INTERNAL AUDIT

Final Assurance Report 2015/16

Effectiveness of the Audit Committee

24th June 2015

Overall IA Assurance Opinion:

REASONABLE

Recommendation Overview:

High Risk	0
Medium Risk	2
Low Risk	3
Notable Practice	0

Review Sponsor:

Paul Whaymand	Corporate Director of Finance

Final Report Distribution:

Rajiv Vyas	Chairman of the Audit Committee
Fran Beasley	Chief Executive and Corporate Director of Administration
Lloyd White	Head of Democratic Services

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HILLINGDON
LONDON

1. Introduction

1.1 This risk based Internal Audit (IA) assurance review was identified as part of the 2015/16 annual IA plan presented to the Council's Corporate Management Team (CMT) and Audit Committee (AC) on 17th March 2015. **The purpose of this review is to provide assurance to management and to the AC over the following key risks surrounding the Effectiveness of the AC:**

- The AC does not effectively support the Council by reviewing the completeness of assurances to satisfy their needs, and by reviewing the reliability and integrity of these assurances. As a result, the Council may be in breach their statutory obligations which could cause reputational damage or financial loss for the Council;

- The AC is not suitably independent and objective. Each Member may not have a good understanding of the Council's objectives, priorities and risks. Members may be unaware of their roles and responsibilities in relation to the AC. Therefore there is an increased likelihood of not achieving the Council's strategic priorities;

- The AC does not contain or have at its disposal an appropriate mix of skills or its Members may not have been adequately trained. Consequently, there is a risk that Members may not be able to perform their duties effectively and fulfil the requirements of their role;

- The scope of work to be performed by the AC is not suitably defined, therefore it may not encompass all the assurance needs of the Council and the Cabinet; and

- The AC does not engage effectively with financial and performance reporting issues, and with the work of key stakeholders, primarily IA and External Audit. Furthermore, the AC may not communicate effectively with the Council's CMT, Cabinet and other stakeholders. This may result in a loss of public money resulting in adverse public reaction and reputational loss.

2. Background

2.1 An effective and independent AC is a key element in the Council's corporate governance and risk management framework. An effective AC leads to improved internal control, risk management and financial reporting. It provides a forum for discussing key issues raised by IA and External Audit, working independently to provide assurance to the Council.

2.2 The CIPFA best practice guidance (A Toolkit for Local Authority ACs) states that in order for the AC to be fully effective and therefore able to provide meaningful advice to the Council, its Members need to be independent, diligent, knowledgeable, and receive relevant, timely and reliable information. The guidance also indicates that AC Members must be in a position to provide robust challenge to all Corporate Directors and Members of the Cabinet and draw attention to any governance weaknesses. Further, the guidance states the AC should have clear reporting lines and unrestricted rights of access to other Council committees and senior managers (as required). In addition, the AC should have sufficient administrative support as well as access to relevant and timely information.

3. Executive Summary

3.1 Overall, the IA opinion is that we are able to give **REASONABLE** assurance over the key risks to the achievement of objectives for the Effectiveness of the AC. Definitions of the IA assurance levels and risk ratings are included at **Appendix C**.

3.2 We confirmed that during 2014/15 the AC has provided challenge and generally operated effectively. Key documents, such as the IA Annual Opinion Statement, the Annual Governance Statement and the Statement of Accounts have been reviewed during the year, in line with the AC Work Programme and the AC Terms of Reference (ToR).

3.3   However, based on a benchmarking exercise performed as part of our testing, we have identified there are some areas for the AC to improve in terms of functionality and best practice, which we believe should be incorporated into an annual review of the AC ToR.

3.4   There was a successful appointment of a new Independent Chairman during the year which should enhance the independent standing of the AC. We concluded that whilst AC Members inherently possess key attributes required of committee Members, there is still a requirement to understand relevant service areas across the Council where further specific AC related training is necessary. AC Members are currently being consulted on a draft Skills Matrix which has been developed by the Head of Internal Audit (HIA). Once finalised and completed the Skills Matrix will help identify the specific AC training requirements to inform a tailored Training and Development Plan (T&DP) for AC Members. However, it was noted at the time of this audit that further engagement from some AC Members is required in order to ensure the Skills Matrix provides sufficient value to the process of compiling the AC T&DP.

