

Final Internal Audit report: Ref 04.18/19 Harlow Trading Services (HTS) Strategic Governance 2018/19

1 Audit opinion

- 1.1 The work of Internal Audit provides **substantial assurance** regarding the strategic governance arrangements in place for the Council, as the shareholder of HTS (Property and Environment).

2 Executive Summary

- 2.1 The governance arrangements for HTS (Property and Environment) consist of its Articles of Association, a Scheme of Delegation, and a Business Plan and were found to be fit for purpose and working well in practice.
- 2.2 The Council's interests are protected by way of the Shareholder Sub-Committee. The Committee is supported by its Terms of Reference, the reports it receives and attendance of HTS at its meetings. Overall, the Committee is fulfilling its role; however, there are a number of opportunities for it to become more strategically focused. For example, by receiving reports from other assurance providers (such as Internal Audit), ensuring it is not too focused on operational issues and considering an away day/session with the HTS Board to explore growth opportunities.

3 Scope and Approach

- 3.1 This audit was undertaken to ensure robust governance arrangements are in place and that potential conflict of interests are being well managed. The audit was undertaken on behalf of the Council, and not HTS. It took into account the Cabinet Office's January 2016 publication Guidance for Directors of companies fully or partly owned by the public
- 3.2 Testing included interviews with a sample of HTS Board and Shareholder Sub Committee Members. These were:
- Michael Harrowven – Chair of the HTS Board
 - John Philips – HTS Managing Director
 - Bob Davis – Councillor Director of the HTS Board
 - Mark Wilkinson – member of the Council's Shareholders Sub Committee (SSC)

In addition, the auditor attended the 11 December 2018 Shareholders Sub Committee to better understand how the committee works in practice.

- 3.3 The audit evaluated key controls to ensure that the key risks are managed adequately and effectively and sought to provide assurance over the following objectives:

Audit Objective	Fully met	Largely met	Partly met	Not met
1. Compliance with the Articles of Association and Scheme of Delegation is working as intended	✓			
2. Appropriate governance structures are in place to ensure the Council's interests, assets and reputation are protected		✓		

Audit Objective	Fully met	Largely met	Partly met	Not met
3. Progress against the business plan, including the loan agreement, is regularly monitored and reported on at an appropriate level within the Council		✓		
4. Potential conflicts of interest are acknowledged and appropriately managed	✓			

3.4 Limitations of scope: This audit did not include the newly formed Housing and Regeneration subsidiary of the HTS Group.

4 Detailed Findings

4.1 The Council's Local Authority Trading Company (LATC), HTS (Property and Environment) Limited, governance arrangements consists of its Articles of Association, a Scheme of Delegation, and a Business Plan. The Council's interests are protected by way of the Shareholder Sub-Committee. Review of the Articles, Scheme of Delegation and Business Plan (2016-20) and interviews confirmed these are fit for purpose and working as intended.

4.2 The Shareholders Sub Committee meets on a regular basis and is politically balanced. There has been a steep learning curve for those involved since its inception in May 2016. Over this time the Committee has introduced a work programme and become more refined in its requirements for reports and management information in order for it to discharge its duties. It has a clear Terms of Reference in place, which has been recently updated to take into account the new HTS subsidiary, HTS (Housing and Regeneration).

4.3 The Shareholders Sub Committee reports to Cabinet (as per the governance structure in the business plan) through the sharing of their minutes.

4.4 A review of Committee papers, interviews and auditor attendance at the December 2018 meeting confirms there is good oversight and challenge by the Shareholders Sub Committee to ensure HTS is held to account. A common theme from the interviews suggested there was room for improvement by the Committee by being more strategically focussed. For example, the Committee was receiving summarised performance information but were at times delving into too much operational detail such as Member enquiries. As another example, there has been in the past little debate or consideration of the strategic future of HTS (Property and Environment) although the revised business plan due soon may help to address this. Consideration should be given to having an away day or session between the Shareholders Sub Committee and the HTS Board in order to provide a more relaxed setting to discuss strategic opportunities and growing turnover.

4.5 The auditor notes that last year's Internal Audit report on HTS payment mechanisms did not go to the Shareholders Sub Committee. The report provided moderate assurance over the key performance indicators that supported the payment mechanism within the HTS (Property and Environment) contract. These types of independent reports could form part of the assurance framework for the Committee as well as help them be more strategically focussed.

