



**Calgary**

City Auditor's Office

# **Annual Control Environment Assessment Audit**

**February 20, 2019**

**THIS PAGE LEFT INTENTIONALLY BLANK**

## Table of Contents

<b>Executive Summary .....</b>	<b>5</b>
<b>1.0 Background .....</b>	<b>7</b>
<b>2.0 Audit Objectives, Scope and Approach .....</b>	<b>7</b>
2.1 Audit Objective .....	7
2.2 Audit Scope .....	7
2.3 Audit Approach .....	7
<b>3.0 Results.....</b>	<b>8</b>
3.1 Assessment Design.....	8
3.2 Principle Three – Controls .....	9
<b>4.0 Observations and Recommendations .....</b>	<b>11</b>
4.1 Assessment Purpose and Level of Control Assurance .....	11
4.2 Control Oversight .....	12
4.3 Demonstrable Controls .....	13
<b>Appendix 1: COSO Internal Control – Integrated Framework.....</b>	<b>15</b>
<b>Appendix 2: Principle 3: Establishes Structure, Authority, and Responsibility .....</b>	<b>16</b>

The City Auditor's Office completes all projects in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

## Executive Summary

Annually, since 2004, Finance has presented a Control Environment Assessment (Assessment) and Management Representation Update report to Audit Committee. This report supports the Audit Committee's Terms of Reference (Bylaw 48M2012), which states that the Committee is responsible to "oversee(s) the integrity of The City's system of internal controls, legal and regulatory compliance regarding financial matters, Codes of Conduct, and other policies, as determined by the Audit Committee".

The most recent Assessment was presented to Audit Committee by Finance on April 17, 2018. Finance prepared the Assessment based on the Committee of Sponsoring Organizations of Treadway Commission's (COSO) 17 Principles of effective internal control and concluded the internal control principles were present and functioning. Given Audit Committee members expressed they valued the delivery of this Assessment in support of their oversight role, and in recognition the Assessment is based on Administration's self-assessment of the operation of controls, this audit was completed to provide additional assurance to Audit Committee regarding the integrity of the information presented.

The objectives of the audit were to assess the effectiveness of the overall design of the Assessment, and the operating effectiveness of specific controls listed in the 2018 Assessment under COSO Principle Three, Establish Structure, Authority, and Responsibility.

We reviewed the purpose of the Assessment, and the process by which the Assessment is compiled. Finance have established a series of activities that support the annual compilation of the Assessment, based on a network of control contributors across Administration, and the utilization of the COSO internal control framework. In reviewing the purpose of the Assessment, we identified transparency regarding the level of assurance being provided to Audit Committee should be improved by the inclusion of a type definition (financial, non-financial) and level definition (entity wide, or Business Unit level) of control included within the Assessment.

In assessing the operating effectiveness of controls listed under Principle Three, we confirmed that five out of the six controls described were present and functioning. The remaining control, specific to defined delegation structures, could not be confirmed as operating effectively, and control improvement opportunities were not disclosed through the Assessment compilation process. We recommended that Finance introduce a system of control oversight (control ownership and associated Director level approval of information provided to Finance) and refine information in the Assessment to include only demonstrable controls. These process changes will promote individual responsibility and collective accountability for a robust system of internal control and are expected to improve the efficiency of the production of the Assessment. As a result, this value-add deliverable can be provided to Audit Committee utilizing City resources in the most effective way possible.

Finance have agreed with the main recommendation, to define and communicate the type and level of control included within the Assessment, with a commitment to provide a proposal and complete consultation with Audit Committee by September 30, 2019. Decisions resulting from this proposal will guide implementation of the remaining two recommendations relating to controls oversight and demonstrable controls to which Finance have provided partial agreement. Any changes to the future scope and design of the Assessment will be incorporated into the 2020 Annual Control

Environment Assessment and will be presented to Audit Committee by April 30, 2020. The City Auditor's Office will follow up on all action plan commitments as part of our on-going recommendation follow-up process.