3.5   The recommendations raised in this report are designed to help the AC further develop the foundations in place and enhance the overall effectiveness of the AC. The detailed findings and conclusions of my testing which underpin the above IA opinion have been discussed at the exit meeting and are set out in section four of this report. The key IA recommendations raised in respect of the risk and control issues identified are set out in the Management Action Plan included at **Appendix A**. Good practice suggestions are set out in **Appendix B** of the report.

4. Detailed Findings and Conclusions

4.1   Audit Committee Terms of Reference

4.1.1   The purpose of an AC is to provide to those charged with governance, independent assurance on the adequacy of the risk management framework, the internal control environment, the integrity of the financial reporting and annual governance processes. The AC's role is documented within its ToR, which is included within the Council's Constitution. Specifically its role is to:

- Review and monitor the Council's audit, governance, risk management framework and the associated control environment, as an independent assurance mechanism;

- Review and monitor the Council's financial/ non-financial performance to the extent that it affects the Council's exposure to risk and/ or weakens the control environment; and

- Oversee the financial reporting process of the Council's Statement of Accounts.

4.1.2   We reviewed the ToR and established that it is included in the Council's Constitution and that it clearly outlines its role and responsibilities in relation to IA, External Audit (EA), the governance framework, accounts and annual review/reporting. It was noted that there was no formal review of the ToR undertaken during 2014/15, with the last review taking place in May 2013. Examination of the May 2013 review process established that the amendments to the ToR had been presented to Full Council prior to review by the AC.

4.1.3   We also reviewed the ToR in relation to best practice guidance and current AC duties. By cross referencing the ToR with the AC Work Programme 2014/15 we identified that the committee's standard duties, in relation to Treasury Management and Investment Strategy, were not included in the latest ToR. Further comparison of the ToR against best practice highlighted that certain elements were absent from the ToR, including the ability to call senior managers to attend meetings, to enhance accountability and understanding of issues. Our recent benchmarking exercise of ACs via London Audit Group (LAG) highlighted that the London Borough of Hillingdon (LBH) AC was the only one out of the eight local authorities benchmarked, that did not have the power to call senior managers to meetings. We understand that this a policy decision that has been made by the Council.

4.1.4 In addition, we identified that the AC ToR contained out of date terminology. Specifically it refers to the "Statement of Internal Control" which was actually replaced in 2008 by the Annual Governance Statement (AGS). If the AC ToR is not formally reviewed annually, there is a risk that mandatory requirements of the AC may not be picked up. An annual review is also an opportune time for any best practice changes to the roles and responsibilities of the AC to be formally considered for adoption. As a consequence we have raised a recommendation aimed at strengthening arrangements in this area (refer to **Recommendation 1** in the Management Action Plan at **Appendix A**).

4.1.5 We evidenced that the ToR is presented on the front sheet of every AC meeting agenda, with declarations of interests a standing agenda item to help ensure the continued objectivity of the AC.

4.2 Independence and Membership

4.2.1 A key requirement for AC Members is independence which is the cornerstone of their effectiveness. Generally, best practice guidance states that an AC Member should possess certain characteristics such as integrity, consistently uphold ethical standards, be proficient in communicating, have the time and personal commitment to perform effectively and be ready to ask challenging questions about the Council's risk management and internal control systems and processes.

4.2.2 We reviewed the membership of the Council's AC and confirmed it complies with the political balance rules, reinforcing its independent nature, and that it is comprised of five Members;

- One Independent Member;
- Three Members from the Conservative Party; and
- One Member from the Labour Party.

4.2.3 This political balance is in accordance with best practice and helps to ensure that no political agenda is given a priority at AC meetings and that decisions made by the Committee are free from political influence.

4.2.4 In June 2014, the Independent AC Chairman stepped down from his role after seven years in post having overseen a successful tenure. During the interim period, two AC meetings took place without an Independent Chairman or any other Independent Member. Since the appointment of the new Independent AC Chairman in July 2014, two meetings have taken place, one of which the Independent Chairman was absent. As a result, only one of the four AC meetings in 2014/15 was chaired or attended by an independent Member. Although this matter will need to be reflected in the 2014/15 AGS, this should no longer be an issue going forward as an independent Chair is now in place.

4.2.5 As part of our testing we noted that Conservative and Labour Party Members were all found to have a reserve member available to cover absences. The AC requires four members to achieve quorum as per the Council's Constitution. We noted that on two of the last four AC meetings the meeting was at the minimum level of Members to meet the Council's quorum requirements. In fact only two of the five AC Members achieved 100% attendance during 2014/15. With only five Members on the AC in total, there is a high dependency on regular Member attendance as well as an effective substitution process, in order for the AC to operate in an effective manner.

