Calgary Housing Company
Internal Control Environment Self-Assessment Report

BACKGROUND

On September 19, 2016, Calgary Housing Company (CHC) Administration presented through report CHC2016-A09 to the CHC Audit and Risk Management (ARM) Committee, recommended and received approval that CHC adopt the Committee of Sponsoring Organizations (COSO) of the Treadway Commission: Integrated Framework to guide future internal control environment assessment and reporting. This report also included an implementation process and schedule to conduct a self-assessment of current internal control environment at the entity level of CHC.

The implementation of an internal control environment framework, assessing of internal controls effectiveness and reporting is to provide the ARM Committee and CHC Board with an overview of CHC's current internal control environment controls, an assurance that adequate controls are in place and a commitment to ongoing continuous improvement.

Reviewing the effectiveness of internal controls is an essential part of the CHC Board of Directors responsibilities while management is accountable to the Board of Directors for developing, operating and monitoring the system of internal control and providing assurance to the Board that it has done so.

The integrated internal control framework of the Committee of Sponsoring Organizations (COSO) of the Treadway Commission: the COSO Internal Control – Integrated Framework is the most widely used framework for Sarbanes-Oxley Act (SOX) compliance and is the model of choice in many North American jurisdictions, including Canada. It is also currently utilized by The City of Calgary and the Calgary Parking Authority.

Internal control is defined as "a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance." (COSO Internal Control-Integrated Framework)

Internal control is a means by which an organization's resources are directed, monitored, and measured, thus playing an important role in detecting and preventing fraud and protecting the organization's resources, both physical and intangible.

KEY CONCEPTS

The COSO 2013 framework involves several key concepts:

- *Geared to the achievement of objectives* in one or more separate but overlapping categories - operations, reporting and compliance.
- *A process* consisting of ongoing tasks and activities - a means to an end, not an end in itself.
- *Effected by people*. It's not merely policy, manuals, and forms, but people and the actions they take at every level of an organization to affect internal control.

- *Able to provide only reasonable assurance* - but not absolute assurance, to an entity's management and board of directors.
- *Adaptable to the entity structure* – flexible in application for the entire entity or for a particular subsidiary, division, operating unit, or business process. *(COSO Internal Control-Integrated Framework)*

COSO 2013 FRAMEWORK CUBE

In an effective internal control system, there is a direct relationship between *objectives*, which are what an entity strives to achieve, *components,* which represent what is required to achieve the objectives, and the *organizational structure* of the company. This relationship is depicted in the form of a cube.

- The three categories of objectives: operations, reporting, and compliance, are represented by the columns.
- The five components: Control Environment, Risk Assessment, Control Activities, Information & Communication and Monitoring Activities, are represented by the rows.
- An entity's organizational structure is represented by the third dimension

There are seventeen principles supporting the components of internal control. In order for a company to achieve an effective internal control it must apply all principles.

The 17 principles supporting the components of internal control are outline in the table below:

Component	Principles
Control Environment	1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibility 3. Establishes structure, authority, and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability
Risk Assessment	6. Specifies suitable objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change
Control Activities	10. Selects and develops control activities 11. Selects and develops general controls over technology 12. Deploys through policies and procedures
Information and Communication	13. Uses relevant information 14. Communicates internally 15. Communicates externally
Monitoring Activities	16. Conducts ongoing and/ or separate evaluations 17. Evaluates and communicates deficiencies

EFFECTIVE INTERNAL CONTROL EVALUATION CRITERIA

According to COSO, an effective system of internal control reduces, to an acceptable level, the risk of not achieving an objective relating to one, two, or all three categories of objectives – that is, operations, reporting and compliance. It requires that (i) *each of the five components* of internal control and relevant principles *is present and functioning,* and that (ii) the five components are *operating together in an integrated manner*.

 "Present" refers to the determination that the components and relevant principles exist in the design and implementation of the system of internal control to achieve specified objectives.

"Functioning" refers to the determination that the components and relevant principles continue to exist in the operations and conduct of the system of internal control to achieve specified objectives.