## 1.0 Background

Annually, since 2004, Finance has presented a Control Environment Assessment and Management Representation Update Report to Audit Committee. This report supports the Audit Committee's Terms of Reference (Bylaw 48M2012), which states that the Committee is responsible for overseeing the integrity of the internal controls. Finance base the Control Environment Assessment (Assessment) on the Committee of Sponsoring Organizations of Treadway Commission (COSO). COSO states each of the five Components of internal controls and relevant 17 Principles (Appendix 1) should be present and functioning to create an effective system of internal controls, and also provides further guidance for designing and implementing a robust system of internal control.

Finance concluded in their most recent Assessment (AC2018-0368) presented to Audit Committee on April 27, 2018, that the overall system of internal controls over The City's financial reporting is effective.

## 2.0 Audit Objectives, Scope and Approach

### 2.1 Audit Objective

The objectives of the audit were to:

1. Assess the design effectiveness of the Assessment process to fulfill the objective of providing Audit Committee reliable information on the effectiveness of internal controls, and
2. Assess the operating effectiveness of the specific controls listed and reported to Audit Committee in the 2018 report (AC2018-0368) under Principle Three, "Establishes Structure, Authority, and Responsibility". (Appendix 2)

### 2.2 Audit Scope

The scope of the audit focused on the activities leading up to, and the documentation and operation of controls, supporting the 2018 Assessment reported to Audit Committee on April 27, 2018. Future enhancements to controls as identified in the report as "further actions planned" were not evaluated, as these activities were in progress and did not form the basis for Finance's conclusions on control effectiveness.

### 2.3 Audit Approach

Our audit approach consisted of the following:

- Review of design effectiveness of the Assessment to support its objective:
  - Confirmation of the documented purpose of the Assessment as communicated to Audit Committee and Council since 2004;
  - Evaluation of the process by which the Assessment is compiled; and
  - Interviews with Financial Controls Group staff associated with compiling the assessment, and specific control owners.
- Review of the operating effectiveness of controls listed under Principle Three through:
  - Validation of the control owner for each control documented;
  - Evaluation of supporting control documentation retained by each control owner; and
  - Attestation of each operating control.

### 3.0 Results

Administration's preparation and presentation of the Assessment supports Audit Committee in its governance role of providing effective oversight on the integrity of internal controls. As part of our audit work we issued a brief questionnaire to all seven Council and citizen members of Audit Committee, and all responses received indicated that members of Audit Committee found value in the 2018 Assessment as presented.

Finance have established a series of activities that support the annual compilation of the Assessment, based on a network of control contributors across Administration, and the utilization of the COSO internal control framework. In reviewing the purpose of the Assessment, we identified that transparency regarding the level of assurance being provided to Audit Committee should be improved by the inclusion of the type definition (financial, non-financial) and level definition (entity wide, or Business Unit level) of control included within the Assessment.

We planned to complete attestation of all controls listed under Principle Three. However, due to the nature of the controls listed, attestation could not be completed in all cases, and where this was not possible, we instead validated the control through reviewing supporting documentation. In assessing the operating effectiveness of controls listed under Principle Three, we confirmed that five out of six controls were present and functioning. We recommended two process changes to promote individual responsibility and collective accountability for a robust system of internal control and to improve the efficiency of the production of the Assessment, so this value-add deliverable can be provided to Audit Committee utilizing City resources in the most effective way possible.

#### 3.1 Assessment Design

We reviewed the purpose of the Assessment, and the process by which the Assessment is compiled.

##### Assessment Purpose

In 2003 Audit Committee Terms of Reference<sup>1</sup> were updated with an approved motion to receive an Annual Report from Administration on the Control Environment within the City. Since 2004 Administration has prepared the Assessment based on COSO internal control framework. Audit Committee's current Terms of Reference state with respect to the City's internal control systems that Audit Committee: *"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 Assessment is one of several reports received by Audit Committee (other reports are presented on an annual basis by Law, and IT) that support this section of the current Terms of Reference.

