

Keywords: *internal control, financial risk*

Corporate Plan:	<i>Corporate Services: Financial Management</i>
Classification:	<i>Executive Services – Financial Management</i>
First Issued/Approved:	<i>March 2022</i>
Review Frequency:	<i>Biennially</i>
Last Reviewed:	
Next Review Due:	
Responsible Officer(s):	<i>Manager Corporate Services</i>
Council File Reference:	<i>7.63.1</i>
Applicable Legislation:	<i>Local Government Act 1999 Local Government (Financial Management) Regulations 2011</i>
Relevant Policies:	<i>Privacy Policy</i>
Related Procedures:	<i>Internal Financial Controls Assessment</i>
Delegations:	<i>Chief Executive Officer / Manager Corporate Services and Delegations Register</i>

OVERVIEW

Internal control is one of the foundations of a robust corporate governance framework. The Committee of Sponsoring Organisations (COSO) broadly defines internal control 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 in the following categories:

- Effectiveness and efficiency of operations; and
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.”

Section 125 of the Local Government Act 1999 (“the Act”) requires that:

“a Council must 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 the Council's assets, and to secure (as far as possible) the accuracy and reliability of Council records”. This Framework provides guidance which Council can use alongside their existing risk framework to aid in developing a risk-based approach to the identification and assessment of financial risks and internal controls, and create a strong internal environment focussed on continuous improvement. This will also assist in ensuring compliance with the provisions of the Local Government Act 1999.

It is important to note that while this Framework considers financial risks primarily, the approach should be forming one part of Council's overall risk management and governance framework. Whilst the Framework excludes non-financial risks, consideration should also be given to any financial implications that these risks could have on the entity.

PURPOSE

To outline a framework for an effective internal control system which conveys to supervisory staff that they are responsible for ensuring that internal controls are established, documented, maintained, and adhered to across the council and to all employees that they are responsible for adhering to those internal controls.

To ensure the propriety of transactions, information integrity, compliance with regulations and achievement of Council objectives through operational efficiency; and

That risks relating to the stewardship of public resources are adequately managed to acceptable and practical levels through effective internal controls.

AUDIT OF INTERNAL CONTROLS

Section 129 (1) (b) of the *Local Government Act 1999* ("the Act") requires a Council's external auditor to audit:

'the controls exercised by the council during the relevant financial year in relation to the receipt, expenditure and investment of money,

the acquisition and disposal of property and the incurring of liabilities.'

Under section 129 (3) (b) of the Act they must provide:

'an audit opinion as to whether the controls audited under subsection (1)(b) are sufficient to provide reasonable assurance that the financial transactions of the council have been conducted properly and in accordance with law'.

External auditors should apply ASAE 3000 Standard on Assurance Engagements and ASAE 3150 *Assurance Engagements on Controls* in conducting their audit under section 129 (1) (b) of the Act.

Pursuant to Section 126(4)(c) of the *Local Government Act 1999*, Council's Audit Committee is responsible for reviewing the adequacy of the accounting, internal control, reporting and other financial management systems and practices of the Council on a regular basis. The provision to Council Members of reports by the Audit Committee concerning internal controls is an important part of good practice financial governance.

Auditors should have regard to the application of the risk-based approach applied by Council in performing their testing and forming their opinion under section 129(3) of the Act. The auditor should obtain sufficient appropriate audit evidence pertaining to controls for each risk to determine if the internal financial controls over that risk provide sufficient assurance that the financial transactions of the council have been conducted properly and in accordance with the law.

INTERNAL FINANCIAL CONTROLS

Internal financial control, as a part of Councils broader internal control processes, is designed to assist Council in addressing the risk of fraud and error, improving reliability of financial reporting and compliance with laws, regulations, and policies. It focuses on Councils financial processes and functions that deal with, but are not limited to, budgeting, financial reporting, transaction processing, financial delegations, and treasury management.

- Internal financial control will be instrumental in:
- Safeguarding Council assets
- Ensuring reliability of both financial and non-financial reporting
- Complying with legislation and Council policies
- Promoting the effectiveness and operational efficiency of Council and compliance with Council's Strategic Plan
- Risks are identified, assessed, and mitigated where possible.

