# **Hexagon Housing Association Ltd**

# **Audit & Risk Committee – 7th July 2015**

**Board of Management – 28th July 2015**

**Agenda Item 5**

**Internal Controls Assurance – Annual Review**

**Report by the Chief Executive**

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| ***1.0*** | ***Summary*** |
|  | This is the annual report from the Chief Executive to the Audit & Risk Committee and the Board. It is no longer a regulatory requirement that the Board receive an Internal Controls Assurance Statement. However for the past five years, the Audit & Risk Committee and the Board have taken the view that the Chief Executive should continue to produce an Internal Controls Assurance Statement for the Audit and Risk Committee and the Board to provide the level of assurance that the Board need in order to approve the Statement on Internal Control that the Board include with the audited annual accounts.  The report recommends that the Audit & Risk Committee and then the full Board approve the statement on Internal Controls contained in **Appendix A** for inclusion in the Financial Statements for 2014/15. |
| ***2.0*** | ***Recommendations*** |
| 2.1 | It is recommended that the Audit & Risk Committee and the Board note the contents of the report and approve the statement contained in **Appendix A** for inclusion with the Financial Statements for 2014/15. |
| ***3.0*** | ***Background*** |
| 3.1 | For the sake of continuity, I have retained the headings in this report as per my previous reports to the Board on the subject of Internal Controls Assurance, to reflect best practice. |
| ***4.0*** | ***Assurance on the Systems of Internal Control*** |
|  | The Board is ultimately responsible for the system of Internal Control and the management of risk, including reviewing the effectiveness of internal control.  Risk management and control processes should be continuous, and obtaining assurance on the effectiveness should not be a separate exercise, but a fundamental and ongoing aspect of running an effective organisation. The annual review should be seen in that context. |
| a. | Strong Management Structures and Clear Accountability The Board has approved the Standing Orders and Delegated Authorities, which provide a clear statement of its role and responsibilities as well as the role of the Chief Executive and other senior managers.  These clearly outline who is delegated to do what, what the authorisation levels are.  The Standing Orders and Delegated Authorities are reviewed on a regular basis and changes are approved by the Board as required.  In the first half of 2013, officers undertook a substantial and comprehensive review of the Standing Orders & Delegated Authorities (SODA). We were assisted by an external consultant, SECTOR, who undertook over 19 interviews to assist in shaping the changes needed. The document was reviewed by the Directors’ Group and Managers before this was put to the Board for approval in July 2013.  Some of the Board approved changes were simply to make the presentation more user friendly, but some other changes were meant to bring the document more up to date as several years had elapsed since some of the authorisation levels for approvals, for example, had been reviewed.  During 2014/15, the Board approved a small number of changes to the SODA document. First, on 21st May 2014, second on 30th September 2014, third on 25th November 2014 and fourth on 31st March 2015.  Although the changes were minor and reflected small items such as creation of new posts, changes to job titles, etc, it is important that the document is kept up to date to ensure everyone is clear on their role and responsibilities. |
| b. | **Management reports on operational and financial matters**  The Directors’ Group receive operational reviews from managers and these reports result in a Board report that identifies the key strategic matters arising from those reviews.  In the past year, the Board received strategic matters arising from annual review reports for a large number of areas including IT, Human Resources, Supported Housing, Housing Services, Community Investment, Resident Involvement, Finance, Stock Improvement, Responsive Repairs, Development and New Business.  All reports included recommendations for actions to ensure the matters identified were properly addressed. This included risk mitigation measures where appropriate. |
| c. | **Management reports on operational and financial controls**  All reports for the Board provide information on significant risk areas identified. They outline the nature of the risk, and what is being done to mitigate against these risks crystallising. This is a fundamental element of our reporting structure. |
| d. | Risk Management Activities Hexagon’s Board keeps the Risk Management process under review via the Audit & Risk Committee, which receives four reports throughout the year. These reports were received in May, July, November 2014, and February 2015.  The risk assessment of the top risks during 2014/15, were primarily driven by the objectives laid out in our corporate strategy. The overall Corporate Risk map is held as a series of 15 departmental risk maps as well as one corporate consolidated risk map.  The Audit & Risk Committee’s final review of Corporate Risks carried out in 2014/15 was carried out in February 2015. This review focused on the highest gross risks and the highest net risks facing the Association.  The Committee considered the top 12 gross risks (risks scoring higher than 49) and the top 8 net risks (risks scoring higher than 35). |