4.2.6 In addition, the LAG benchmarking exercise highlighted that LBH's AC had the lowest number of committee Members out of the eight LAG ACs reviewed. Most authorities in the sample have six AC Members, although we noted some have as many as ten. Given there is no political appetite to have a reserve Independent Member and the high reliance on the substitutions process, we believe there is benefit in considering increasing the AC Membership.

4.2.7   An increase in membership would help reduce the risk of the meeting having to be delayed or cancelled due to being unable to meet the Council's quorum requirements of four Members. We have therefore raised a good practice suggestion in this area (refer to **Recommendation 3** in the Management Action Plan at **Appendix B**).

4.2.8   In order to maintain independence and objectivity, the Council's Constitution follows best practice and stipulates that Members of the AC should not hold an additional position in relation to Cabinet or Scrutiny functions. We identified that during 2014/15, a reserve AC Member held a position on the External Services Scrutiny Committee. As a result there is a minor risk that membership of the AC could breach the Council's Constitution. Therefore a recommendation in this area has been raised to help prevent a reoccurrence (refer to **Recommendation 4** in the Management Action Plan at **Appendix B**). We understand that the Head of Democratic Services has now taken action in this area.

4.2.9   In addition, we confirmed that in line with best practice AC Members declare any interests at the start of each AC meeting as a standing agenda item, maintaining an element of independence and transparency.

4.3   Members Experience, Training and Development

4.3.1   The effectiveness of the AC in performing its duties is often dependent upon Member's experience, knowledge and competence in business matters, financial reporting, internal control and reporting. The AC should not be solely reliant upon management for this experience and skills.

4.3.2   Membership of the AC is made through selection by the Leader of the Council. In order to ensure that selected AC Members have the required knowledge, a Skills Matrix for them has recently been drafted by the Head of IA (HIA). This has been distributed to AC Members for comments, although we noted at the time of this review that further feedback is required to enable sufficient value to be provided by this initiative.

4.3.3   The LAG benchmarking exercise highlighted that LBH had the only AC from a sample of 8 London authorities that does not currently provide specific AC Member training. No specific AC training has been undertaken for over 3 years and although there is no formalised Training and Development plan (T&DP) in place for AC Members, in March 2014 a draft T&DP for AC Members was produced by the HIA. Following the review of the Effectiveness of the AC in 2013/14, the Head of Democratic Services agreed to form an AC Member T&D Plan by 30th November 2014 as part of the corporate Member Development Plan. However, we noted that to date a formal AC Member T&DP has not been produced or agreed. We understand that the delay was to enable the AC T&DP to be aligned to the requirements of the relatively recently appointed Independent AC Chairman.

4.3.4   The purpose of the T&DP is to provide a comprehensive record of training subjects to assist AC Members improve their understanding of core areas within their remit and the roles and responsibilities of the AC. This includes IA, EA, Anti-Fraud and Anti-Corruption, Corporate Governance (including the AGS), Risk Management and Financial Reporting requirements including Treasury Management. The idea behind the Skills Matrix which is currently being consulted on is to help inform the AC T&DP. As a consequence we have raised a recommendation in this area (refer to **Recommendation 2** in the Management Action Plan at **Appendix A**).

4.4   Review of Key Documents

4.4.1   The AC is stated as being responsible for reviewing and monitoring the Council's audit, governance, risk management framework and the associated control environment. The AC, as an independent assurance mechanism, reviews and monitors the Council's financial and non-financial performance to the extent that it affects the Council's exposure to risk and/ or weaknesses in its control environment.

4.4.2   In order for effective review to take place, AC Members receive an agenda reports pack to review eight days prior to the AC meeting to allow sufficient time, as far as possible, to review reports prior to the meeting taking place. The AC meets on a quarterly basis in line with best practice, which is deemed adequate for LBH to allow discussion of relevant current issues. Historically, individual private meetings have been held between the AC and EA and IA without management present, to allow free discussion. However, it was noted that the private meeting between IA and the AC had not taken place during 2014/15 due to the requirement to swap suitable dates with EA. Nevertheless, we understand this has been rescheduled for the upcoming AC meeting due to take place on 2nd July 2015. In addition, we noted that the AC Work Programme (Forward Planner) now has slots set aside for private meetings between the AC and the Corporate Director of Finance and the Corporate Fraud Investigations Manager.