Internal control will not remove all financial risk but is a means of managing risk and reducing the likelihood and consequence of adverse events. A sound system of internal financial control is essential for a council to ensure that its resources are allocated in the most appropriate manner, operational and financial objectives are being met and to facilitate compliance with the accountability provisions of the *Local Government Act 1999*.

THREE LINES OF DEFENCE

Councils internal control environment typically includes the following components:

- Structure of the organisation
- Culture of the organisation
- Knowledge, skills, and experience of employees
- Processes employed by the organisation to conduct business

Management is primarily responsible for managing organisational risks on a day-to-day basis and thereby forms the **first line** of defence for Council. Management achieves this by establishing an appropriate internal control environment including the relevant internal financial controls addressing the underlying financial accounting assertions.

The **second line** of defence is composed of the corporate functions that establish the policies and procedures which govern organisational activities and processes. This is established through monitoring activities such as self-assessment of the adequacy of internal controls on an aggregated level which establishes the boundaries and expected standards by which the business operates.

Finally, the **third line** of defence consists of internal audit which is charged with the responsibility to perform an objective assessment on the performance of control activities and business processes. An internal audit function is not a mandatory requirement for Council, however the absence of such a function may increase the consequence of control failure.



Additionally, Council's Audit Committee, external auditor and the Local Government Act 1999 and Regulations play an important part in framing the Councils governance and internal control environment.

Legislation and regulation set the framework for the governance and internal control environment by establishing requirements designed to improve the environment as it is developed. The Audit Committee and external auditors are also able to provide independent and objective feedback and assessment of the internal controls in relation to the financial reporting processes of Council as they relate to the three lines of defence.

INTERNAL FINANCIAL CONTROL ENVIRONMENT

Council should establish an internal financial control environment. This should be based on the following steps, and incorporate a suite of internal controls, policies and procedures that create a framework for a robust and strong environment within the organisation.

1. Identification of Financial Risks
2. Assessment of Inherent Risk (the level of risk associated with the issue before the implementation of related controls)
3. Evaluation of Control Activities
4. Assessment of Residual Risk (risk that remains with Council over a particular issue after controls have been implemented and assessed for their effectiveness)
5. Address Residual Risks and Control Activities
6. Ongoing Monitoring of Internal Financial Controls.

The above approach is detailed further in 1.7 of the 'Better Practice Model – Internal Financial Controls' prepared by the South Australian Local Government Financial Management Group Inc. (SALGFMG) available on the following link:

[Better Practice Model-Internal Financial Controls](#)

The steps above should be performed on a regular basis, with steps 1 to 5 performed at least annually, noting steps 1 and 2 need only be considered at a high level to identify if there have been any changes within Council or to Council's external environment (e.g., new legislation) that would result in new or revised financial risks or a change in the assessment of inherent risk associated with a financial risk. Council's internal control framework should be designed as a living process aimed at embedding a culture of continuous improvement within the Council. This is achieved by performing regular assessments of risk and identification of areas that are deficient or where improvement may be possible and implementing processes and controls that address these areas.

Council maintains internal control procedures relating to the following business activities:

Accounts Payable	Accrued Expenses	Banking
Borrowings	Budgets	Contracting
Credit Cards	Debtors	Elected Members
Employee Provisions	Employee Reimbursements	Fee for Service
Fixed Assets	General Ledger	Grant Funding
Inventory	Investments	Loans/Grants to Clubs etc.
Management Reporting	Other Expenses	Other Revenue
Payroll	Petty Cash	Prepayments
Project Costing	Purchasing & Procurement	Rates
Recepting	Statutory Reporting	Taxation

Controls can be divided into 3 categories:

- Preventative – processes put in place to avoid undesirable events from occurring.
- Detective – processes put in place to detect and subsequently correct undesirable events that have already occurred.
- Directive – processes put in place to encourage a desirable event to occur.

