including planning application reports, Heads of Terms reports, Director of Resources sign off reports, reports to Council on individual projects etc.</p> <p>Conclusion: Partially Satisfied – New Recommendation 5.2</p>
5	<p>For assets procured in advance of contributions being received:</p> <ul style="list-style-type: none"> • a spreadsheet should be prepared comparing the capital and borrowing cost of assets procured with the contributions received to ensure sufficient contributions have been collected to meet the agreed proportion of costs on either fully or partially funded assets; and • The Supplementary Planning Guidance should be updated to make it clear to developers that contributions are being sought for forward funded assets and that contributions will be applied to related borrowing costs. 	Medium	<p>Financial Services have been carrying out an analysis of forward funded assets. Costs have been ascertained for these assets and the analysis of amounts allocated to these assets will form part of the above analysis of contributions received. However this exercise has not been fully completed. Costs associated to school projects were concluded as part of the Learning Estate Strategy (LES) however costs associated to other projects are still not complete.</p> <p>The new supplementary guidance could not be updated until the Local Development plan 2017 was approved by the Planning Committee in November 2017. The new supplementary guidance is still in draft form; the Planning Team are in the process of consulting on the revised guidance with services.</p> <p>Conclusion: Partially Satisfied – New Recommendation 5.4</p>

No	Original Recommendation (2016)	Original Priority	New Findings and Conclusion (2019)
6	<p>A procedure should be developed that covers the entire developer contribution process identifying which steps in the process are to be carried out by each service. Each service should then develop their own procedures for each of their parts</p> <p>The process should be outlined in the revised Supplementary Planning Guidance for the information of the developers (although this would not be required at the same level of detail as the council's procedure).</p>	Medium	<p>Procedures on how to use the new Exacom database system are in place. Procedures will be developed when the system is being rolled out to areas across the Council ie Finance and Legal etc. The new supplementary guidance will note the Developer Contribution process at a high level (e.g. monitoring agreement set by the Council and the Developers).</p> <p>Conclusion: Partially Satisfied – New Recommendation 5.5</p>

5 Recommendations

Rec. Ref No	Recommendation	Rating	Management Response	Responsibility and Timescale
5.1	All Developer Contribution agreements should be fully recorded on the new Exacom database system. This includes recording all of the Planning Agreements, when developments are complete, contribution received from each of the Planning Agreements, contributions allocated to the infrastructure projects and when they were spent.	Medium	This was the Planning Service's aim when securing the new monitoring system and appointing a Compliance Officer. Over 75% of agreements are recorded and there is a plan to fully populate the new system over the coming months. The delay in populating system is a result of the Compliance Officer post becoming vacant.	Planning Manager, 31/12/2019
5.2	<p>Regular reporting to the Capital Plan and Asset Management Board should be provided and include the following information:</p> <ul style="list-style-type: none"> agreements signed during the year reporting the value and number of units; agreements completed during the year with the value of contributions received; 	Medium	3 reports on specific infrastructure projects have been presented to the Capital Plan Asset Management Board over the last 12 months. Further reports will be presented as required.	Planning Manager, 31/12/2019

Rec. Ref No	Recommendation	Rating	Management Response	Responsibility and Timescale
	<ul style="list-style-type: none"> the infrastructure projects funded during the year and value of funding allocated; a breakdown of the balance held by agreement and infrastructure project; and highlight any contributions which have passed or are approaching their contractual date and what actions are required to be undertaken. 			
5.3	The Developer Contribution risk register should be recorded on the Pentana Performance system and regularly reviewed and updated.	Medium	The Performance Officer for Education, Communities and Economy has been tasked with inputting the risk register on Pentana Performance and Officers will be given access to the register.	Planning Manager, 30/06/2019
5.4	An analysis of the forward funded assets needs to be fully completed for all of the infrastructure projects. There also needs to be a clearer audit trail of the schedule of estimated future payments to establish how future forecast payments have been determined and calculated.	Medium	Agreed	Senior Accountant Projects & Treasury 31/12/2019 -TBC
5.5	A procedure should be developed that covers the entire developer contribution process identifying which steps in the process are to be carried out by each Service. Each Service should then develop local procedures for the functions carried out in their area.	Medium	Procedures are in place for the developer contribution processes whilst progressing through the planning system. Planning section will liaise with other services with regards to their procedures.	Planning Manager, 31/12/2019

Recommendation Ratings

Recommendations in Internal Audit Reports are suggested changes to existing procedures or processes, to improve the controls or to introduce controls where none exist. The rating of each recommendation reflects our risk assessment of non-implementation, being the product of the likelihood of the risk materialising and its impact. The ratings are:

- High – Significant weaknesses in existing controls, leaving the Council or Service open to error, fraud, financial loss or reputational damage, where the risk is sufficiently high to require immediate action within one month of formally raising the issue. The risk should be added by Management to the relevant Risk Register for control and monitoring purposes and included in the relevant Head of Service Annual Assurance Statement.
- Medium – Substantial weaknesses in existing controls, leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage requiring reasonably urgent action within three months of formally raising the issue.

- Low – Moderate weaknesses in existing controls, leaving the Council or Service open to low risk of error, fraud, financial loss or reputational damage requiring action within six months of formally raising the issue to improve efficiency, effectiveness and economy of operations or which otherwise require to be brought to the attention of Senior Management.
- Other - Minor administrative weaknesses posing little risk of error, fraud, financial loss or reputational damage.

The Action Plans in Internal Audit Reports address only Recommendations rated High, Medium or Low. Outwith the Internal Audit Report, we inform Service Management about Other Minor matters to improve internal control and governance.

The recommendations have been input to the Pentana performance system to assist with Management tracking of implementation. If responsible owners are unable to achieve the agreed timescales for actions please notify the Chief Internal Auditor with the reason for the delay in implementation and the revised timescales to assist with the implementation and follow-up of these recommendations to improve internal control and governance.

Jill Stacey
Chief Internal Auditor