

## CONTROL ENVIRONMENT ASSESSMENT AND MANAGEMENT REPRESENTATIONS UPDATE

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### EXECUTIVE SUMMARY

This report provides the Audit Committee the annual update on the control environment, including matters with respect to financial reporting, within The City and information on the management representation letter process.

### ADMINISTRATION RECOMMENDATION(S)

That the Audit Committee receives this report for information.

### PREVIOUS COUNCIL DIRECTION / POLICY

The Audit Committee's Terms of Reference (included in Bylaw 48M2012) states that the Committee is responsible for overseeing the integrity of The City's system of internal controls. The Committee is authorized to "review reports from Administration about The City's internal control systems, including technology, security and financial controls, and assess whether they are operating effectively."

The most recent annual Control Environment Assessment and management representations was presented and received for information at the 2015 April 23 Audit Committee meeting (AC2015-0345).

### BACKGROUND

Administration has provided an annual control environment assessment and management representation since 2004. Since 2004, Administration has reported that the overall control environment over The City's financial reporting is effective. In certain cases where internal controls continue to be updated, for example, in Tangible Capital Assets (TCA), Administration is committed to ongoing continuous improvement.

### INVESTIGATION: ALTERNATIVES AND ANALYSIS

The annual assessment of the control environment (Attachment 1) is based on the integrated internal control framework of the Committee of Sponsoring Organizations of the Treadway Commission; the COSO Internal Control – Integrated Framework. This is the predominant framework used for Sarbanes-Oxley Act (SOX) compliance and is the model of choice in other jurisdictions, including Canada.

The COSO Internal Control - Integrated Framework is comprised of five inter-related components and 17 principles (See Attachment 2). The five components include: control environment, risk assessment, control activities, information and communication, and monitoring. These components can be described as:

"The *control environment* is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. ...

*Risk assessment* involves a dynamic and iterative process for identifying and analyzing risks to achieving the entity's objectives, forming a basis for determining how risks should be managed. ...

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*Control activities* are the actions established by policies and procedures to help ensure that management directives to mitigate risks to the achievement of objectives are carried out. ...

*Information* is necessary for the entity to carry out internal control responsibilities in support of achievement of its objectives. *Communication* occurs both internally and externally and provides the organization with information needed to carry out day-to-day controls. ...

*Monitoring Activities:* Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of the five components of internal control, including controls to effect the principles within each component, is present and functioning.”

(Internal Control – Integrated Framework, COSO, 2013 May, pages 12-14).

For internal controls to be deemed effective, each of the five components of internal control and relevant principles must be present and functioning and the five components operating together in an integrated manner. (Internal Control – Integrated Framework, COSO, 2013 May, p.18).

Based on the assessment (see Attachment 1), Administration's conclusion is that the overall system of internal controls over The City's financial reporting is effective. The conclusion is based on the professional experience and judgment of Administration.

Administration is committed to ongoing continuous improvement of internal control processes and appropriate resources are being assigned as required. A risk-based approach and culture are being embedded amongst the staff through Administration training initiatives. In certain cases where internal controls continue to be updated, for example in Tangible Capital Assets (TCA), and therefore were not fully in place and weaknesses existed, adequate and appropriate compensating controls were put in place to ensure an overall effective control environment for The City. Administration formed a TCA project team during 2014 and continued in 2015 to ensure compliance and to simplify and develop consistent Corporate TCA procedures to ensure that appropriate internal control activities are embedded within TCA processes. Additional details are provided in Attachment 1.

Administration continues to keep on top of current developments in internal control and to implement 'best practice' for municipalities, where appropriate.

The City Manager, Chief Financial Officer (CFO), General Managers (GMs), Directors, the City Treasurer and other senior management sign the Management Representation Letters (MRLs) as part of the annual financial reporting process. The annual MRLs are management's declarations indicating that the financial statements are fairly presented in all material respects, and in accordance with Canadian Public Sector Accounting Standards. Administration's representations are also relied upon by the external auditor during the annual audit process. The City Manager and CFO sign the overall MRL representing that to the best of their knowledge and belief, the financial statements are accurate and represent the financial

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position and activities of The City. They rely in part on the representations made within each business unit (i.e., the cascading representations). Individuals in the business units are responsible for those items that they should have reasonably been aware of, given their position and responsibilities. These individual MRLs will be completed prior to the presentation of the financial statements to the April meeting of the Audit Committee.

In accordance with historical practice, information and guidance is provided to those individuals required to sign the MRLs to ensure they fully understand their responsibilities and accountabilities when providing their representations.

### **Stakeholder Engagement, Research and Communication**

The contents and recommendations of this report are developed using a process of gathering information from various business units. The process relies on the information provided by the business unit's respective Finance Managers and Directors and the management representations made within each business unit (i.e., the cascading representations). Individuals in the business units are responsible for those items that they should have reasonably been aware of, given their position and responsibilities. Upon request, detailed information on items included in Attachment 1 is available from the respective areas.

### **Strategic Alignment**

Effective internal controls are embedded in the financial reporting processes within The City. These internal controls, along with the annual management representations, align with Council's priority of a well-run city.

### **Social, Environmental, Economic (External)**

No implications have been identified with this report.

### **Financial Capacity**

#### **Current and Future Operating Budget:**

There are no budget implications for this report. The ongoing management and monitoring of internal control is included within the existing operating budget.

#### **Current and Future Capital Budget:**

No implications have been identified with this report.

### **Risk Assessment**

The City has maintained its excellent credit rating of AA+ from Standard & Poors and R-1 (High) and AA (High) from Dominion Bond Rating Service confirming that The City is well-managed and financially stable. The City's 2014 Annual Report received the Canadian Award for Financial Reporting from the Government Finance Officers Association (GFOA) in recognition of excellence in government accounting and financial reporting. The City will apply for the 2015 award and will endeavour to ensure that all requirements are met.

The City's rating and reputation could be at risk if a significant breakdown in internal controls over financial reporting impacted The City's ability to achieve its financial reporting objectives.

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The presence of an appropriate governance structure will allow management to provide reasonable (but not absolute) assurance of The City's ability to achieve its objectives. As such, The City's voluntary compliance with the spirit of the SOX legislation provides greater confidence to the citizens of Calgary.

**REASON(S) FOR RECOMMENDATION(S):**

As a component of overall Corporate governance practice, this annual control environment assessment and management representations ensures that Audit Committee is informed on the processes to gather information regarding the effective functioning of internal controls and to report those areas where internal controls are effective and those areas where effective internal controls are evolving.

**ATTACHMENT**

Attachment 1: Control Environment Assessment

Attachment 2: Components & Principles of Effective Internal Control