"Operating together" refers to the determination that all five components collectively reduce, to an acceptable level, the risk of not achieving an objective. Components should not be considered discretely; instead, they operate together as an integrated system. Components are interdependent with a multitude of interrelationships and linkages among them, particularly the manner in which principles interact within and across components.

A *control gap* is a difference between expected and actual performance of the internal controls. It occurs when there are either insufficient or no actions taken to avoid or mitigate a significant riskis. It occurs for various reasons: deficiency in control, evidence, standards, performance, practice, and technology.

A *major deficiency* is defined as an internal control deficiency or combination of deficiencies that severely reduces the likelihood that the entity can achieve its objectives. A major deficiency exists when management determines that a component and one or more relevant principles are not present and functioning or that components are not operating together.

In September 2016 at the ARM committee meeting CHC Administration recommended that management conduct a top-down assessment of critical environment controls. With the support of the CHC Management Team, a self assessment was initiated to allow CHC Administration to disclose details of its current internal controls and identify any weak areas which can be improved in the future operating and strategic plans.

CHC STRATEGIC ALIGNMENT

Reviewing the effectiveness of internal control is an essential part of the Board's responsibilities while management is accountable to the Board for developing, operating and monitoring the system of internal control and providing assurance to the Board that it has done so.

Also, as internal control is designed to mitigate risk to the organization, auditors care about risk and the riskier an item is, the more it gets tested. Through better internal controls, organizations can control and manage risk, and possibly have less risk overall. Auditors conduct the organizational audits in areas depending on the results of an internal risk assessment determined by the quality of the internal controls. Having effective internal controls implemented could help auditors provide organizations with better audit reports conducted in less time and cost effective.

CHC's Audit and Risk Management (ARM) Committee has a mandate "to assist the Board in fulfilling its oversight responsibilities by reviewing:

I. The external audit process
II. The financial information that will be provided to the shareholder and to the public; and
III. The systems of internal controls that the President and Corporate Finance and Risk Officer (CFRO) have established."

To oversee the development, implementation and monitoring of appropriate corporate risk strategies relative to legislative compliance, legal/statutory and business requirements." *(Audit and Risk Management Committee's Terms of Reference)*

The ARM Committee also requires the "President and the Corporate Finance and Risk Officer provide appropriate assurances with compliance with key regulatory requirements and internal control practices."*(Audit and Risk Management Committee's Terms of Reference)*

Developing an effective internal control environment framework aligns with CHC's Strategic Priority to Strive for Organizational Excellence. Through effective internal controls, CHC Administration is able to provide assurance to the CHC Board of Directors that it makes sound operating decisions, in all aspects of business, has reliable reporting and is compliant with all applicable laws and regulations.

Every operating area of CHC plays an important role in the organization's internal control and everyone has a shared accountability and individual responsibility to assess, monitor, report and communicate the status of the CHC's internal control environment. An internal control framework assessment will help promote a positive economic impact by reducing the likelihood of unnecessary costs and misappropriation of funds. Further it will help support transparency on the operational and financial processes while building a strong workforce that is informed, aware and knowledgeable in internal control implementation and execution.

INTERNAL CONTROLS OBJECTIVES

Overall, the internal control objectives:

- At organizational level, relate to the reliability of financial reporting, timely feedback on the achievement of operational or strategic goals, and compliance with laws and regulations.

- At the specific transaction level, refer to the actions taken to achieve a specific objective. Internal control procedures reduce process variation, leading to more predictable outcomes.

CLASSIFICATION OF CONTROLS

Hard Controls refer to policies, procedures, and systems designed to prevent fraud and error undertaken by the organization and its staff to mitigate risk. For example: authorization, separation of duties, reconciliation, documentation, security of assets, etc.

Soft Controls refer to competency, integrity and commitment to honesty and accuracy by employees, managers, and business partners. For example: organizational structure, commitment to competence, management philosophy and operating style, etc.