4.4.3   The AC Work Programme timetables the key AC activities for the year. Review of the Programme for 2014/15 against the activities minuted for each meeting confirmed that the AC's review of key documents was conducted as intended. We also verified that key activities took place including the review of EA and IA plans. The AC also considers the Effectiveness of IA and Effectiveness of the AC annual reviews to gain assurance over its own processes and the processes in which its assurance is obtained, as per best practice.

4.4.4   We reviewed the minutes of meetings held during 2014/15 and confirmed that key documents and their significant findings have been reviewed throughout the year. These have included the Statement of Accounts, AGS, Annual Grant Letter, Annual Audit Letter and the Annual IA Report. These key duties were incorporated into the AC's Work Programme for 2014/15 and are in the 2015/16 AC Forward Programme. Further, the AC reviews the internal controls and risk management systems at quarterly meetings via the Quarterly IA Progress report, which details key risks and findings for the quarter, and through Quarterly Risk Management and Corporate Fraud Investigation Progress reports.

4.4.5   The review of key documents, discussed above, and the Work Programme also highlighted that the AC obtains its assurances from only a few assurance providers including IA and EA. Local authorities are able to provide assurances from varying sources, including Health and Safety functions and Performance functions, which can further inform the AC's Annual Report to Full Council and the assurances it provides. We noted that an 'assurance mapping' exercise has not been carried out across the Council. The advantage of such an exercise would be to enable the AC to identify the sources of assurance across the Council and to help identify gaps in the assurance being provided, as well as reduce the risk of duplication of effort. Therefore, we have raised a best practice suggestion for the Council to consider (refer to **Recommendation 5** in the Management Action Plan at **Appendix B**).

5. Acknowledgement

5.1   We would like to formally thank all of the officers contacted during the course of this review for their co-operation and assistance.

6. Internal Audit Contact Details

This audit was led by: Elaine Portess CIPFA, **Principal Internal Auditor**

This audit was reviewed by: Anthony Dean CMIIA, **Assistant Internal Audit Manager**

Thank you,

[signature]

Muir Laurie FCCA, CMIIA
Head of Internal Audit

Management Action Plan

No.	Recommendation	Risk	Risk Rating	Risk Response	Management Action to Mitigate Risk	Risk Owner & Implementation date
1	The Audit Committee (AC) Terms of Reference should be subject to annual review against relevant guidance to ensure that it is up-to-date and includes all mandatory responsibilities and considers any new best practice guidance. All changes proposed following the annual review should be formally approved (para ref 4.1.4).	*If the AC Terms of Reference have not been reviewed annually, there is a risk that mandatory changes required to the roles and responsibilities of the AC may go unidentified. This could potentially negatively impact the objectivity, independence and overall effectiveness of the AC, which ultimately could damage the Council's reputation.*	MEDIUM ●	**TREAT**	In future an annual review of the Audit Committee Terms of Reference will be conducted and any changes will be approved in line with Council policy.	Lloyd White, Head of Democratic Services **30th April 2016**
2	The Audit Committee (AC) Skills Matrix should be used to help inform an AC Training and Development Plan (T&DP). All relevant training should be included within the AC T&DP (para ref 4.3.4).	*Without a T&DP for AC Members there is an increased risk that the AC may not be effective in discharging its statutory responsibilities.*	MEDIUM ●	**TREAT**	It has been agreed that the Head of Internal Audit will take responsibility for producing a rolling T&DP for AC Members. The T&DP will be produced to reflect the recent feedback from the draft Skills Matrix for AC Members.	Muir Laurie, Head of Internal Audit **30th September 2015**

