

Chief Financial Officer's Report to  
Audit Committee  
2019 April 23

ISC: UNRESTRICTED  
AC2019-0529

## **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.

#### **ADMINISTRATION RECOMMENDATION:**

That the Audit Committee:

1. Receives this report for information.
2. Directs that Attachment 3 and the closed session discussions remain confidential pursuant to Section 25(1)(b) and (c) of the *Freedom of Information and Protection of Privacy Act* to be reviewed by 2021, April 23.

### **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 Update (AC2018-0368) was presented and received for information at the 2018 April 17 Audit Committee meeting.

On February 28, 2019, the City Auditor's Office presented an audit of the Control Environment Assessment and Management Representations process (AC2019-0214), including three recommendations. These recommendations were approved 2019, February 28. Administration has created action plans to implement these recommendations, and, following consultation with the members of the Audit Committee, will implement them over the course of 2019 and 2020.

### **BACKGROUND**

Administration, through the Finance business unit, has provided an annual Control Environment Assessment and Management Representation Update since 2004. Since 2004, Administration has reported that the overall control environment over The City's financial reporting is effective. Administration is committed to 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.

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:

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### **Control Environment Assessment and Management Representations Update**

"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. ...

*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).

Business unit Finance Managers and Directors self-assessed whether the internal controls they are accountable for are present and functioning; these assessments were used to determine the effectiveness of the overall system of internal controls over The City's financial reporting.

Based on this assessment outlined in Attachment 1, Administration's conclusion is that the comprehensive system of internal controls over The City's financial reporting is effective, while noting that there is a deficiency specific to revenue recognition related to capital financing.

This deficiency resulted in delayed recognition of revenues associated with capital deposits, which include government grants and developer contributions which are used to fund capital projects. While this had a material effect on The City's financial reporting which was detected and corrected prior to the release of the 2018 year-end financial statements, it was conservative in nature in that revenue was under-recognized. There was no effect on service delivery, capital project costs and timelines, or on The City's cash balances, fees, rates, or property taxes.

Certain opportunities for improvement were identified at the individual internal control level. These opportunities for improvement do not impact the overall effectiveness of the system of internal controls over financial reporting. Administration is committed to continuous improvement of internal control processes, and appropriate resources are being assigned as required. Attachment 3 contains the opportunities for improvement that need to be presented in a closed session.

A deficiency has been identified around internal control activities relating to financial reporting as a result of the discovery of timing differences relating to financing entries for capital expenditures. Refer to Attachment 4 for further information.

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### **Control Environment Assessment and Management Representations Update**

The City Manager, Chief Financial Officer (CFO), General Managers (GMs), Directors and the City Treasurer sign the internal Management Representation Letters (MRLs) as part of the annual financial reporting process. The internal 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 external auditor MRL representing that to the best of their knowledge and belief, the financial statements are accurate and represent the financial 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.

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

The content and recommendations of this report were developed by obtaining information from self-assessments conducted on internal controls from various business units, represented by Directors, Finance Managers and other control and process experts; including updates on further actions committed to in the prior year's report. These control and process experts are responsible for managing, monitoring and updating the internal controls in their area.

Business unit Directors have approved the contributions made by their staff to this report. 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 as a result of this report.

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

No implications as a result of this report.

### **Risk Assessment**

The City has maintained its high investment grade credit rating of AA+ from Standard & Poor's and R-1 (High) and AA (High) from DBRS Limited which is an important indicator that The City is well-managed and financially stable. The City's 2017 Annual Report received the Canadian Award for Financial Reporting from the Government Finance Officers Association (GFOA) in

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recognition of excellence in government accounting and financial reporting. The City was also a winner of the 2017 GFOA Distinguished Budget Presentation Award. The City will apply for the 2018 awards, 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.

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 Control Environment Assessment and Management Representations Update 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 Update ensures that Audit Committee is informed on the processes to gather information regarding the effective functioning of financial controls and to report those areas where internal controls are effective and those areas where effective internal controls are evolving.

#### **ATTACHMENT(S)**

1. Attachment 1 – Control Environment Assessment
2. Attachment 2 – Components & Principles of Effective Internal Control
3. Attachment 3 – Opportunities for Improvement (Confidential)
4. Attachment 4 – Deficiency Identified