

Internal Financial Control Framework

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Responsible Officer:	General Manager, Corporate and Development
Relevant Legislation:	<i>Local Government Act (1999)</i> <i>Local Government (Financial Management) Regulations (2011)</i> <i>Australian Securities and Investments Commission (ASIC) Act</i>
Related Documents:	<i>Better Practice Model – Internal Financial Controls for South Australian Councils</i> <i>Department of Treasury and Finance (State) – Financial Fraud & Corruption Prevention Policy</i> <i>Local Government Authority (LGA) Financial Sustainability: Information Paper No. 18 – Financial Policies and Procedures</i> <i>Information Paper No. 21 – Internal Financial Controls</i> <i>Management Compliance Program (FMCP) Risk Management Policy</i> <i>Risk Management Framework</i>

1. Introduction

- 1.1 This framework applies to the internal controls and governance measures ensuring all Council transactions are undertaken within a risk management framework.
- 1.2 It oversees the Policy and Protocol documents underpinning Council's obligations under Section 125 (Internal Control Policies) of the *Local Government Act (1999)* (the Act) to ensure an effective and efficient internal control environment exists within Local Council's risk management framework.

- 1.3 This includes, but not limited to, risk management in administrative areas such as finance, strategic management, business development and project management where assets are safeguarded, legislation and other formal guidelines are complied with and financial reporting is accurate and reliable.

2. Strategic Community Plan Desired Outcome

- 2.1 The strategic Desired Outcomes are:

- 2.1.1 Governance - Delivery of good governance in Council business;
and

- 2.1.2 Finance - A financially sound Council that is accountable, responsible and sustainable.

3. Strategic Community Plan Approach

- 3.1 The strategic Community Approaches are;

- 3.1.1 Regularly review, update and adopt leading governance, risk management and administrative practices.

- 3.1.2 Provide sufficient resources to meet current and future needs of the community.

4. Legislative Requirements and Corporate Policy Context

- 4.1 This framework operates as a direct consequence of the provisions of Section 125 (Internal Control Policies) of the Act for South Australia.

- 4.2 This commits Council to ensure that appropriate policies, practices and procedures of internal control are implemented and maintained in order to assist the Council to carry out its activities in an efficient and orderly manner to achieve its objectives, to ensure adherence to management policies, to safeguard Council assets, and to secure the accuracy and reliability of Council records.

- 4.3 In addition Section 129 (Conduct of Audit) of the Act requires an external auditor to form an opinion as to whether there is sufficient evidence providing reasonable assurance that the financial transactions of the Council have been conducted properly and in accordance with law.

- 4.4 This has been further elaborated upon within *Local Government (Financial Management) Regulations 2011* (the Regulations) at Part 6 – Audit clause 19(b) which compels an audit of the internal controls must be carried out in accordance with Standards set out by the Auditing and Assurance Standards Board, established under the *Australian Securities and Investment Commission Act 2001*.

- 4.4.1 According to the Regulations, in forming this opinion the auditor must assess internal financial controls of the Council based on the criteria contained in the Better Practice Model – Internal Financial Controls.

- 4.4.2 The Better Practice Model (BPM) has been agreed and adopted by peak local government financial management and auditing bodies as the

framework by which all local councils in South Australia self-assess risk management areas of their business and establish measures to mitigate this risk.

- 4.5 In addition to the BPM, the LGA has published revised Financial Sustainability Information Papers (FSIP) as part of its ongoing Financial Sustainability Program (FSP) with the aim of harmonising high-level policy positions for Council administration adoption and use.
- 4.6 The Information Papers are not statutory measures however they are considered best practice for Council administrations to commit to.
- 4.7 This Internal Financial Control Framework references and makes use of;
 - 4.7.1 *LGA FSIP No. 21 – Internal Financial Controls* and;
 - 4.7.2 *LGA FSIP No. 18 – Financial Policies and Procedures*.
- 4.8 Other numerous legislative frameworks and Acts relating to specific areas of Council services are subsequently dealt with through Policy and Protocols directly relating to those areas of operations.

5 Interpretation

5.1 For the purpose of this policy:

- 5.1.1 “Council” means the City of Burnside Council.
- 5.1.2 “BPM” means the internal control and risk management framework that local government bodies in South Australia use to assess, mitigate against and apply measures to minimise risk when undertaking all financial transactions. This is commonly known as the *Better Practice Model – Internal Financial Controls*.
- 5.1.3 “Framework” means a layered structure that underpins and informs the financial reporting policies and procedures for Council.
- 5.1.4 “External Auditor” means the professional auditing or advisory firm currently contracted to perform the annual audit of Council’s financial statements and offer an opinion of the effectiveness of Council’s internal controls.
- 5.1.5 “LGA” means the Local Government Association as the peak body in South Australia for local government established under the *Local Government Act (1999)*.
- 5.1.6 “Inherent Risk” means the risk associated with an activity in its purest form prior to an assessment of internal controls that could be applied to the activity to reduce that risk.
- 5.1.7 “Target Risk” means the level of risk acceptable to Council for performing a particular activity.

