



INTERNAL CONTROLS ASSURANCE FRAMEWORK

2006

**NORTHWARDS HOUSING
INTERNAL CONTROLS ASSURANCE FRAMEWORK**

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1. Introduction

- 1.1. The Board is at the centre of governance in an organisation, and is responsible, among other things, for ensuring Northwards operates effectively and achieves its objectives. If this responsibility is to be applied properly, then the Board must set those objectives, review them and identify risks that might prevent the organisation from achieving its business objectives.
- 1.2. Good practice, therefore, says that Northwards must operate within a framework which effectively identifies and manages risks, identifying all risks which might prevent it from achieving its objectives with the necessary arrangements to manage risks and mitigate their effects.
- 1.3. In addition, Northwards must have management arrangements, resources, skills and systems which are appropriate to its circumstances, scale and scope of operation, and ensure that its activities are backed by proper systems of assurance for internal control.
- 1.4. The focus on assurance represents good business practice by ensuring that attention centres on achieving organisational business objectives. This has been reinforced by research that concluded that:
 - Obtaining Internal Controls Assurance is an integral part of good governance and hence the sound planning and running of the business. The Statement of Internal Controls Assurance should be a by-product of the activities undertaken by the Board to ensure that its organisation remains on track;
 - Obtaining assurance requires an approach to understanding and managing risk that is both systematic and challenging. Systematic because it must cover every facet of the business, but do so in a logical way that allows appropriate conclusions to be drawn, and challenging because otherwise, even with the best of intentions on all sides, 'group think' can set in and potential threats can be missed; and
 - Communication with the outside world matters. The opportunity presented by the Statement of Controls Assurance should not be squandered.
- 1.5. Therefore, the Internal Controls Assurance Framework for Northwards is built up from the organisation's Objectives and Values together with other documents including the Risk Management Strategy.
- 1.6. This Framework has been drawn up from published information by the Auditing Practices Board (APB) and the Housing Corporation, plus Internal Control; Guidance on the Combined Code published by the Institute of Chartered Accountants in England and Wales, known as Turnbull.

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2. The Combined Code: Turnbull

- 2.1. The Combined Code states that: 'The Board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets'; and that 'The Directors should, at least annually, conduct a review of the effectiveness of the Group's system of internal control and should report to shareholders that they have done so. The review should cover **all controls**, including financial, operational and compliance controls and risk management.'
- 2.2. The term 'all controls' means the whole range of controls rather than every single control. Turnbull deals with 'the adoption by a company's Board of a risk-based approach to establishing a sound system of internal control and reviewing its effectiveness [which] should be incorporated by the company within its normal management and governance processes [and which] should not be treated as a separate exercise undertaken to meet regulatory requirements'.
- 2.3. The Board is responsible for Northwards' system of internal control. It will set appropriate policies on internal control and seek regular assurance that will enable it to be satisfied that the system is functioning effectively. The Board will further ensure that the system of internal control is effective in managing risks in the manner which it has approved.
- 2.4. It is the role of Management to implement Board policies on risk and control. In fulfilling their responsibilities, Management will identify and evaluate the risks faced by Northwards for consideration by the Board and design, operate and monitor a suitable system of internal control which implements the policies adopted by the Board.
- 2.5. All employees have some responsibility for internal control as part of their accountability for achieving objectives. They, collectively, have the necessary knowledge, skills, information and authority to establish, operate and monitor the system of internal control. This requires an understanding of Northwards, its objectives, the communities and neighbourhoods it serves, and the risks it faces.

3. Forms of Assurance

- 3.1. The Board will not obtain assurance from just one source but from several. The **key steps** that the Board needs to take are:
 - a) identify/review the organisation's business objectives, the possible opportunities, and the risks or threats to achieving those objectives (which may in turn lead to a revision of the objectives);
 - b) form/review the organisation's framework for managing the identified risks; and
 - c) identify how the Board is to obtain assurance that the risk-management policies adopted are adequate and operating effectively.

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3.2. **Three elements** relating to assurance have been identified as follows:

- a) the identification and evaluation of applicable risks;
- b) the design of the system of controls; and
- c) the operation of those controls.

3.3. The Board needs to decide how much assurance it needs and then set about determining how to get it. For example, if it decides to use an Internal Audit service, then the resourcing of that service should be dictated by the amount of work needed to get the appropriate assurance, not restricted by a budget set in advance of any needs assessment.

3.4. The table below shows how the different forms of assurance might contribute to the different elements of Northwards' control culture. Examples of some of these forms of assurance are detailed below. The matrix is based on guidance since different organisations will obtain assurance over different elements of the system of internal control through different means.