The following steps are carried out to develop and maintain adequate internal financial controls:

- Examine current procedures relating to the above business activities of Council
- Identify key risks threatening the achievement of Council's objectives
- Identify existing internal financial controls
- Assess current controls for effectiveness
- Identify any new controls needed as well as existing controls requiring adjustment
- Identify relevant officer for each internal control

To maintain confidence in the internal financial controls a regular spot check on key controls is undertaken. As well as spot checking, a full review is carried out on an annual basis. The outcome of each review is then reported to the Audit Committee of Council.

A manual of internal control procedures has been established and is maintained and read in conjunction with this policy.

RISK BASED APPROACH

Given Council's limited resources, it is important to focus on the key financial risks and controls. Council should design and implement internal financial control activities and monitoring systems that prioritise extreme and high financial risks as identified by the Council's risk tolerance framework.

This can be achieved by applying a risk-based approach to the Risk and Control Assessment Process documented at 1.7. of the 'Better Practice Model – Internal Financial Controls'

By applying a risk-based framework, councils should document and assess the internal financial controls that relate to a particular financial risk to the extent that they mitigate that risk to an acceptable level.

Council should apply judgment as to the quantum of controls to document in relation to each financial risk. Council must satisfy itself that, in aggregate, the controls as documented and assessed are sufficient to provide comfort that the financial risk is being managed at an acceptable level. The controls implemented will depend on the inherent risk assessment, the residual risk given controls already in place and the risk tolerance of the organisation. If Councils can demonstrate through their self-assessment that controls in place reduce a particular financial risk to a low level it is not considered necessary to document further controls in relation to that risk.

The Council's internal control structure comprises three elements: the financial accounting system; control procedures; and the control environment. It is important to note that while all these elements are applicable to Councils of all sizes, the degree of formality and the specifics of how the components are implemented may vary considerably for practical and sound reasons and highlights the inherent weaknesses and limitations of internal control. As stated in the COSO Integrated Framework,

"An internal control system, no matter how well conceived and operated, can provide only reasonable--not absolute--assurance to management and the board regarding achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people, and management could override the system. Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs."

Council should also consider liaising with their internal and external auditors as part of this process to validate that the internal financial controls implemented are sufficient to mitigate the risks.

RISK AND CONTROL ASSESSMENT PROCESS

The risk management methodology outlined below has been adapted from the Australia / New Zealand Standard on Risk Management (AS/NZS ISO 31000:2009) ("the Standard") to provide a structured approach for councils. This methodology will assist in Council's risk management processes with particular emphasis on the following:

- Identifying the key financial risks facing the organisation
- Assessing whether the associated internal controls are effective
- Identifying where further controls may be required.

This Framework incorporating of the 'Better Practice Model – Internal Financial Controls' focuses on the risks specifically of a financial nature, with control assessment worksheets provided to further assist in the application of the risk management methodology. The key financial risks identified have been grouped under relevant risk category and business processes. These risks are a guide only, with the identification of the actual risks relevant for each council being a fundamental component of the risk management practices of each council.

For each risk the Framework identifies the possible control measures that are typically in place to mitigate the risks identified, however it is important to note that no control is considered mandatory for Council but are provided as guidance on the likely controls that exist or could be implemented to mitigate a particular risk. Councils should tailor the appropriate controls to reflect their individual circumstances to demonstrate the existence of a set of relevant controls to ensure that inherent financial risk is mitigated through the application of those controls to an acceptable level of residual risk, and to meet the requirements of the *Local Government Act 1999* and Regulations.

If the residual financial risk is at an acceptable level then there is no need to implement further internal controls, and there may be an opportunity to reduce the controls in place and focus resources to areas where the residual risk requires further mitigation. Should the residual financial risk not be at an acceptable level, then the council should review the controls identified in the Framework as a starting point to identify further controls for implementation. The purpose is to reduce the residual risk to an acceptable level, noting that this may form part of the control assessment action plan.

To ensure accountability each control needs to be assigned to an assessing officer and reviewing officer. Typically, the assessing officer is the person performing the task or function (e.g., Financial Accountant) and the reviewing officer the person reviewing completion of the task or function (e.g., Financial Accountant's Line Manager).

Management should apply the following methodology when performing their assessment of financial risk and internal controls.