4.6 During the audit the auditor was asked by a Council Officer how the Council could obtain assurances that HTS is Teckal compliant. Good practice seen elsewhere is

through some form of assurance statement (control and function testing) which is set out in more detail later on in the report. The results of this could be fed back to the Shareholders Sub Committee as another way to improve its strategic oversight.

- 4.7 The HTS Board too meet on a regular basis with job descriptions in place for the Chair and the Councillor Directors. The Council's interests are represented on the Board by the Head of Housing, who has no voting rights. Consideration should be given to documenting the purpose and remit of this role to ensure transparency.
- 4.8 It was recognised by everyone interviewed there was a fine line between being a constituent Councillor and being a Councillor Director. On the whole these were being well managed with appropriate mechanisms in place to reduce the risk of a conflict of interest including conflicts of interest as a standing agenda item and training provided to Board members, with more planned. HTS is a founding member of the newly created National Federation of LATCOs, which will help to disseminate good practice to Board Members.
- 4.9 In line with good practice the HTS Chair appraises the Board as a whole as well as individual Board members. The Shareholders Sub Committee at their December 2018 meeting requested that updates are provided on the work carried out by Councillor Directors now they are remunerated. To further strengthen accountabilities both the HTS Board and the Shareholders Sub Committee should consider undertaking a skills and knowledge analysis to ensure it has an appropriate mix of both.
- 4.10 No concerns were identified regarding the £1.4M loan between the Council and HTS. Repayments, including interest payments, are being made on time and in line with the signed agreement.
- 4.11 The action plan attached includes detailed findings and recommendations. This report makes two recommendations (one medium and one low risk).

5 Background

- 5.1 This audit forms part of the agreed 2018/19 Internal Audit Plan. HTS strategic governance has not previously been subject to an audit review.
- 5.2 On 1 February 2017 the Council's Local Authority Trading Company HTS Property and Environment Ltd (HTS) commenced trading to deliver the services previously provided by Kier Harlow Ltd. HTS is part of a wider group company structure, created under the umbrella of a Council owned holding company. Governance arrangements for the trading group of companies were agreed by Cabinet in November 2015.
- 5.3 Until June 2018 the group structure comprised of a holding company called HTS Group Limited and one wholly owned subsidiary called HTS (Property & Environment) Limited. Both boards have the same Councillor Directors and Non-Executive Chair appointed to them. In addition, HTS has a Managing Director appointed to the Board and a Company Secretary.
- 5.4 HTS is held to account by a politically balanced Shareholder Sub-Committee (SSC), which is a sub-committee of Cabinet. The SSC has express terms of reference and retains overall strategic decision making powers enshrined in an approved delegation matrix for both the holding company and HTS.
- 5.5 The SSC consists of the Leader of the Council, the Portfolio Holder for Housing, and the Portfolio Holder for Environment, together with two opposition councillors (currently the Leader of the Opposition, and the Deputy Leader of the Opposition). Both the Managing Director and Non-Executive Chairman of HTS attend and report to each SSC meeting.

- 5.6 At the June 2018 Cabinet meeting it was agreed to establish a wholly owned subsidiary of HTS Group to act as a delivery vehicle for Council housing and wider regeneration and development activity and projects and did not form part of this audit.
- 5.7 The use of the Teckal exemption is complex and subject to challenge, therefore the Council and the local authority trading company (LATC) must ensure that the company is within the Teckal parameters. As stated earlier to be Teckal compliant there are two key tests: the control test and the functional test. Points 1-3 answer the 'Control Test' and Point 4 answers the 'Function Test'.
1. Provide evidence that the council is able to influence the Teckal company on key policy matters (evidence you could get for this could include reserved matters for the shareholder in the Articles of Association of the company);
 2. Provide evidence that the council is able to control membership of the Board of the Company (again, this should be in the Articles of Association/Shareholder Agreement);
 3. Provide evidence that the council holds all share capital in the company (evidence you could get for this would be from the annual accounts of the company);
 4. Provide evidence that at least 80% of the Teckal company's turnover for the last three years (when applicable) comes from its parent council (this could in the form of a breakdown of turnover over the last three years, by source – note a rolling three year period can be used as this is the time period over which 20% of turnover is allowed to come from sources other than the Council to control for peaks and troughs).
- 5.8 Significant findings from the review will be presented to the next Audit and Standards Committee. Implementation of recommendations will be tracked through a separate report to CMT and the Audit and Standards Committee.