The report accompanying the Assessment presented to Audit Committee on April 17, 2018 states the purpose of the Assessment is: *"Audit Committee is informed on the processes to gather information regarding the effective functioning of financial controls..."* However, the Executive Summary to the report states that *"This report provides the Audit Committee the annual update on the control environment, including matters with respect to financial reporting within The City."* which implies the inclusion of both financial and non-financial controls.

---

<sup>1</sup>Bylaw 48M2012

Controls documented in the Assessment presented in 2018 include both financial and non-financial controls, at differing levels of the organization (entity wide, Business Unit level). We recommended (Recommendation 1) Finance improve clarity on the purpose of the Assessment by defining the level and type of controls included in the Assessment. The implementation of the recommendation may also support greater efficiency in delivery of the annual Assessment, through focus on key controls rather than all types of control activities occurring across Administration.

### **Compilation Process**

The Assessment is compiled by Finance based on input from 32 control contributors across City of Calgary Administration. Finance invited all control contributors to kick-off meetings held during early January of 2018 to provide instructions on producing control information. The kick-off presentation slides covered the purpose of the Assessment, along with a high-level summary of COSO, and the requirement for control contributors to self-assess whether controls are present and functioning.

Control contributors each submit a Control Environment Report to Finance which includes a brief description of specific controls operating during the previous fiscal year and are required to affirm (self-assessment) if the control is present and functioning.

We interviewed two control contributors to confirm if Finance provided appropriate support/instructions, and they provided positive agreement indicating Finance provided appropriate instructions to control contributors on completing the Control Environment Reports, arranged subsequent meetings with control contributors to clarify instructions and promptly answered and resolved follow-up questions.

Based on process walkthrough information provided, Finance collate information received from the Control Environment Reports into the Assessment and use this information to assess whether each COSO Principle is present and functioning. Director approval of the accuracy of the control information is not requested, however approval is provided implicitly as they are copied on email correspondence between the control contributor and Finance. Finance monitor that this implicit approval has been provided by each relevant Director. In the Assessment presented to Audit Committee in 2018, each COSO Principle was described as present and functioning.

### **3.2 Principle Three – Controls**

We reviewed the operating effectiveness of each control listed in the Assessment under Principle Three, “Establish Structure, Authority, and Responsibility” (Appendix 2). Finance assessed the Principle as present and functioning.

All six controls listed under Principle Three were described as present and functioning in the respective Control Environment Reports provided by the control contributors. We reviewed the related Control Environment Reports and validated the operation of the controls described. Implicit Director approval was provided for each control via being copied into email correspondence between each relevant control contributor and Finance.

Through validation of support documentation, we confirmed that five of six controls were present and functioning. One control could not be confirmed as operating effectively. Control

03-003 Defined Delegated Structure states that “The City of Calgary operates under a defined authority structure” and that “some duties are delegated by way of bylaw, while others are delegated by Administration”. Through discussion with control contributors listed for this control, we noted that there is no City-wide documentation or supporting process to monitor and track duties delegated through bylaw or by Administration. We confirmed that City Clerk’s Office are working with Law to compile a full list of duties delegated; however, neither City Clerk’s Office or Law were listed as control contributors, nor was this action listed as a “Further Action Plan” in the Assessment. We raised a recommendation (Recommendation 2) to enhance the level of assurance provided by establishing a control oversight system, including dedicated control owners, and explicit Director level control sign off confirming that controls are present and functioning. Designating a control owner for each control will support good governance by ensuring appropriate responsibility for controls is assigned across Administration.

In reviewing individual controls listed under Principle Three, we noted Internal Control Descriptions were not consistently articulated as demonstrable controls, e.g. descriptions were written as statements or events rather than as a control, which makes it more difficult to identify a control owner and ultimately verify the existence and operation of the control. We raised a recommendation (Recommendation 3) to refine the Assessment Internal Control Descriptions to reflect only demonstrable controls.