- 5.1.8 “Residual Risk” represents the net risk position after control processes have been applied to inherent risks for the activity. Residual risk should be above target risk after the implementation of internal controls has been applied to the activity.
- 5.1.9 “Legislation” means all relevant State and Commonwealth legislation and Council By-Laws.

6 Internal Financial Controls & Risk Management

- 6.1 This framework provides guidance to Council implementing, complying with and monitoring its adherence to effective internal financial controls systems and procedures.
- 6.2 It also guides both Council and its administration in how to apply internal financial controls to operational areas of the business and provide a clear understanding of those controls to the context of the framework, policies and procedures.
- 6.3 The LGA has developed guidelines which address internal financial controls – Financial Sustainability Information Papers, specific to local government administrations and the operational risks they face.
- 6.4 (FSIP’s provide clear guidance to Council and its administrations of the statutory requirements and the best practice for mitigating risks when undertaking financial processes and transactions.
- 6.5 In particular *FSIP No. 21 – Internal Financial Controls* and *FSIP No 18 – Financial Policies and Procedures* are clear in their descriptions of how to formulate both a controls framework and policies.

Definition

- 6.6 FSIP No. 21 – Internal Financial Controls defines for Council;
- 6.6.1 internal financial control as “a risk management framework that manages the risk to the organisation from error or fraud and therefore assists in the achievement of a Council’s objectives”.
- 6.6.2 it is instrumental in allocating scarce resources to those areas where Council sees fit in order to undertake its duties to the community in a transparent manner.
- 6.7 Internal financial control will not remove all risks associated with financial processes and transactions, but is a means of managing risk and mitigating the risk by reducing the likelihood and consequences of adverse events.

Fundamental Elements

- 6.8 *FSIP No 21 – Internal Financial Controls* outlines the fundamental elements of a sound financial control framework as possessing;

- 6.8.1 adequate separation of duties in the financial operations;
 - 6.8.2 independent checks of changes to key master data files;
 - 6.8.3 reconciliation of the bank account balance to the amount showing in general ledger bank account) which are independently reviewed; and
 - 6.8.4 documentation and distribution of policies and procedures for all major activities.
- 6.9 Segregation of duties means the disaggregation of processes (either manual or system generated) across multiple officers in order to reduce the risk of fraud or error.
- 6.9.1 It is a paradigm designed to ensure that no individual or system is solely responsible for processes, that otherwise may lead to adverse outcomes for Council and its administration. This may include restricting access to certain levels of authority for specific information held by Council.
 - 6.9.2 Leading on from this concept, independent checks to key master data files means ensuring data and information captured and stored by Council is maintained with integrity and completing back-ups of system generated information on a regular basis.
 - 6.9.3 Regular key reconciliations of financial information are detective controls designed to ensure financial transactions processing is being completed as originally intended.
 - 6.9.4 In line with the segregation of duties paradigm, reconciliations are normally performed by individuals or systems not directly responsible for the financial information undergoing the integrity reconciliation.
 - 6.9.5 Policy and procedure distribution is key to having those officers adopt common and known risk management instructions across the appropriate areas of Council administration and Council's elected members.

Statutory Controls Adoption – Better Practice Model

- 6.10 The Regulations prescribe an internal controls framework customised for Council adoption and use. This has been developed and endorsed by peak local government finance and audit management bodies in conjunction with private sector risk management experts.
- 6.11 The Better Practice Model – Internal Financial Controls framework is a risk management tool that assists Council and its administration assess, mitigate against and employ processes to reduce risk in its day-to-day operations.

6.12 The model is underpinned by the “Three Lines of Defence” – functions that own and manage risk, functions that oversee risk (e.g. control self-assessment) and independent assurance (e.g. internal audit).

6.13 A diagram depicting the relationship between these planks and their relationship with local government peak bodies (LGA) and external auditors is provided below.



Responsibility for Control Environment

- 6.14 Council is statutorily responsible for maintaining financial controls aimed at preventing fraud and minimising the likelihood of error or misstatement.
- 6.15 As part of the delegated powers passed to the Council administration, the Chief Executive plays a key role in establishing and developing an effective internal control environment, through delegating functional control duties to management.
- 6.16 Administrative management is primarily responsible for overseeing and mitigating organisational risks on a day-to-day basis. Practically this means identifying risks, establishing and adhering to policies and procedures and undertaking control self- assessment in establishing the procedural framework by which all business operations will be transacted within.
- 6.17 The final line of defence specifically calls for internal audit function to perform objective tests on the performance and effectiveness of the first two lines.
- 6.18 Further advice and assurance may be sought from the current external auditor and peak body if required, particularly leading up to and within the annual external audit engagement period.