6 Distribution

- 6.1 **Brian Keane** (Managing Director for the Council)
Andrew Murray (Head of Housing)
Julie Galvin (Principal Solicitor)

Final report also to

Simon Freeman (Section 151 Officer)
Francesca Palmer (External Auditors, BDO)
Shareholders Sub Committee
John Philips (HTS (P&E) Managing Director)

6.2 Issue date

Draft report issued: 01 February 2019
Final report issued: 07 February 2019

6.3 Auditor

Sarah Marsh (Internal Audit Manager)

Management Action Plan – HTS (Property and Environment) Strategic Governance 2018/19

Ref	Findings	Risk	Priority	Recommendation	Manager's response	Implementation date
1	There is a general consensus that the Shareholders Sub Committee could be more strategically focussed	Inability to hold HTS to account as per the Committee's Terms of Reference	Medium	<p>With the assistance of Council Officers the Shareholders Sub Committee should undertake the following in order to improve its strategic oversight:</p> <ul style="list-style-type: none"> • Ensure reports of operational information is summarised, such as complaints and Member enquiries, in order to gain an understanding of themes or issues rather than the detail • Is provided with reports from other assurance providers, including Internal Audit and the Council's control and function testing for Teckal compliance. • Consider holding an away day/session with the HTS Board to discuss strategic opportunities • Consider undertaking a skills and knowledge analysis, which could be based on that format used by the Council's Audit and Standards Committee. (Note – something similar could be undertaken by the HTS Board, the results of which are reported back to the Committee) • Consider whether the frequency of Committee meetings should be reduced, ensuring they link in with the HTS Board and Council cycles. 	<p>This report will go to the April 2019 Shareholders Sub Committee for consideration. It is anticipated it could take up to year for the Committee to implement any actions agreed by them.</p> <p>Responsibility: Managing Director for the Council</p>	Date due: 31 March 2020
2	The governance arrangements set out in the 2016-20 business plan is working as expected, however the role of the Head of Housing as the	Reduced transparency/lack of accountability	Low	With the assistance of Council Officers the Shareholder Sub Committee should ensure the role and remit of the Council's representative on the HTS Board is	As above – this will be considered by the Shareholders Sub Committee when they	Date due: 30 September 2019

Management Action Plan – HTS (Property and Environment) Strategic Governance 2018/19

Ref	Findings	Risk	Priority	Recommendation	Manager's response	Implementation date
	Council's representative on the HTS Board is not documented			documented. :	receive this report at their April 2019 meeting. Responsibility: Managing Director for the Council	

Management Action Plan – HTS (Property and Environment) Strategic Governance 2018/19

Definitions of Assurance and Recommendation Priority Ratings

Levels of Assurance	
Substantial Assurance	Overall, there is a sound system of control. Any weaknesses which put system/service objectives at risk will be minor and does not lead the Council to significant risk exposure.
Moderate Assurance	Basically sound control, with areas of weakness, which put system/service objectives at risk. (Any high priority recommendations will prevent this level of assessment).
Limited Assurance	There are significant weaknesses in more than one key control area, which could put system/service objectives or the Council at risk.
No Assurance	There are fundamental control weaknesses, leaving the system/service open to material errors or abuse and exposes the Council to significant risk.

Recommendation Priority Ratings

The Public Sector Internal Audit Standards (PSIAS) make it clear that the work of the Internal Audit function should be risk-based; therefore the agreed priority ratings are based on the risk criteria used by Broxbourne Council in their current risk management strategy. Each recommendation is linked to a category of risk, with most recommendations falling into 'high', 'medium' or 'low' risk. A more scientific approach can be adopted in assessing recommendation priority ratings by using these [risk criteria](#).

A 'critical/catastrophic' rating will only be used in exceptional circumstances, with senior management being informed immediately if such a serious control failing was being observed or suspected during audit fieldwork.

Managers' responsibilities

Managers should develop and maintain sound systems for governance, risk management, and internal control, including measures to prevent and detect error and fraud. Internal Audit is not a substitute for this. We plan our work to identify significant control weaknesses, and do not guarantee to detect error or fraud – managers should not rely on our work to replace their own monitoring and vigilance.