# **Hexagon Housing Association Ltd**

# **Audit & Risk Committee**

**16th February 2016**

###### Agenda Item 7

**Draft format for assessment of compliance with Governance & Financial Standards**

**Report by the Chief Executive**

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| ***1.0*** | ***Introduction*** |
| 1.1 | The Homes & Communities Agency (HCA) updated the Governance & Viability Standard effective from 1st April 2015.  I reported on this in some considerable detail to the full Board on 31st March 2015. The new Standards introduced a requirement to assess compliance with the Governance & Viability Standard at least once a year.  Furthermore, for the first time it required Registered Provider boards to certify in their accounts their compliance with the Governance & Viability Standard.  As we have not yet completed a full year of the Standard, the certification of compliance will not be put forward to the Audit & Risk Committee and the Board until July 2016. However, as this is the first time that we will have assessed compliance with the Standard, I thought it might be a good idea now to start early and provide a draft format of the sort of information I propose to bring to the full Board for Members’ early comment and approval. |
| ***2.0*** | ***Recommendations*** |
| 2.1 | That the Board comment on and approve the draft format of an assurance report which will be used to report to the Audit & Risk Committee and the full Board in July 2016. This report will provide assurance in respect of the annual compliance statement as it relates to the HCA’s Governance and Viability Standard as updated in April 2015. |
| ***3.0*** | ***Summary of the main changes*** |
|  | To remind Members of some of the main changes which were introduced from 1st April 2015 in the Governance & Viability Standard, I thought the following might be useful:   * An explicit requirement to protect social housing assets; * A new requirement to prepare and maintain a clear and thorough record of assets and liabilities; * A new requirement to subject the Business Plan to robust and multi-variant stress testing and to stress test these Business Plans to destruction; * A strengthening of the existing requirements to comply with the law and to pro-actively inform the HCA of actual or potential non-compliance; * Introduction of a Code of Practice to ‘amplify’ the revised Governance and Viability Standard; * Revisions to the Rents Standard to switch the formula to CPI+1%. The previous £2 allowance for rent convergence was cancelled.   Otherwise, many of the key features of the previous Governance & Viability Standards were mostly preserved. |
| ***4.0*** | ***Code of Practice*** |
|  | When the HCA issued the new Governance & Viability Standards, they also issued something called a ‘Governance & Financial Viability Code of Practice’. The Code of Practice was designed to “amplify the requirements in the Governance & Viability Standard”.  The HCA suggests that where necessary, Registered Providers should have regard for the Code when assessing their compliance against the Standard. They do make it clear, however, that it is the Standard rather than the Code that the regulator can enforce against. |
| ***5.0*** | ***General Themes in the Regulatory Framework*** |
|  | The main thrust of the Regulatory Framework changes, surrounded risk and changes in the operating environment for housing associations.  The reduction in grant rates since 2010, the increasing reliance on funding to bridge the gap, and the increasing diversification of many providers pursuing commercial activities to close the gap created by the loss of the grant, means that in general, the housing association sector is being subjected to increasing risk.  It is in that context that the new regulatory regime puts a much higher priority on providing **assurance** to the regulator that HA businesses continue to be well run as the sector changes given the new operating environment. |
| ***6.0*** | ***Actions since March 2015*** |
|  | When I reported to the Board I March 2015, I reported that the Board was to receive a further report on the Business Plan at the May meeting, which indeed it did.  I also recommended that the Board agreed that the Audit & Risk Committee keep a close watch on the development of the new Assets & Liabilities Register to ensure that it meets the regulator’s requirements as well as Hexagon’s needs. That too was actioned. Following the completion of an internal audit on our work on the Asset and Liability Register, a report went to the Audit & Risk Committee in November 2015. This provided “substantial assurance”.  In March 2015, I also confirmed to the Board that we were not aware of any areas of actual or potential non-compliance with any Standards in the new regulatory framework, but that we would keep this under constant review as required by the new Framework.  Lastly, I recommended to the March 20115 Board that they receive a further report in July 2016 which outlines our compliance with the Regulatory Framework for inclusion in the Financial Statements for the year ending 31st March 2016.  The purpose of this report is to provide an early report on the draft format for the compliance report which will be presented in full in July 2016 to both the Audit & Risk Committee and the Board. I should emphasise that the report deals only with the format of the report rather than the evaluation itself, which will follow. |
| ***7.0*** | ***Sources of Assurance*** |
|  | I think it is important to remind the Committee that the provision of assurance is only partly a function of internal and our external audit function. Assurance is also about the provision of accurate and current information by management to the Board about the efficiency and effectiveness of our policies and operations and the status of our compliance with statutory and regulatory obligations. |
| ***8.0*** | ***Proposed format for the Assurance report*** |