Step 1: Identify Risks

The first step is to identify the key financial risks facing Council. The aim of the risk identification process is to consider all finance-related risks which might affect the achievement of the Council's objectives and operations. Comprehensive identification of risks is important because a potential risk not identified at this stage may not be included in further analysis.

The control assessment worksheets included within this Framework provide details of the activities and financial risks that are expected to apply to all councils. These should be used as a starting point for the identification of financial risks but are not intended to be an exhaustive list. Council should include additional risks if they are considered relevant to their activities.

Step 2: Assess Inherent Risk

Once the key financial risks have been identified they are analysed in terms of 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. The inherent risk represents the level of risk associated

with the issue before the implementation of related controls. That is, Council should not consider any of the controls that are in place in their assessment of inherent risk.

Council should refer to their own risk assessment matrix when assessing inherent risk to arrive at a rating based on the likelihood and consequence of the financial risk occurring. An example risk matrix detailing the suggested parameters for quantification of likelihood and consequence as provided in the Standard is provided below, with further details of the parameters for likelihood and consequence included in Appendix A.

Consequence Likelihood		Insignificant	Minor	Moderate	Major	Catastrophic
		1	2	3	4	5
Almost Certain	E	Moderate	High	High	Extreme	Extreme
Likely	D	Low	Moderate	High	Extreme	Extreme
Possible	C	Low	Low	Moderate	High	Extreme
Unlikely	B	Low	Low	Low	Moderate	High
Rare	A	Low	Low	Low	Moderate	High

Step 3: Evaluate Control Activities

The next step is to identify and document the control activities in place and evaluate the appropriateness, design, and effectiveness of these controls on a scale from 1 – 5. A suggested control effectiveness rating scale is provided below. An effectiveness rating should be provided by both the assessing officer (typically the person performing the function) and the reviewing officer (typically the person reviewing completion of that task or function such as the line manager), along with commentary as to the basis for the assessment on that rating.

The worksheets contained in this document detail suggested core and additional controls that relate to each risk. The controls are classified as core and additional with the intention being that the suggested core controls are likely to be more important or critical. The worksheets may be amended to reflect the Council's unique operating environment. This may be achieved by modifying, removing, or including alternative controls.

It should be emphasised that the suggested 'core' controls are not intended to depict a minimum list of controls required but may provide a suitable reference point for considering the appropriate internal financial controls for Council.

Ultimately Council should aim to implement relevant control activities which result in an acceptable level of residual financial risk.

ELEMENTS OF AN INTERNAL CONTROL FRAMEWORK

Internal control systems vary depending on the organisation operating environment, such as size and nature, type of operation, level of autonomy or other practical implications.

The essential elements of an effective internal control framework are:

- Structure of Council
- Delegation of Authority
- Policies and procedures
- Risk identification and assessment
- Information Technology system controls
- Culture and organisation behaviours

- Management compliance assurance
- Trained and properly qualified staff
- Regular and effective review of process e.g., internal audit
- Liaison with auditors and legal advisors

LIMITATIONS OF INTERNAL CONTROL

A sound system of internal control will provide a high degree of confidence that Council operations are effectively managed, and all resources are properly deployed.

However, there are limits to the level of certainty.

Limitations include:

- controls are designed for routine transactions – abnormal or non-routine transactions may bypass control mechanisms
- the internal control system is operated by people, so there is potential for human error with mistakes because of lack of attention, carelessness, improper judgement, lack of knowledge or misunderstanding of instructions
- people may act together in collusion to undermine the system of internal control
- employees may abuse a delegation or responsibility to override the internal control system
- the cost of implementing some controls may be greater than the benefit over time
- internal controls may become ineffective because of changes to procedures or practices

PURPOSE OF SYSTEM CONTROLS

The Information system comprises all the records and reporting methods of Council used to maintain accountability for assets, liabilities, revenue and expenses and for the achievement of the objectives of Council. The processing system with control procedures including policies, delegated authority levels, system procedures and practices has been established to achieve the objectives of this policy.

The use of technology with automated controls adds considerable strength to the internal control framework.