	Control environm't	Gover-nance framework	Risk identification evaluation	Risk assurance	Operation of controls	Monitoring	Independ't assurance
Board overview	Yes	Yes	Yes			Yes	
Management assurances on internal control	Yes	Yes		Yes	Yes		
Management reports on operational and financial matters	Yes	Yes		Yes		Yes	
Risk management activities	Yes		Yes		Yes		
Internal audit	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Quality management systems	Yes	Yes					
External audit	Yes	Yes			Yes		Yes
Performance indicators	Yes	Yes				Yes	
Other external reports	Yes	Yes			Yes		Yes

Board or Sub-Committee Overview

3.5. The Board, either itself or through a Sub-Committee with an Audit remit (Resource & Governance Sub-Committee), will keep the risk-management process under review. Risk management is a continuous process, so the Sub-Committee will receive throughout the year, on a regular basis, reports on internal control.

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- 3.6. *Implementing Turnbull: A Boardroom Briefing* (from the Institute of Chartered Accountants in England and Wales' Centre for Business Performance) suggests that 'risk and control issues' could be a standard agenda item for the Board and that reports from Sub-Committees provide an opportunity to discuss risk and control at Board level.
- 3.7. Board members must be involved in the risk identification and assessment processes, and must take ownership of and approve Northwards' risk-management framework. Unless there is a demonstrable commitment to governance and risk management among both Board Members and the Senior Management Team, it is unlikely that a flourishing control culture will exist in the organisation.
- 3.8. As part of the Governance Development Plan, training for Board Members in the area of Internal Controls Assurance and Risk Management will be kept under review.

Management Assurances

- 3.9. One of the main sources of assurance for many organisations are Managers' and Directors' routine reports that the internal control activities are providing adequate risk management. Such reports cover operational and financial matters as well as lower-level information giving assurance that controls are operating as they should be.
- 3.10. Objectivity is an issue here. In *Risk Management and the Value Added by Internal Audit*, The Institute of Chartered Accountants in England and Wales questions whether 'those who are responsible for managing risks and operating controls always take a wholly objective and systematic view of their own performance'. A negative answer strengthens the case for a degree of independent and objective assurance.
- 3.11. An organisation that seeks to rely on management certification on the operation of controls needs to be sure there is a proper basis for that certification. When professional auditors test the operation of controls, they usually take a sample, using scientific techniques to extrapolate their findings. If Management adopts such an approach, it needs an adequate understanding of the techniques.

Risk Management Activities

- 3.12. Northwards' risk management and risk identification activities will by themselves provide assurance that the organisation is focusing on and addressing the key risks that threaten the attainment of the Objectives. This process will continue to evolve over time and could include:
- a) formation of a risk panel to hold roundtable debates on key risks, which would involve members of staff from all levels and sectors of the organisation, and possibly other stakeholders from time to time; and

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- b) control and risk self-assessment procedures, which may make use of structured interviews, workshops or questionnaires.

Internal Audit

- 3.13. Assurance is also obtained through the Internal Audit service as set out below.

Quality Management Systems

- 3.14. An organisation may gain business assurance on specific areas of its work where it operates quality management systems and receives external accreditation or certification for them; for instance:
 - Investors in People;
 - Chartermark
 - Social audit;
 - Excellence Model; and
 - ISO 9000.

External Audit

- 3.15. External audit is another form of assurance on the accuracy of the financial statements and on the operation of internal controls. But if Northwards seeks to rely on the External Auditor's management letter as a form of assurance, it must take into account that:
 - a) the management letter will refer only to matters identified in audit work, so it will not necessarily cover all significant risks to the organisation;
 - b) it will usually refer only to weaknesses, so will not provide positive assurance; and
 - c) the level of assurance required by the external auditor will not necessarily tally with the level of assurance required by the Board.
- 3.16. There is therefore a limited degree of assurance available from the routine work of the External Auditor. However, the External Auditor may still be seen as a source of assurance.

Performance Management

- 3.17. Northwards is involved in compiling, monitoring and reporting on a number of performance indicators. Performance Management has an important role in assurance by allowing the Board (and relevant Sub-Committees) to assess whether the organisation is meeting its objectives.
- 3.18. If performance indicators are used properly, then there must be agreement within the organisation that they are appropriate and do in fact measure achievement of business objectives.