CHC INTERNAL CONTROL ENVIRONMENT SELF-ASSESSMENT INVESTIGATION

Objective:
The objective of the CHC Internal Control Environment Self-Assessment is to identify CHC's existing system of internal controls at the entity level.

This is the first step in implementing the COSO Internal Control - Integrated Framework to ensure:
- Effectiveness and efficiency of operations
- Reliability of financial and non-financial reporting;
- Compliance with applicable laws and regulations; and adequate safeguard of public resources.

The next steps are for CHC Administration to provide annual updates on internal control existence and effectiveness at CHC to the ARM Committee.

Project Scope:
1. Establish Internal Control **evaluation criteria** for when a control is considered to be functioning
2. Engage with operational divisions to **identify existing internal controls**
3. Engage operational divisions to **conduct self-assessment** of internal controls. This will include best management judgement information on the effectiveness of these controls and any further actions planned to improve these controls and mitigate any identified deficiencies.
4. **Identify priority areas** that require control protocols. Depending on the results of the assessment, any significant deficiencies or weaknesses, including addressing existing controls enhancements, will be addressed in the next phase.
5. Scope the work of a City or consultant resource to test CHC internal controls in **next phase** if instructed by ARM committee.
6. **Present report** to ARM and Board on the existence and effectiveness of internal controls at CHC.

Methodology:
The following procedure was performed:
- Engaged senior level management representing each operational division of CHC to identify existing internal controls and their owners
- Conducted one on one interviews with senior management regarding current status of internal controls of CHC at the entity level. This is based on the best management judgement information on the effectiveness of these controls and any further actions planned to improve these controls and mitigate any identified deficiencies.   This is a top-down assessment of critical internal environment controls

    Internal Control Evaluation criteria used when completing the 2017 CHC Internal Control Self-Assessment Questionnaires:
    - ✓ Present: Does a control exist (designed & implemented)?   Answer: Yes or No
    - ✓ Functioning: Does the control operate as intended to achieve objectives?   Answer: Yes or No

✓ Major Deficiency: Management comment if a control exist and is there a major deficiency in the way the control operates to extent that one or more principles is omitted or effectively nonfunctional.

- Reviewed supporting documentation. For example: formal and informal written internal policies, procedures, manuals
- Consolidated the management responses into one assessment report and opportunities for improvement list.

Limitations of the Self-Assessment:

Internal control can be expected to provide only reasonable assurance to management and board of directors of the achievement of CHC's objectives. No system of internal control will always do what it is designed to do or provide absolute assurance for any of the objective categories. While there are internal control limitations, management must be aware of these when selecting, developing and deploying controls that can practically minimize these limitations.

Types of limitations to internal control are:
- Preconditions of Internal Control such as weak governance
- Flawed human judgment in decision making
- External events outside the organization's control
- Breakdowns due to human errors
- Management can override the system of internal control
- Circumvent controls through collusion by staff

Resources:

The project is supported with resources provided internally by CHC pending availability and direction for CHCMT and ARM Committee.

Testing of Internal Controls:

This project is a review of the entity level internal controls at CHC. No testing was performed at the operational or functional level. CHC is currently, through the implementation of the Enterprise System Solution (ESS) is undergoing a systems, processes and procedures review in all areas of the organizations as it is preparing to transition to new technology in Q3 2018. As such, further scoping of work of a consultant resource to test CHC internal controls could be reviewed in the next phase as instructed by the ARM committee and CHCMT.

INTERNAL CONTROL FRAMEWORK RECOMMENDATION

Based on the assessment, CHC Administration's conclusion and recommendation is that the overall system of internal controls is effective. The conclusion is based on the professional experience and judgement of the Administration. CHC division managers and the president self-assessed whether the internal controls they are accountable for are present and functioning.

Some opportunities for improvement were identified at the individual internal control level. These individual opportunities for improvement do not impact the overall effectiveness of the system of internal controls. CHC Management team is committed to ongoing continuous improvement of internal control processes and recommends appropriate resources be assigned as required.