|  | Crucially, all risks considered by the officers and the Audit & Risk Committee included an assessment of existing strategies in place, and where relevant, further action required, together with a clear timescale and a responsible person(s) identified.  The minutes of the February 2015 Audit & Risk Committee meeting were considered at the full Board meeting on 31st March 2015.  The top net risks to the Association at year end were are as follows:   1. Welfare Reform; 2. Development programme delivery for 2015/18; 3. Compliance with LA and GLA affordability criteria for shared ownership housing, particularly in high value areas; 4. Disruption of the maintenance service as a consequence of a change of contractor; 5. Cash flow risks caused by slow shared ownership sales; 6. Failure of the Responsive Repairs contractor; 7. Dissatisfaction with service by customers and escalated complaints; 8. Changes in Accounting Policy leading to stakeholders forming an adverse view of Hexagon’s finances;   All risks will be reviewed and re-assessed on a quarterly basis including actions to prevent risks crystallising.  The Board also look at the Corporate Risk Map following consideration by the Audit & Risk Committee. The Board considered the Corporate Risk Map at its May and July 2014 meetings. At the November 2014 meeting, they considered a wider report on risk entitled ‘Sector-Wide report’ which considered the HCA’s sector risk profile 2014 report. The Board approved two strategic areas for improvement and began a process of examining the Board’s “Risk Appetite” which began at the January 2015 meeting, which resulted in a further report to the March 2015 meeting entitled ‘Financial Risk Appetite’.  Lastly, changes to Corporate Risk were also considered by the Board at its March 2015 meeting. |
| e. | **Assignment of responsibility for oversight of audit activities**  As mentioned in Section 4d above, Hexagon’s Board structure includes an Audit & Risk Committee. The Terms of Reference for the Audit & Risk Committee were last reviewed by the Committee in November 2013. This was primarily a ‘tidying up’ exercise to reflect changes in the regulatory regime and changes to the frequency of monitoring corporate risks (from annual to quarterly). The Committee also clarified that they are now responsible for reviewing the financial statements prior to the Board consideration in July, and that they are responsible for internal controls in the context of the Association’s risk management arrangement.  At the Board meeting in March 2015, the Board considered and adopted the National Housing Federation’s Revised Code of Governance 2015 and agreed that the Board and the Audit & Risk Committee should consider the Terms of Reference to ensure that the Chair of the Board is not a voting member of the Audit & Risk Committee. This will be formally implemented by the end of July 2015 when both the Audit & Risk Committee and the Board have considered the matter further.  The Audit & Risk Committee is also responsible for monitoring progress with the Internal Audit Plan and they receive all of the internal reports. (This is covered in more detail in Section g). The Audit Committee also looks at any cases of fraud, attempted fraud, or maladministration.  All of the Audit & Risk Committee minutes are reported to the Board. The Audit & Risk Committee Chair summarises the work of the Committee to the main Board via the minutes and the Chair highlights the most important points arising. |
| f. | Control and Risk Assessment As reported above, the organisation carried out four quarterly control and risk self-assessment exercises during 2014/15, the last of which was reported to the Audit & Risk Committee in February 2015. The same report was considered by the full Board on 31st March 2015. Both the Audit & Risk Committee and the full Board considered the top gross and net risks as described in the report and the actions proposed to address the risks identified.  The self-assessment is driven by the Association’s Corporate Plan in that it concentrates on the main risks that may prevent the Group achieving its objectives. The Risk Map is built up on a departmental level and is then reviewed by the senior management team as a matter arising from the corporate planning process. The risks are recorded and assessed in terms of their impact and probability. They are then scored to ensure that we concentrate on those risks which need the most attention.  The officers’ Risk Assessment Panel (RAP) meets on a monthly basis to keep these risks under regular review and reports any material or significant changes to the Audit & Risk Committee for further discussion/decision at each of their meetings. |
| g. | Internal Audit The Association has had an internal audit function in place for the last 20 years and it is fundamental to the way that we work.  **General approach**  For the fourth year running, the Audit & Risk Committee has taken a slightly revised approach to the Internal Audit by carrying out two distinct types of internal reviews:   * **Strategic Risk Reviews**: these are detailed internal audit assignments focusing on how effectively the association is managing the key risks that it faces. These generally focus on key risks faced by the Association, particularly where officers and the Audit & Risk Committee have jointly identified a possible area of weakness in relation to risk management; * **Compliance Reviews**: these are short regular checks of compliance with important internal controls, particularly around finance, recruitment and health and safety. These compliance reviews will enable Mazars to provide objective, regular assurance to the Audit & Risk Committee that Hexagon colleagues are complying with important internal controls.   **Results of 2014/15 Internal Audits**  During 2014/15, Mazars carried out Compliance Reviews for the following areas:   * Gas Certificates * Water checks (Legionella) * Fire Risk Assessments * Portable Appliance Testing * Asbestos Checks * DBS Checks (relevant positions) * Voids (including Electrical Surveys) * Arrears * Nominal Ledger reconciliation * Purchases and Payments * Payroll * Compliance with Tendering and Financial Regulations * Fire Alarm Testing and Drills * IT Administration of Leavers and Starters * Property Disposals and Handbacks * New Tenant Sign-up   In respect of the Compliance Audit recommendations, there were a total of 17. This was an increase from a total of 9 recommendations arising from the Compliance Reviews in the previous financial year.  All recommendations were accepted and were accompanied by a management action plan. These are implemented by officers under the scrutiny of the Audit & Risk Committee. The Committee receives regular reports at each of its meetings until all of the action points have been actioned.  Of the 17 recommendations, 3 were ‘fundamental’ (versus 1 in 2013/14), 12 were ‘significant’ (versus 6 in 2013/14), and 2 were ‘housekeeping’ (versus 2 in 2013/14).  In respect of the Strategic Reviews, Mazars carried out 4 Strategic Reviews, including the following areas:   * Stock Improvement Programme * Voids Management (General Needs and Supported Housing) * Service Charges * Responsive Repairs   It should be pointed out, that the selection for the 4 Strategic Reviews is driven by a number of considerations including the Corporate Risk Map, as well as the Board, Audit & Risk Committee, and the Directors’ Group views on where there may be issues of internal controls that need to be strengthened.  For the 4 reports, Mazars concluded that three areas provided ‘adequate assurance’ (Stock Improvement Programme, Service Charges, and Responsive Repairs). One area (Voids Management – General Needs and Supported Housing) provided ‘limited assurance’.  A total of 16 recommendations were made. This compares to a total of 26 in 2013/14). All of the recommendations were accepted and accompanied by a management action plan which was approved by the Audit & Risk Committee. These action points are implemented by officers under the scrutiny of the Audit & Risk Committee which receives regular reports at each of its meetings until all of the outstanding points have been actioned.  Of the 16 recommendations, none were considered ‘fundamental’ (versus 1 in 2013/14), 8 were considered ‘significant’ (versus 14 in 2013/14) and 8 were considered to be ‘housekeeping’ matters (versus 11 in 2013/14).  **The plan for 2015/16**  At the February 2015 meeting, the Audit & Risk Committee received a detailed plan developed by Mazars, our internal auditors, following consultation with the Directors’ Group.  The 2015/16 Internal Audit Plan has been developed within the context of our Corporate Plan objectives, our Risk Map and an assessment of our performance.  Four Strategic reviews for the coming have been agreed as follows:   * Asset/Liabilities Register * Stress Testing the Business Plan * Serious Detriment * Data Protection Issues   The Compliance Reviews will look at the following areas:   * Gas Certificates * Water Checks (Legionella) * Fire Risk Assessments * Portable Appliance Testing * Asbestos Checks * CRB checks (relevant positions) * Voids * Arrears * Nominal Ledger reconciliation * Purchases and Payments * Payroll * Compliance with Tendering and Financial Regulations * Fire Alarm Testing * IT Administration of Leavers and Starters * Property Disposals and Handbacks * New Tenant Sign Up   **Mazars’ opinion for 2014/15**  The Internal Auditors’ annual report for 2014/15, which was considered by the Audit & Risk Committee on 12th May 2015, states that “**In our opinion, Hexagon Housing Association has in place an appropriate framework for identifying, evaluating and managing the significant risks faced by the Association.”**  **In respect of their areas of activity which we reviewed and subject to the weaknesses identified and reported in our internal audit reports, Hexagon Housing Association has an adequate, effective and reliable framework of internal control, and effective risk management and governance processes, which provide reasonable assurance regarding the effective and efficient achievement of the Association’s objectives.**  **It is noted that a limited assurance report was provided in relation to the management of Voids, and three ‘fundamental’ recommendations were raised during the year regarding Water Safety. We have seen, however, that Hexagon has appropriate internal processes for monitoring progress against the completion of recommendations raised by internal audit.**  **No instances of actual or suspected fraud have been encountered directly during our internal audit work.”** |
| h. | **External Audit**  The Association receives a limited degree of assurance from the routine work of the external auditor. I refer to this as ‘limited’ as the annual management letter only refers to matters identified during audit work and usually only refers to weaknesses rather than positive assurance.  Nevertheless, this is piece of an overall puzzle, which the Board receives in relation to internal controls. The external auditors’ management letter is contained under **Agenda item 10.** I would draw Members’ attention to this document. |