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- 3.19. Through the Performance & Quality Services Sub-Committee, and at the Board on a quarterly basis, there is an overview of the organisation's performance. Further development of the reporting will take place over time that might include a balanced scorecard approach. The measures selected must, however, give an overview of performance on all critical aspects of the organisation's work (e.g. tenant satisfaction, property maintenance, financial performance).
- 3.20. Performance indicators are a very useful tool in comparing performance over time, against budget and within and without the organisation. But in itself, for any particular area of work, the monitoring of indicators is unlikely to be enough to provide assurance. For example, performance on arrears collection may be good, but certain circumstances may be likely to trigger a control weakness that could lead to a downturn in performance — the indicator might pick this up in time, but other forms of assurance could also detect it before it affects performance.

External Reports

- 3.21. Northwards will also gain assurance from some other regulatory or external reports received, including the Inspection Report from the Audit Commission. However, care should be exercised with these as they often focus purely on the negative findings and do not give positive assurance and the Board - not an external body – should be setting the level of assurance required for its purposes.
- 3.22. The Board should recognise that the organisation, not an external body, is responsible for satisfying itself on the adequacy and operation of internal controls. Absence of comment by the third party should not be regarded as assurance that there are no issues.

4. Internal Audit

- 4.1. Internal Audit differs from the other sources of assurance in that it can provide independent and objective assurance across the whole range of an organisation's activities. Other functions may be able to provide assurance in specialist areas. However, Internal Audit has the advantage of being positioned within the organisation in such a way that it can take an overview and retain a degree of independence that is not possible for other functions.
- 4.2. The need for Internal Audit to retain its objectivity and independence has implications for the role of internal audit in the risk management process. The Institute of Internal Auditors - UK and Ireland's Briefing Note 10 *Managing Risk* lists several appropriate roles for Internal Audit in the process of assessing and identifying risk:
- a) as facilitators enabling and guiding managers and staff through the process;

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- b) as team members who are part of broader based multi-disciplinary and multi-skilled groups, providing Internal Audit expertise to the company;
 - c) as risk and control analysts, providing advice to managers on business risk and strategies for dealing with business risk;
 - d) as providers to management of tools and techniques used to analyse risks and controls; and
 - e) as a centre of expertise for managing risk, for example in managing databases or maintaining corporate risk profiles.
- 4.3. Internal Audit should not be responsible for the design and construction of control systems. Even when advising management on system development, Internal Audit should take care to ensure that it can review those systems, and the overall risk management process, objectively at a later date.
- 4.4. In preparing the Internal Audit assurance systems for Northwards, an internal audit needs assessment will be conducted, taking into account the existence of other forms of assurance, which will calculate the resource level required. The resource level should not be seen purely as a quantitative measure but also in terms of the quality of the service. Effective internal audit requires compliance with appropriate professional standards. If the organisation cannot
- 4.5. A Service Level Agreement should be in place with the Internal Auditors setting out clearly the expectations on both sides.
- 4.6. The Director of Business Services is responsible for the Internal Audit provision for Northwards. However, the Internal Auditor is first and foremost accountable to the Board through its Sub-Committee and it approves the programme of work and monitors delivery of the programme.
- 4.7. Individual reports are distributed to relevant section heads for initial review. This allows for the factual accuracy of the report and the proposed action plan to be developed with section heads before agreement with the Director of Business Services.
- 4.8. The Internal Auditor reports to the Sub-Committee on an assignment by assignment basis or periodically, for example providing progress reports on the implementation of action plans.
- 4.9. It is an essential part of the function that the Internal Auditor has full and free access to the Board and Sub-Committee and arrangements are in place to ensure this is possible.
- 4.10. In addition to the ongoing reporting referred to above, the Internal Auditor should give the Sub-Committee an annual report including:
- a) restatement of terms of reference and standards;

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- b) audit work conducted in the year together with comparison to approved plan;
 - c) other areas of work during the year;
 - d) main findings arising from internal audit work, together with a status report on key control weaknesses identified; and
 - e) overview of the systems of internal control reviewed.
- 4.11. If Internal Audit is to be effective and to add value, then its recommendations must be sensible, worthwhile and practical. To ensure this happens, issues raised through Internal Audit reviews are shared with Directors or Senior Managers prior to recommendations being made. Management must then take ownership of the issue, and consider the recommendations. Failing to do so would mean that Management had effectively accepted responsibility for the residual risk. Mechanisms are in place to enable the Sub-Committee, to monitor the implementation of recommendations and Management action plans.
- 4.12. The overall audit framework has been designed so the Internal Auditor can have an effective and understanding relationship with the External Auditor. The relationship recognises the differences in their roles, but facilitates co-ordination of audit work where appropriate. If the Internal or External Auditor wishes to rely on the work of the other, then they must ensure that it is appropriate to do so.
- 4.13. The performance of the Internal Audit service is measured, at least on an annual basis. This review includes consideration of planning arrangements, completion of work in line with plans, understanding the business, the quality of conclusions and recommendations, the timeliness of reporting and the cost of the service.