7 Other Internal Financial Control Frameworks

National Risk Management Frameworks

- 7.1 Local Government peak body risk management frameworks such as the BPM and State Government financial management compliance programs, like the FMCP have been compiled and framed with reference to international standards.
- 7.2 The International Organisation for Standards (ISO) is an independent, non- governmental membership organisation and the world's largest developer of voluntary international standards, with over 160 member countries of which Australia is a member.
- 7.3 ISO has developed a risk management standard (ISO 31000:2009) applicable to all entity types with the intention of providing a self-assessment framework for evaluating, monitoring and mitigating risk via the implementation of internal controls.
- 7.4 This international framework explicitly underpins the internal controls that the LGA have adopted through the BPM, reinforced by FSIP 18 and 21 previously discussed.

- 7.5 The adoption of the risk assessment methodology prescribed in ISO 31000 Risk Management Standard within the BPM underpins the formulation of the internal controls for Council administrations.
- 7.6 This methodology, underpinned by the risk assessment matrix below, assists Council mitigate risk by implementing processes with particular emphasis on:
 - 7.6.1 Identifying the key risks facing the organisation
 - 7.6.2 Assessing whether the associated current internal controls are effective
 - 7.6.3 Identifying where further controls may be required
- 7.7 The aim of the risk identification process is to consider all financial events which might affect the achievement of the Council's objectives and operations.
- 7.8 Identified risks are analysed for how likely the risk event is to occur (likelihood) and the possible magnitude (consequence) of the risk event. From this analysis, the level of inherent risk can be determined.
- 7.9 Inherent risk represents the level of risk associated with the particular issue without considering any controls that might already be in place.
- 7.10 By establishing inherent risk levels for an activity, residual risk after controls have been successfully implemented and assessed for their effectiveness can be monitored as being acceptable, in meeting target risk levels, or requiring further attention.
- 7.11 Council refers to the Risk Management Framework to determine consequence and likelihood.
- 7.12 The next step is to identify the control activities in place and evaluate the effectiveness of these controls.
- 7.13 A Control Self-Assessment (CSA) program provides the core method of monitoring the ongoing effectiveness of internal control activities.
- 7.14 The aim of the CSA program is to provide a reasonable level of assurance to Council that control activities are operating effectively.
- 7.15 A risk-based methodology is used to determine the control activities to be included in the CSA program.
- 7.16 The effectiveness of control activities are rated on a scale from 1 (ineffective) to 5 (effective). Action plans will be developed for control activities with an effectiveness rating of 3 or below to address the deficiency.

Essential Control Types

- 7.17 As part of the continual process of implementing, undertaking and reviewing the effectiveness of internal controls, management will establish controls categorised as directive, preventative or detective in nature.
- 7.18 Directive controls are prescriptive in nature and are designed to set a qualitative or quantitative standard by which Council's operations will be undertaken and regularly assessed against.
- 7.18.1 Examples of Council directive controls are by-laws, policies and procedures, workplace guidelines, job descriptions and meetings.
- 7.19 Preventative controls are pre-emptive in nature and are designed to prevent errors, irregularities and misstatements. Where practical, Council will impose internal controls that are preventative in nature as a default risk management strategy.
- 7.19.1 Examples of preventative internal controls are segregating duties, secure and hierarchal based access to information systems, physical asset control and security and disposing of confidential information in a secure and prompt manner.
- 7.20 Detective controls are retrospective in nature and are designed to ascertain errors or irregularities after they have occurred. Detective controls also assist management in ascertaining the effectiveness of directive and preventative controls.
- 7.20.1 Examples of detective controls are account reconciliations, physical stocktakes and performance reviews against procedures and guidelines.

8 Application to Policies and Protocols

- 8.1 This framework is the pinnacle document that must be referred to whenever the formulation of Council Policy and Executive Protocols concerning Internal Financial Controls is being undertaken.
- 8.2 It serves to provide guidance to Council's external auditors in how internal controls are derived, assessed for effectiveness and refined according to the demands of Council administration.
- 8.3 In addition, it reinforces and codifies the risk management methodology by which Council's external auditor is statutorily required to assess and form an opinion of the effectiveness of Council's internal controls.

9 Audit Committee

- 9.1 Division 2, Section 126 (Audit Committee) of the Act compels a Council, amongst other requirements, to establish an ongoing Audit Committee.
- 9.2 At Section 126, it outlines the functions of the Audit Committee which includes reviewing the adequacy of the accounting, internal control, reporting and other financial management systems and practices of the Council on a regular basis.
- 9.3 Given these statutory requirements, in consultation with Council's senior finance staff, the audit committee will review and discuss enhancements to Council's internal controls as a standing Agenda item at scheduled Audit Committee meetings.

10 Availability

- 10.1 The Framework is available to be downloaded, free of charge, from Council's website www.burnside.sa.gov.au
- 10.2 The Framework will be available for inspection without charge at the Civic Centre during ordinary business hours and a copy may be purchased at a fee as set annually by Council.

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