We would like to thank staff from Finance and control contributors across City Administration for their assistance and support throughout this audit.

## 4.0 Observations and Recommendations

### 4.1 Assessment Purpose and Level of Control Assurance

The Assessment does not define the type of controls (financial, non-financial) which are being assessed, or the level of controls (entity level controls, Business Unit controls).

A level of guidance was provided in the report accompanying the Assessment presented to Audit Committee in April 2018 under “Purpose”, which states the focus is to provide information regarding the effective functioning of financial controls, however we noted examples of controls (e.g. Control 006-02, Civic Innovation YYC) that extend beyond financial controls.

The report Executive Summary states the report provides an annual update on the control environment, however does not provide clarity to the recipient whether the assurance provided relates to financial controls or all operating City controls (e.g. whether only entity level controls, operating city-wide, are included in the Assessment).

Defining controls included in the Assessment provides greater transparency to Audit Committee and reinforces an efficient Assessment compilation process, as it minimizes the risk that staff time is spent assessing controls which are required, or not relevant to the Assessment purpose.

#### Recommendation 1

The Director of Finance/City Treasurer define and communicate the type and level of control included within the Assessment.

#### Management Response

Agreed.

As noted above, the citizen and elected members of the Audit Committee find the Annual Control Environment Assessment to be valuable in its current form. The choice of which controls to include within the Assessment is inseparable from its scope and form; to mitigate the risk of making changes that would lower the report’s usefulness, consultation is required.

At present, the Annual Control Environment Assessment focuses on those controls that support The City’s financial functions. In keeping with the guidance of the COSO Framework, this includes some entity-level controls that are not explicitly financial in nature. The Annual Control Environment Assessment is not intended to provide an assessment of operational controls or unrelated entity level controls. Further clarification of reporting scope, in addition to the recommendation provided, will be sought through the management action plan.

Action Plan	Responsibility
<p>The Director of Finance/City Treasurer will prepare a report for the members of the Audit Committee, providing recommended alternatives discussing potential changes to:</p> <ul style="list-style-type: none"> <li>a) The appropriate scope of City activities to be covered by the Assessment; and</li> <li>b) The level and degree of detail desired in the disclosure of controls that affect those activities.</li> </ul> <p>Following this consultation and the selection of preferred options by the Audit Committee, the Director of Finance/City Treasurer will cause any additional alterations to be reflected in the Annual Control Environment Assessment.</p>	<p><u>Lead</u>: Director of Finance/City Treasurer</p> <p><u>Support</u>: Manager, Corporate Financial Reporting</p> <p><u>Commitment Date</u>: The consultation will be completed by September 30, 2019, with any results reflected in the 2020 (2019 Year-end) Annual Control Environment Assessment presented to Audit Committee by April 30, 2020.</p>

#### 4.2 Control Oversight

In reviewing controls documented in Principle Three of the Assessment, we identified gaps in control oversight. Finance staff compile the Assessment based on information from control contributors, and we noted in our review several control contributors were listed for each control rather than one specific owner. Director confirmation that controls were present and operating was obtained implicitly via being copied into email correspondence between control contributors and Finance staff. We identified one control which could not be confirmed as operating effectively, which had not been identified in the Assessment compilation process.

Control 03-003 Defined Delegation Structure states “The City of Calgary operates under a defined delegated authority structure” and “Some duties are delegated by way of bylaw, while others are delegated by Administration”. Although the Assessment provided no direct control owner, Finance was able to identify control contributors for this control. Through interviews we determined there is no City-wide documentation or supporting process to monitor and track duties delegated through bylaw or by Administration. We were informed City Clerk’s Office are working with Law to compile a full list of duties delegated; however, neither Law nor City Clerk’s Office were identified as control contributors, and this action was not listed as a “Further Action Planned” in the Assessment.