5. Embedding Risk Management

- 5.1. An internal control system aims to minimise the occurrence of significant control failings and weaknesses. This requires that all people in an organisation understand the internal control and risk implications of the tasks they perform, and act accordingly. They must also understand the importance of assurance and internal control in achieving the organisation's objectives.
- 5.2. To achieve these objectives and understandings, an organisation's system of internal control must be embedded in its operations and culture. Some or all of the following may help to achieve this:
- a) communication of the Board's risk management policy at all levels;
 - b) consultation at all levels on, for instance, what is risk, what risks does the organisation face, how should those risks be addressed;
 - c) setting out clear guidelines on the responsibility for risk;
 - d) linking corporate objectives to individual staff targets, reward mechanisms and training opportunities;

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- e) encouraging a climate of openness and honesty;
- f) ensuring that Board Members and employees have the knowledge and skills to address risk and internal control issues (and providing training opportunities if not);
- g) establishing a risk panel including members from all levels and across the organisation;
- h) establishing a common risk language in the organisation; and
- i) communication of the importance attached to risk management by the Board and the Executive Management Team.

6. Annual Review and Statement

- 6.1. Best practice states that the Board should conduct an annual review of the effectiveness of the organisation's system of internal control.
- 6.2. Each year the Board will prepare, with the audited financial statements, a statement of internal control that refers to the Board's annual review of the effectiveness of the organisation's internal control systems.
- 6.3. The annual review and annual statement are important, but they should be seen in context. Assurance and risk management are not once-a-year exercises: they should be continuous processes. In this light the Board's annual review will largely consist of bringing together the results of the forms of assurance that the Board has identified as appropriate to obtaining its overall assurance on the organisation's system of control.
- 6.4. To achieve this, the Executive Management Team will present to the Resource & Governance Sub-Committee an annual report on the organisation's system of internal controls and this will be forwarded onto the Board.
- 6.5. It is for the Board and Sub-Committee to review this report in the light of the ongoing assurance reporting process.
- 6.6. The annual report may be prepared by the Director of Business Services but must be approved and owned by the Executive Management Team and covers all aspects of the organisation's system of internal control.
- 6.7. The report should refer to:
 - summary of risk management activities undertaken;
 - changes in the nature and extent of significant risks since the previous annual review;
 - forms of assurance previously approved by the Board and Sub-Committee, together with a summary of findings from each form of assurance;

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- external audit matters;
- all significant control failings reported in the year;
- any fraudulent activity which has taken place.

6.8. As a Sub-Committee will be fulfilling some of the responsibilities relating to assurance, for example receiving a report from the Executive Management Team, the Sub-Committee will report to the Board to assist it in publishing its statement with the audited accounts.

7. Audit Sub-Committee

7.1. Turnbull recognises that the Board might wish to delegate some of its tasks on internal control to designated Sub-Committees. This is a decision for the Board to take in reviewing the terms of reference for Sub-Committees and there should be consideration of to what extent it wishes to delegate authority for internal controls to an Audit Sub-Committee.

7.2. **However, responsibility for the Internal Controls Assurance Framework remains with the Board.**

7.3. In considering the need for an Audit Sub-Committee, the Board should particularly consider whether, without one, it can dedicate enough time to detailed debate on assurance, risk and internal controls. There are also advantages in bringing together all control and risk-related matters to a specialist forum that can then take an overview of the organisation's position on these matters.

7.4. The functions of an Audit Sub-Committee might include:

- a) providing an annual report to the Board on internal control;
- b) reviewing the risk management framework;
- c) approving the Internal Audit plan;
- d) receiving assurance reports including Internal Audit findings;
- e) reviewing the performance of both the Internal and External Auditor;
- f) making recommendations to the Board on the appointment of the External Auditor;
- g) receiving the External Audit management letter; and
- h) reviewing the audited financial statements and the External Auditor's report on them.