|  | This year, the Management Audit Letter picked up one ‘significant’ deficiency identified during the 2015 audit. The Policy for Authorisation of Variation of Repairs Orders is that all variations from the original purchase order of over £50 are required to be authorised by a surveyor.  The external auditors noted as part of their testing, that for the five months since the change from using a single repairs and maintenance contractor, R R Richardson, to using a number of contractors, this policy was not being adhered to and invoices were being paid without the appropriate authorisation. The implication is that a lack of authorisation could result in inappropriate levels of costs being incurred by the Association and increasing the risk of fraud and error. Failure to challenge the contractors on variation could result in them to continuing to overcharge for their services.  The auditors have recommended that a formal Policies and Procedures document was produced and that adherence is then enforced and that documentation to evidence this operation of control is retain and stored appropriately.  They also recommended that exception reporting should be performed to spot check compliance and ensure that these processes are being followed.  The management response will be considered by the Board at its July 2015 meeting. In short, the officers accept the observation and recommendation. We need both an interim arrangement to cover the period in which we have three contractors providing a maintenance service on an interim basis, as well as a permanent solution from February 2016 when we hope to have a contract in place for three contractors with electronic links to our Genero system which will enable closer monitoring of variation orders.  The auditors also identified two “other” deficiencies in internal controls (not ‘significant’). The first relates to Voids Reporting as they reported that during their testing, there were discrepancies within the voids reporting process; the spreadsheet used for both management reporting and HouseMark data, has errors when compared with Genero. This is a result of reconciliations not being performed on a timely basis.  Again, the management response will be included in the July 2015 Board report at which point we will confirm our intention to perform a reconciliation in the future.  Lastly, during the audit BDO reported that they requested supporting documentation to enable them to carry out a number of audit procedures. They noted that the Finance team had difficulty finding the requested information; this appeared to be due to a lack of co-ordination in standard filing protocols. The implication is that a lack of organisation could result in key documents being misplaced or not being readily available when required by management, auditors or the regulator, They recommended that the policy around documents retention/filing are revisited to ensure that they are appropriate; the revised policy/procedure should then be mandated and adhered to.  Again, the July 2015 Board will consider the management response to this point. |
| i. | Internal financial control The Board approved the annual budget for 2014/15 in March 2014 and each quarter, the quarterly management accounts were produced with a narrative showing progress against target and any remedial action required. |
| j. | **Quality Management Systems**  Investors in People (IIP) is a national standard which sets a level of good practice for improving our overall performance through better planning, implementation, and evaluation of learning and development programmes for our workforce.  In 2015, Hexagon received a ‘Gold’ award under the Choices Framework, by exceeding the national IIP standards by evidencing the achievement of a further 126 criteria. This followed on from six years of work starting in 2009 when we received a Bronze award and 2012 when we received a Silver award, where we implemented an action plan arising from the ‘Bright Ideas’ arising from the IIP Assessments carried out. We have been particularly focused on increasing levels of ‘employee engagement’.  IIP Gold is a fairly elite standard in that only approximately 7% of organisations assessed under the IIP framework achieve this award, so it should give the Board some assurance in respect of external quality management assessments.  The IIP Gold award followed on from the Opinion Research Corporation (ORC) award in June 2014 for having the highest levels of employee engagement of any of the 200 organisations benchmarking themselves against each other in respect of a standard set of questions forming a staff survey. This benchmarking club includes 43 housing associations as well as other sectors across the UK economy.  Whilst the ORC award is not be compared with the IIP award, it also provides some limited further assurance to the Board on how well the organisation is managing staff in pursuit of achieving our corporate objectives.  Hexagon is one of 65 housing associations to participate in the SHIFT (Sustainable Homes Index For Tomorrow) benchmarking scheme. SHIFT is a government endorsed scheme which analyses the environmental performance of housing associations including their homes, offices, and other operations. SHIFT looks at things such as energy efficiency, water use, waste, and adaptations to climate change.  Every two years, members receive an independent in depth assessment comparing them with other housing providers. Just six other housing associations across the country recently received a GOLD award and we reported in January 2015 that Hexagon was one of these associations, putting Hexagon at the very forefront of sustainability work across the sector.  The Board has approved a Sustainability Strategy and a Greening of the Stock Strategy, both of which have some read across to our Asset Management Strategy.  The Board monitors progress on all three, but once again, we do receive some additional assurance from an external accreditation process which gives us some perspective on our relative performance compared to other housing associaitons. |