|  | I attach under **Appendix 1**, a proposed format for reporting on compliance to the July Audit & Risk Committee and Board.  Column 1 outlines the actual Governance and Viability Standard, column 2 provides the Code of Practice amplification which accompanies the actual Code. The Code is useful in that it gives a steer on how we might comply with the Standard.  Column 3 will show whether we are fully, partially or non-compliant (F, P or N). Column 4 will provide an explanation of any possible gaps in compliance.  Column 5 includes sources of the evidence of compliance. Some of these will be from the Executive, others will be from auditors (either internal or external). Some could be from our lawyers if appropriate, whilst others might be from other advisors, such as our treasury advisors.  The sixth, and final, column will give a rating for the assurance as either ‘high’, ‘medium’, ‘limited’, or ‘none’.  Members are asked to confirm whether this method of reporting on compliance with the Governance and Financial Viability Standards will assist in informing our compliance statements within our Financial Accounts for the financial year ending 31st March 2016.  In putting this format together, I should emphasise that there are no particular requirements laid out by the regulator about exactly how the assurance is provided and it is up to boards to decide.  I should also point out that in the first year, getting hold of best practice has not been particularly easy, although I have utilised some helpful information which was provided by Liz Kulczycki, the partner at BDO who oversees our external audit function as provided to a conference in early November attended by Phil Newsam, our Finance Director.  The approach has also been informed by several discussions I have had with my L8 Chief Executive colleagues, particularly in respect of how other HAs will address the requirements to provide assurance about complying with “relevant laws”, which I cover below. |
| ***9.0*** | ***New Areas in the Standard*** |
|  | One of the new requirements of the Governance Standard in 1.1 is that Registered Providers must “adhere to all relevant laws”. The Code suggests that to meet the required outcome on adherence all relevant laws, Boards should take “reasonable measures to assurance themselves of their compliance”.  I think the reference to “reasonable measures” is quite important because there is a very large raft of legislation that is relevant to our work which we must comply with. I attach, for example, under **Appendix 2**, a list of relevant law which has been produced by the L8 Group of Chief Executives.  This is our first attempt at compiling a list and I suspect that it will evolve over years, but at the moment it appears to be a comprehensive list.  Clearly, it would be rather impractical and beyond the requirements in the Standard, to do an internal audit or review on compliance with each of the laws. By the same token we are required to give assurance to the Board on compliance with relevant law, so a “reasonable” approach will need to be followed.  With that in mind, my proposal is that we circulate this list to all Hexagon Managers and Directors, as well Board Members and ask them if there is any reason to believe that we have breached any of these laws during the financial year in question. The results will inform our final report. |
| ***10.0*** | ***Possible gaps in compliance*** |
|  | I should emphasise that this report proposes a format for a future report due in July rather than a completed assessment.  However, I thought it might be useful at this early stage to highlight for the Audit & Risk Committee where we might have any gaps in compliance. This should of course be accompanied by a warning that the more comprehensive work to follow might add to this preliminary list.  The first point to make is that the Regulator (HCA) currently assesses HA compliance with the Governance Standard and the Financial Viability Standard. They have judged Hexagon as a G1 for Governance and a V1 for Viability. These are the highest ratings possible and they indicate that the Regulator’s judgement is that Hexagon “meets the requirements” set out in both Standards.  However, the revised Regulatory Standard now mandates that a self-assessment be undertaken and the result should inform the compliance statement to be included in the Financial Statements.  A preliminary assessment has identified the following areas of possible non-compliance:   1. Compliance with all “relevant laws”  * Hexagon’s performance on Gas Safety has been excellent over the year. The Q1 and Q3 reports indicated 100% compliance. Q2 however indicated one outstanding gas safety certificate at that point in time. The Board were assured of the legal action being taken to gain access where it had been denied. The “compliance” question to ask is whether such a technical breach of the 12 months would be a breach of the law or not. * Data Protection Act 1998. We have requested an internal audit of compliance with the Data Protection Act for Q4. The context is that we anticipate there are some areas where our procedural compliance with the Act might have some gaps. This situation therefore will be clarified in time for our July report.  1. Compliance with the NHF Code of Governance  * The Board will be aware from previous reports that we are not fully compliant with the NHF Code of Governance adopted in March 2015, given the current approach to recruiting tenant Board members via an election only process. This in turns means we are not fully compliant with the HCA Governance Code. We are on track to remedy this process for 2016/17, but we will need to declare our non-compliance for 2015/16.   The final report will of course provide a more comprehensive assessment, but in the meantime, the Audit & Risk Committee and Board should expect these matters will probably feature in our final self-assessment. |