System controls include:

- Document controls
- Reconciliations and verifications
- Physical access controls
- Protection of assets
- Financial accounting procedures
- Information technology controls
- Budgeting and reporting
- Management controls

REVIEW OF THE INTERNAL CONTROLS FRAMEWORK

An ongoing program of review should be implemented to monitor and identify any changes in the level of type of risk exposure. A risk review should also be undertaken in response to a process or system change.

The aim of a review is to:

- Assess reliability and integrity of system information
- Ensure that system procedures comply with policies, standards, laws and regulations
- Evaluate system compliance to written procedures and work practices

- Determine overall effectiveness
- Identify issues
- Plan & implement changes

Major task of a review program is to:

- identify key issues
- assess whether associated controls are effective
- determine whether additional or different controls are needed

The assessment of risks should consider aspects of internal control including:

- relevant principles
- recommended practices
- key issues
- options for improvement

The Executive Leadership Team is to be informed of the outcome of each review and updated regularly on progress with action plans identified during the reviews.

The Audit Committee is to be updated regularly on progress with action plans identified during the reviews.

IMPLEMENTATION

An initial full review of system processes should be undertaken. A review should not be an audit of past transactions. Its objective is to identify, evaluate and document existing internal financial controls and recommend changes and/or new internal controls where necessary.

Purpose of a review:

- examine current procedures
- identify key risks
- identify existing internal financial controls
- assess current controls for effectiveness
- identify any new controls needed as well as existing controls requiring adjustment
- identify relevant officers for each internal control

Number:	Identification number of internal controls for each risk
Description of Control:	Description of the internal financial control
Current Situation:	Current situation regarding each internal control
Target Date:	Target date allocated to the implementation of the control
Responsible Officer:	Responsible officer for each internal control
Checking Officer:	Checking officer and/or if the internal control is included in the "Spot Check" process (refer below in the Review Process)

For each risk identified an assessment of its likelihood and consequence should be undertaken according to the classifications included in the Risk Management Policy.

To maintain confidence in the internal controls, regular spot checks on key or "core" controls should be conducted. These controls can be removed, or new controls added at any time. If spot checks are undertaken regularly the timing for a full review may be extended.

An employee will be responsible for specific tasks to certify on a regular basis that the internal controls relating to a particular procedure are in place and are being observed.

If new systems are introduced, or when employees change, it is essential that any internal controls that relate to that position are reviewed within the context of the new system, and/or with new employees.

FINANCIAL SYSTEMS

Financial internal controls are critical to effective risk management of a Council's operations and promote the achievement of its goals and objectives.

As a first step towards developing a complete risk management and corporate governance framework the financial component of internal controls is being addressed.

An initial full review has been completed to identify and document the internal controls that will be managed. Examples of the types of activities addressed are accounts payable, payroll, banking and contracting.

The internal financial controls will be reviewed at least every twelve months to ensure all controls are current and appropriate.

REPORTING

Directors, Managers and Supervisors are responsible for the monitoring and review of procedures to be integrated into operational activities, using relevant checklists to undertake a planned review or in response to identification of a risk.

Any proposed changes need to be referred to the relevant Director / Manager for assessment and implementation planning, taking into consideration the need for consultation and the level of impact across the entire council operations.

A Control Assessment worksheet will need to be completed and all related documents should be retained on file.

FURTHER INFORMATION

This policy will be available for inspection at the Council offices listed below during ordinary business hours and available to be downloaded, free of charge, from Council's internet site:

www.berribarmera.sa.gov.au

Copies will be provided to interested parties upon request, and upon payment of a fee in accordance with Council's Schedule of Fees and Charges.

Council will where practical apply the principles outlined in this Internal Control Policy and the processes in accordance with the 'Better Practice Model – Internal Financial Controls' prepared by the South Australian Local Government Financial Management Group Inc. (SALGFMG) available on the following link:

[Better Practice Model-Internal Financial Controls](#)

Internal financial control is designed to assist the organisation in addressing risk of fraud and error and improving reliability of financial reporting and compliance with laws, regulations, and policies. It focuses on Council's financial processes and functions that deal with budgeting, financial reporting, transaction processing, financial delegations, treasury management, infrastructure management etc.

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