7.5. If an Audit Sub-Committee is formed, it should:

- a) be constituted formally as a Standing Sub-Committee of the Board with approved terms of reference;

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- b) have right of access to all information and people that it sees fit;
 - c) comprise a membership consistent with the governance arrangements of the Company with proper representation of the three groups of Board Member (Council, Independent and Tenant) and ensuring that the majority of its membership are Board Members;
 - d) seek to have a range of skills and experience, including those relating to business, finance and internal control, by co-opting additional Members where necessary;
 - e) report directly to the Board; and
 - f) be chaired by a Board Member other than the Chair of the Board.
- 7.6. For the purposes of this Framework, the Board has designated the Resource & Governance Sub-Committee to act as the Audit Sub-Committee for the present time and has covered the specific items it is responsible for in its terms of reference.
- 7.7. As good practice, whenever the External or Internal Auditors attend the Sub-Committee or Board meetings, there will be an opportunity for Members to meet with the auditors without the Officers being present.

8. Fraud

- 8.1. The Board have approved policies designed to prevent and detect fraud and procedures in case fraud is discovered or suspected.
- 8.2. The IAA—UK and Ireland's Professional Briefing Note 12 *Fraud and the Internal Auditor* advises organisations to publish a policy statement on business ethics and fraud. This advice includes making clear:
- a) a policy statement issued by the Board stressing the organisation's commitment to the highest ethical standards and requiring all employees to make themselves aware of and comply with the policies and guidelines issued on corporate conduct;
 - b) the need for all employees to comply with all laws and regulations applicable to the place of business;
 - c) guidance relating to conflicts of interest on holding other positions, for example, directorships outside the business, and on engaging in personal transactions within the business or which might affect the business;
 - d) the need for compliance with policies relating to information security and confidentiality; and
 - e) policies relating to the payment of inducements, gifts and entertainment and the acceptance of such gifts or entertainment.

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- 8.3. Written procedures will include details on the need to comply with the organisation's disciplinary procedures where appropriate, arrangements for prompt and proper investigation of allegations and the recording, substantiation and safeguarding of evidence.

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Appendix 1 – Assurance Evidence

Assurance	Proposed Output to meet Assurance Requirements	Lead and Support	Timescale and/or Frequency	Action
Board Overview	Board and Sub-Committee reports give reference to risk and control issues	Governance Support Officer	July 06	
	Sub-Committee review of the Fraud Register	DBS	Monthly	
Management Assurances	Reports from Senior Managers providing financial and operational information on significant risk areas identified	SMT	As required	
Management Reports	Reports from Senior Managers summarising findings, recommendations and action plans arising from internal control reviews	SMT	Quarterly	
Risk	Review of idea of risk panel	EMT	October 06	
	Regularly reviewed and updated strategic and operational risk maps	DBS	Quarterly	
Internal Audit	Internal Audit needs assessment and work plan	Resource & Governance Sub-Committee	August 06	
	Internal Audit reports summarising work conducted, findings, recommendations and action plans arising	Resource & Governance Sub-Committee	Quarterly	
	Reports summarising progress against action plans and implementation of recommendations	Resource & Governance Sub-Committee	Quarterly	
Quality Management Systems	Accreditation and certifications from external bodies	EMT	As produced	
External Audit	External Audit management letter and supplementary reports	DBS	September 06	
Performance Indicators	Performance Management Framework	Board, Sub-Committees, EMT and SMT	Monthly	
Other External Reports	Reports received as a result of work done by external bodies	EMT	As received	

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Appendix 2 – Glossary

- Assurance** The means whereby a responsible person or body (for example, a director, a manager or the Audit Sub-Committee) knows or reasonably believes that risk-management and risk-control activity is working as intended.
- Control and risk** A systematic and participative technique used to identify, clarify, self-assessment assess, measure and evaluate risks and controls.
- Control environment** The overall attitude, awareness and actions of directors and management regarding internal controls and their importance in the organisation. The control environment encompasses the management style and the corporate culture and values shared by all employees. It provides the background against which the various other controls are operated.
- Control procedures** Policies and procedures established in addition to the control environment to achieve the organisation's specific objectives.
- Fraud** An act of deceit undertaken to gain an advantage or to gain possession of some property belonging to another.
- Internal audit** An independent, objective, assurance and consulting activity designed to add value and improve the organisation's operations. It helps the organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
- Internal control system** The control environment and control procedures. It includes all the policies and procedures (internal controls) adopted by the organisation's directors and management to help achieve its objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including: adherence to internal policies; the safeguarding of assets; the prevention and detection of fraud and error; the accuracy and timeliness of management information, external reports and returns; and compliance with legal and regulatory obligations.
- Risk** The threat that an event or action will adversely affect an organisation's ability to meet its business objectives and execute its strategies successfully.

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Risk management A logical and systematic method of establishing the context, identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable organisations to minimise losses and maximise opportunities.

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