| k. | **Performance information (including performance indicators)**  The Board receives quarterly detailed performance indicators and these go some way to assessing whether the organisation meets its objectives.  The Board also receives information about how our performance on key PIs compare to our peers.  The PI reports include commentaries that contain action points where we are not achieving the target with remedial actions for the Board to discuss. This is also covered in the Performance Indicator cover report. |
| l. | **Reports from regulatory and other external bodies**  In July 2013, the HCA published the following straplines on their website for Hexagon:  G1 (the provider meets the requirements on governance set out in the Governance and Viability Standard) and V1 (the provider meets the requirements on viability set out in the Governance and Viability Standard and has the capacity to mitigate its exposures effectively). These are the top ratings for both governance and viability.  The Homes and Communities Agency (HCA) also report on Hexagon’s financial viability.  The HCA Viability review is based on a financial capacity model which we send to the HCA during the year and on our responses to their quarterly surveys which cover things such as cash flow and property sales.  In March 2015, Hexagon received an updated Viability Review from the Homes and Communities Agency (HCA), our regulator, and this was reported to the 31st March Board meeting.  The Viability Review confirmed that Hexagon retained the highest viability rating that he regulator can award, namely V1.  Development performance is handled by the Greater London Authority (GLA) rather than the HCA.  On 27th January 2015, I reported to the Board that the Chair received a letter from the GLA dated 22nd December 2014 with an attached report on procedural performance.  This letter confirmed that our procedural performance in respect of the 2008/11 and the 2011/15 programmes was ‘good’ in respect of both administration and procedural performance. The audit did make reference to one ‘minor’ issue namely a breach of funding conditions which resulted from a retrospective request for a design waiver which should have been identified before the start on site claim. The GLA did note, however, that we did bring this to their attention well before completion and it therefore did not affect our overall grading.  The Board is also aware that in respect of our two registered care homes (Townley Road and Woodcote Road), external registration visits including unannounced inspections are carried out by the Care Quality Commission (CQC). The Board received confirmation as part of the ‘Strategic matters arising from the annual review of Supported Housing’ in May 2015 that during 2014/15, both of the Homes remained compliant with the Regulatory Regime. The last two CQC inspections took in April 2014 and December 2014 for Woodcote Road and Townely Road respectively.  In respect of Newstead Road, although this is not a registered care home, this is evaluated under the Supporting People regime and as reported to the Board in May 2015, the Home was last inspected in March 2013 when it was assessed an overall ‘B’ rating. The report said that “Newstead Road is an excellent service that is moving towards an overall ‘A’ rating”. |
| m. | **Fraud**  Hexagon has register of frauds and thefts and we keep an up to date register and report all incidents to the Audit & Risk Committee and Board as appropriate.  During the last financial year, there was only one entry and this was reported to the November 2014 Audit & Risk Committee.  In summary, upon the replacement of mobile phones for all of Hexagon staff, the old mobiles were returned to the HR department and kept in their office in an insecure location. In mid-October, the HR staff noticed that approximately 17 of these phones had been removed from a box. No SIM cards were taken and there was no possibility of charges to Hexagon’s account, but the old phones had an approximate value of £10 and therefore the loss was estimated at £170.  Following this incident, all staff working at the Sydenham office were warned that there had been a theft, and to take action to secure their own belongings as well as Hexagon’s property. The value of the phones was such that on Police report was made, but the Audit & Risk Committee was informed. |
| **5.0** | **Board Statement on Internal Financial Control** |
|  | I attach at **Appendix A** the Board statement on internal financial controls. There have been some minor revisions made to the document to ensure better accuracy.  The statement confirms that the Board of Management have reviewed the effectiveness of the Association’s internal controls systems for the year ending 31st March 2015.  I would **recommend** that the Audit & Risk Committee and the full Board approve this statement on Internal Controls in the context of this report. |