

Internal Financial Control Framework Policy

Strategic Reference	Provide leadership, good governance, and efficient, effective and responsive Council services
File Reference	
Responsibility	Manager Finance, Procurement and Infrastructure
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Next Review Date	May 2021
Relevant Legislation	Local Government Act 1999 Local Government (Financial Management) Regulations (2011) (the Regulations) Public Finance and Audit Act 1987
Related Policies	Fraud & Corruption Prevention Policy Risk Management Policy
Related Procedures / Documents	Local Government Authority (LGA) Financial Sustainability Information Paper No.18 – Financial Policies and Procedures LGA Financial Sustainability Information Paper No. 21 – Internal Financial Controls Department of Treasury and Finance (State) – Financial Management Compliance Program (FMCP) Better Practice Model – Internal Financial Controls for South Australian Councils LGA Circular 27.5 July 2017

1. Introduction

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

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- 1.3. This includes, but is 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. Legislative Requirements and Corporate Policy Context

- 2.1. The framework operates as a direct consequence of the provisions of Section 125 (Internal Control Policies) of the Act for South Australia.
- 2.2. This commits 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.
- 2.3. 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.
- 2.4. 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 and;
 - 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 2017*.
 - 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.
 - A copy of the BPM is available on the LGA website (www.lga.sa.gov.au) under its *Publications* link.
- 2.5. In addition to the BPM, the LGA has published revised Financial Sustainability Information Papers as part of its ongoing Financial Sustainability Program (FSP) with the aim of harmonising high-level policy positions for council administration adoption and use.
- 2.6. The Information Papers are not statutory measures however they are considered best practice for council administrations to commit to.
- 2.7. This Internal Financial Control Framework references and makes use of;
 - *LGA Financial Sustainability Information Paper No. 21 – Internal Financial Controls* and;
 - *LGA Financial Sustainability Information Paper No. 18 – Financial Policies and Procedures*.
- 2.8. In formulating this framework, reference and instructions found within the Financial Management Compliance Program (FMCP) overseen and managed by the South Australian Department for Treasury and Finance (DTF) have been adopted in forming the context for a comprehensive risk management framework applicable to State public authorities.

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- 2.9. Whilst the FMCP and supporting Treasurer's Instructions (TI's) do not specifically refer to council administrations adhering to that risk management program, applicable TI's do provide guidance in formulating a comprehensive framework covering multi-jurisdictional areas, which Council may find itself operating under from time to time.
- 2.10. Elements of Treasurer's Instructions No. 2 – Financial Management and Treasurer's Instructions No. 28 – Financial Management Compliance Program, as part of DTF's Financial Managers Toolkit, have been referenced to ensure this framework is consistent with other public authorities performing services for the community within the State.
- 2.11. Other numerous legislative frameworks and Acts relating to specific areas of Council services are subsequently dealt with through specific Policies directly relating to those areas of operations.

3. Interpretation

- 3.1. For the purpose of this policy framework:

- 3.1.1. "Council" means the District Council of Yankalilla.
- 3.1.2. "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 2017.
- 3.1.3. "Framework" means a layered structure that underpins and informs the financial reporting policies and procedures for Council.
- 3.1.4. "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.
- 3.1.5. "Legislation" means all relevant State and Federal legislation and Council By-Laws.
- 3.1.6. "LGA" means the Local Government Association, as the peak body in South Australia for local government established under the Local Government Act (1999).
- 3.1.7. "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.
- 3.1.8. "Target Risk" means the level of risk acceptable to Council for performing a particular activity.
- 3.1.9. "Residual Risk" represents the net risk position after control processes have been applied to inherent risks for the activity. Ideally residual risk should be consistent with the above target risk for any particular activity, after the implementation of internal controls have been applied to the activity.

4. Internal Financial Controls & Risk Management Framework

- 4.1. This framework provides guidance to Council implementing, complying with and monitoring its adherence to effective internal financial controls systems and procedures.
- 4.2. 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.
- 4.3. The LGA has developed guidelines which address internal financial controls – Financial Sustainability Papers, specific to local government administrations and the operational risks they face.
- 4.4. Financial Sustainability Papers (FSPs) 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.
- 4.5. In particular FSP No. 21 – Internal Financial Controls and FSP No 18 – Financial Policies and Procedures are clear in their descriptions of how to formulate both a controls framework and policies.

Definition

- 4.6. FSP No. 21 – Internal Financial Controls defines for Council internal financial control;
 - 4.6.1. 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.
 - 4.6.2. 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.
 - 4.6.3. will not remove all risks associated with financial processes and transactions, but is a means of managing risk and reducing the likelihood and consequences of adverse events.

Fundamental Elements

- 4.7. FSP No. 21 – Internal Financial Controls outlines the fundamental elements of a sound financial control framework as possessing;
 - 4.7.1. adequate separation of duties in the financial operations;
 - 4.7.2. independent checks of changes to key master data files;
 - 4.7.3. regular key reconciliations (e.g. reconciliation of physical bank account balances to amounts showing in the general ledger) which are independently reviewed; and
 - 4.7.4. documentation and distribution of policies and procedures for all major activities.
- 4.8. 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.
- 4.9. 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.
- 4.10. Where Council's resourcing levels allow, this principle will be practicably employed to ensure Council assets are safeguarded against adverse events.