Controls documented in the Assessment do not have an assigned control owner, or explicit Director sign off regarding the operation of the control, creating uncertainty in the control oversight framework. Clear ownership and oversight of control operation assists in supporting individual accountability and collective responsibility for effective control operation, and supports the accuracy of the Assessment by ensuring that appropriate responsibility is assigned.

Recommendation 2

The Director of Finance/City Treasurer establish a control oversight system including control ownership, and associated Director level control sign off confirming that controls are present and functioning.

Management Response

Partially agreed.

As noted, some controls described in the Annual Control Environment Assessment are entity-level controls that have contributors from across The City. Assigning a single control owner to these would be challenging, as it would not accurately reflect the underlying organizational structure.

Action Plan	Responsibility
<p>The Director of Finance/City Treasurer will:</p> <ul style="list-style-type: none"> <li>a) Ensure that Director-level control sign-offs are provided for the approval of all contributions to the report and</li> <li>b) Explore, depending on the results of Recommendation 1, adding specific control ownership to each control documented in the Annual Control Environment Assessment.</li> </ul>	<p><u>Lead:</u> Director of Finance/City Treasurer</p> <p><u>Support:</u> Manager, Corporate Financial Reporting</p> <p><u>Commitment Date:</u></p> <ul style="list-style-type: none"> <li>a) Director sign-off: to be included in the 2019 (2018 Year-end) Annual Control Environment Assessment, presented to Audit Committee by April 30, 2019.</li> <li>b) Specific control ownership: the results of the exploration will be ready by December 31, 2019, with potential implementation in the 2020 (2019 Year-end) Annual Control Environment Assessment, presented to Audit Committee by April 30, 2020.</li> </ul>

**4.3 Demonstrable Controls**

Segments of the internal control descriptions provided under Principal Three in the Assessment are not demonstrable, which impacts the ability of the control owner to assess design or effective operation of the control.

The Assessment includes under the heading “Internal Control Descriptions” a variety of statements, events, processes and controls which support the relevant Internal Control Principle. For example, Control 03-005 starts with the statement “The City’s organizational structure is defined and promotes accountability throughout the Corporation.” While this relates to the Principle (Management establishes....structures, reporting lines), it is unclear what could be verified to support the accuracy of this statement.

Ensuring that Internal Control Descriptions only contain demonstrable controls supports both the transparency of the Assessment by clearly communicating controls present and operating, and may improve the efficiency of collation of information for the Assessment by refining the content included.

**Recommendation 3**

The Director of Finance/City Treasurer to:

- Establish and communicate Finance – Internal Control & Policy Coordination’s responsibility for ensuring that Internal Control Descriptions supporting each Control Principle are worded as demonstrable controls; and
- Develop and issue guidance to control contributors to support the initial draft of Internal Control Descriptions as demonstrable controls.

**Management Response**

Partially agreed.

The Annual Control Environment Assessment in its current form is designed to report on the general state of internal controls at The City and to provide governance-level information that is useful to the Audit Committee. By necessity, its information is summarized, reflects only certain key controls and is non-exhaustive. It is often preferable to describe a general policy rather than provide an explicit list of actions taken by Administration in support of that policy.

However, depending on the results of the consultation discussed in Recommendation 1, there is a potential that changes to the scope and format of the report would align the Internal Control Descriptions to demonstrable controls.

Action Plan	Responsibility
<p>The Director of Finance/City Treasurer will:</p> <ul style="list-style-type: none"> <li>a) Review the results of the consultation process with the Audit Committee, as detailed in Recommendation 1, to determine whether revisions to the scope and format of the Annual Control Environment Assessment support and would benefit from the use of exclusively demonstrable controls, and;</li> <li>b) If supported by a) above, ensure that the Internal Control Descriptions contained in the Annual Control Environment Assessment are written as demonstrable controls.</li> </ul>	<p><u>Lead:</u> Director of Finance/City Treasurer</p> <p><u>Support:</u> Manager, Corporate Financial Reporting</p> <p><u>Commitment Date:</u></p> <ul style="list-style-type: none"> <li>a) December 31, 2019</li> <li>b) Potential application in the 2020 (2019 Year-end) Control Environment Report, presented to Audit Committee by April 30, 2020.</li> </ul>