Good Practice Suggestions & Notable Practices Identified

No.	Observation/ Suggestion	Rationale	Risk Rating
3	Consideration should be given to increasing Audit Committee (AC) Membership to reduce the risk of AC meetings being delayed or cancelled because they do not meet the quorum requirements of four members (para ref 4.2.7).	*If there are only five AC Members and regular reliance on the substitutions process, there is an increased risk that LBH AC meetings may have to be delayed or cancelled as they cannot go ahead if they do not meet the quorum requirements of four Members. Any AC meetings cancelled at short notice would increase the Council's administrative costs.*	**LOW** ●
4	Membership of the Audit Committee (AC) should be allocated to ensure that it is in accordance with the Council's Constitution, specifically in relation to AC Membership which requires independence from Cabinet and Scrutiny functions. The requirements for Member selection could be included in the list of discussions with the Chief Whip from each party (para ref 4.2.8).	*There is a minor risk that membership of the AC breaches the Council's Constitution and does not comply with best practice guidance.*	**LOW** ●
5	A formal assurance mapping exercise could be undertaken to identify the sources of assurance from across the Council, enabling reliance to be placed on other forms of assurance and direct the Audit Committee resources to any assurance gaps identified (para ref 4.4.5).	*There is a risk that that different sources of assurance are not identified resulting in gaps in assurance arising with increased potential for risks materialising. Further, there is an increased likelihood that duplication of effort arises, reducing the efficiency of the Council's sources of assurance.*	**LOW** ●

INTERNAL AUDIT ASSURANCE LEVELS AND DEFINITIONS

ASSURANCE LEVEL	DEFINITION
SUBSTANTIAL	There is a **good level of assurance** over the management of the key risks to the Council objectives. The control environment is robust with no major weaknesses in design or operation. There is **positive assurance** that objectives will be achieved.
REASONABLE	There is a **reasonable level of assurance** over the management of the key risks to the Council objectives. The control environment is in need of some improvement in either design or operation. There is a misalignment of the level of residual risk to the objectives and the designated risk appetite. There remains **some risk** that objectives will not be achieved.
LIMITED	There is a **limited level of assurance** over the management of the key risks to the Council objectives. The control environment has significant weaknesses in either design and/or operation. The level of residual risk to the objectives is not aligned to the relevant risk appetite. There is a **significant risk** that objectives will not be achieved.
NO	There is **no assurance** to be derived from the management of key risks to the Council objectives. There is an absence of several key elements of the control environment in design and/or operation. There are extensive improvements to be made. There is a substantial variance between the risk appetite and the residual risk to objectives. There is a **high risk** that objectives will not be achieved.

1. **Control Environment:** The control environment comprises the systems of governance, risk management and internal control. The key elements of the control environment include:

   - establishing and monitoring the achievement of the authority's objectives;

   - the facilitation of policy and decision-making;

   - ensuring compliance with established policies, procedures, laws and regulations – including how risk management is embedded in the activity of the authority, how leadership is given to the risk management process, and how staff are trained or equipped to manage risk in a way appropriate to their authority and duties;

   - ensuring the economical, effective and efficient use of resources, and for securing continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness;

   - the financial management of the authority and the reporting of financial management; and

   - the performance management of the authority and the reporting of performance management.

2. **Risk Appetite:** The amount of risk that the Council is prepared to accept, tolerate, or be exposed to at any point in time.

3. **Residual Risk:** The risk remaining after management takes action to reduce the impact and likelihood of an adverse event, including control activities in responding to a risk.

RISK RESPONSE DEFINITIONS

RISK RESPONSE	DEFINITION
TREAT	The probability and / or impact of the risk are reduced to an acceptable level through the proposal of positive management action.
TOLERATE	The risk is accepted by management and no further action is proposed.
TRANSFER	Moving the impact and responsibility (but not the accountability) of the risk to a third party.
TERMINATE	The activity / project from which the risk originates from are no longer undertaken.

INTERNAL AUDIT RECOMMENDATION RISK RATINGS AND DEFINITIONS

RISK	DEFINITION
HIGH ●	The recommendation relates to **a significant threat** or opportunity that impacts the Council's corporate objectives. The action required is to mitigate a substantial risk to the Council. In particular it has an impact on the Council's reputation, statutory compliance, finances or key corporate objectives. **The risk requires senior management attention**.
MEDIUM ●	The recommendation relates to **a potentially significant threat** or opportunity that impacts on either corporate or operational objectives. The action required is to mitigate a moderate level of risk to the Council. In particular an adverse impact on the Department's reputation, adherence to Council policy, the departmental budget or service plan objectives. **The risk requires management attention**.
LOW ●	The recommendation relates to **a minor threat or opportunity** that impacts on operational objectives. The action required is to mitigate a minor risk to the Council as a whole. This may be compliance with best practice or minimal impacts on the Service's reputation, adherence to local procedures, local budget or Section objectives. **The risk may be tolerable in the medium term**.
NOTABLE PRACTICE ●	The activity **reflects current best management practice** or is an innovative response to the management of risk within the Council. **The practice should be shared with others**.