## Appendix 1: COSO Internal Control – Integrated Framework<sup>2</sup>

FIVE COMPONENTS OF INTERNAL CONTROL	17 PRINCIPLES OF EFFECTIVE INTERNAL CONTROL
<b>Control Environment</b>	<ol style="list-style-type: none"> <li>1. The organization demonstrates a commitment to integrity and ethical values.</li> <li>2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.</li> <li>3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.</li> <li>4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.</li> <li>5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.</li> </ol>
<b>Risk Assessment</b>	<ol style="list-style-type: none"> <li>6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.</li> <li>7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.</li> <li>8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.</li> <li>9. The organization identifies and assesses changes that could significantly impact the system of internal control.</li> </ol>
<b>Control Activities</b>	<ol style="list-style-type: none"> <li>10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.</li> <li>11. The organization selects and develops general control activities over technology to support the achievement of objectives.</li> <li>12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.</li> </ol>
<b>Information &amp; Communication</b>	<ol style="list-style-type: none"> <li>13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.</li> <li>14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.</li> <li>15. The organization communicates with external parties regarding matters affecting the functioning of internal control.</li> </ol>
<b>Monitoring Activities</b>	<ol style="list-style-type: none"> <li>16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.</li> <li>17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.</li> </ol>

<sup>2</sup>Source: AC2018-0368 – ATTACHMENT 2

## Appendix 2: Principle 3: Establishes Structure, Authority, and Responsibility<sup>3</sup>

Identification No.	Internal Control Description
03-001	<p>The City Manager and Chief Financial Officer (CFO) provide representations in the annual report with regards to how their responsibilities are discharged. As part of this process, they rely on the cascading representations made within each business unit by General Managers, Directors, Finance Managers and Finance Leads.</p> <p>Senior managers across the organization are responsible for managing, monitoring and updating the risks and internal controls in their areas. They acknowledge this responsibility as it pertains to risks and internal controls impacting the BU's Financial Reporting when signing the annual Management Representation Letters.</p>
03-002	<p>A Management Representation Letter (MRL) overview, example, and tips document is provided to all those individuals required to sign MRLs to ensure they fully understand their responsibilities and accountabilities when providing their representations. This information is posted on the Financial Reporting intranet site. This ensures that all involved parties are making informed representations about the contents of the financial statements and are accountable for their accuracy.</p>
03-003	<p>The City of Calgary operates under a defined delegated authority structure.</p> <p>The Municipal Government Act (MGA) outlines Councillors' duties, the Mayor's duties, and the duties of the City Manager. It also provides for the delegation of some of these duties. Some duties are delegated by way of bylaw, while others are delegated by Administration.</p>
03-004	<p>The City Manager's Office (CMO) will continue with its expanded Administrative Leadership Team (ALT) which includes the Chief Human Resources Officer, the Director of Customer Service &amp; Communications and the Chief Information Technology Officer, and the Chief of Staff (CMO) to ensure additional participation in ALT deliberations about opportunities available to and risks facing the corporation.</p>
03-005	<p>The City's organizational structure is defined and promotes accountability throughout the Corporation. Within Administration, the responsibility to manage people and budget, known as Dept ID Ownership, is delegated through a standard process.</p>
03-006	<p>The Enterprise Suite Program (PeopleSoft), which includes clear identification of DeptID and Process Owners, has further clarified authority and accountability. The Human Capital Management (HCM) System is an application within the PeopleSoft Suite and has been further enhanced in 2017.</p> <p>Automated workflows and approvals are inherent within the design of the PeopleSoft HCM and Financials and Supply Chain Management (FSCM) systems.</p>

<sup>3</sup> Source: AC2018-0368 – ATTACHMENT 1 – page 5