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- 4.11. 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.
- 4.12. Regular key reconciliations of financial information are detective controls designed to ensure financial transactions and processing is being completed as they are intended.
- 4.13. In line with the segregation of duties paradigm, key reconciliations safeguarding Council assets are normally performed by individuals or systems not directly responsible for the financial information underpinning the integrity reconciliation.
- 4.14. 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

- 4.15. 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.
- 4.16. The revised Better Practice Model – Internal Financial Controls 2017 framework is the risk management tool that assists a Council and its administration assess, mitigate against and employ processes to reduce risk in its day-to-day operations.
- 4.17. 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).
- 4.18. A diagram depicting the relationship between these planks and their relationship with local government peak bodies (LGA) and external auditors is provided below.

The ‘Three Lines of Defence’ Internal Financial Controls Model



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Responsibility for Control Environment

- 4.19. Council is statutorily responsible for maintaining financial controls aimed at preventing fraud and minimising the likelihood of error or misstatement.
- 4.20. 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.
- 4.21. 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 protocols and undertaking control self-assessment, in establishing the procedural framework by which all business operations will be transacted within.
- 4.22. The final line of defence specifically calls for an internal audit function to perform objective tests on the performance and effectiveness of the first two lines.
- 4.23. 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.

5. Other Internal Financial Control Frameworks

State Government Requirements

- 5.1. The Act (s129) requires Council's external auditor to provide the State Minister responsible for Local Government any financial irregularities or adverse opinions concerning the audit of the completed annual financial statements and the accompanying internal financial controls opinion for a Council.
- 5.2. Certain specific provisions of The Act defines a public authority as;
 - (a) a Minister; or
 - (b) an agency or instrumentality of the Crown; or
 - (c) a council or council subsidiary.
- 5.3. Furthermore, the State's Public Finance and Audit Act (1987) (s32) provides specific powers for the Auditor-General to examine the accounts of a local government council, defined as a publicly funded body, and present the results of the examination to statutory oversight bodies defined in that Act.
- 5.4. The Department of Treasury and Finance (DTF), as part of the State Government's Executive, has developed a standing Financial Management Toolkit as part of its compliance with the State's Public Finance and Audit Act (1987), that is applicable to all public authorities in South Australia.
- 5.5. This framework has been developed to assist government agencies comply with and be responsible for sound financial management, by providing guidance on core financial management controls, procedures, and financial management compliance programs.
- 5.6. Supporting the toolkit are Treasurers Instructions (TI's) that specifically instruct and guide all public authorities in how to develop, implement, document and maintain a robust and transparent financial management compliance program.
- 5.7. A copy of the Financial Management Toolkit and accompanying TI's can be found via www.treasury.sa.gov.au.

National Risk Management Frameworks

- 5.8. Local Government peak body risk management frameworks (the BPM) and State Government financial management compliance programs (FMCP) have been compiled and framed with reference to international standards.
- 5.9. 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.
- 5.10. 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.
- 5.11. This international framework explicitly underpins the internal controls that the LGA have adopted through the BPM, reinforced by FSP 18 and 21 previously discussed above and also the FMCP applicable to all public authorities in the State managed by the DTF.

Design of Council's Internal Controls

- 5.12. Council's adoption of the risk assessment methodology prescribed in ISO 31000:2009 Risk Management Standard within the BPM underpins the formulation of the internal controls.
- 5.13. This methodology, underpinned by the risk assessment matrix below, assists Council mitigate risk by implementing processes with particular emphasis on:
 - Identifying the key risks facing the organisation
 - Assessing whether the associated current internal controls are effective
 - Identifying where further controls may be required
- 5.14. 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.
- 5.15. 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.
- 5.16. Inherent risk represents the level of risk associated with the particular issue without considering any controls that might already be in place.
- 5.17. 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 attentions.
- 5.18. The suggested parameters for the quantifying consequence in an ascending manner, along with identifying likelihood with alpha identifiers outlined in the Standard are included in the risk matrix below.

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ISO 31000:2009 Risk Identification Matrix

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

Monitoring of Controls

- 5.19. The next step is to identify the control activities in place and evaluate the effectiveness of these controls.
- 5.20. A Control Self Assessment (CSA) program provides the core method of monitoring the ongoing effectiveness of internal control activities.
- 5.21. The aim of the CSA program is to provide a reasonable level of assurance to Council that control activities are operating effectively.
- 5.22. A risk-based methodology is used to determine the control activities to be included in the CSA program.
- 5.23. 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

- 5.24. 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.
- 5.25. 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. Examples of Council directive controls are by-laws, policies and procedures, workplace guidelines and job descriptions and meetings.
- 5.26. 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.
- 5.27. 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.
- 5.28. 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.
- 5.29. Examples of detective controls are account reconciliations, physical stocktakes and performance reviews against procedures and guidelines.

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6. Application to Policies and Protocols

- 6.1. 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.
- 6.2. It also 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.
- 6.3. 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.

7. Audit Committee

- 7.1. Division 2 s125 of the Act compels a Council, amongst other requirements, to establish an ongoing Audit Committee.
- 7.2. At s126 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.
- 7.3. 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.

8. Further Information

This policy will be available for inspection at the Council office listed below during ordinary business hours and provided to interested parties as per Council's Fees and Charges Register. Copies are available to be downloaded, free of charge, from Council's internet site: www.yankalilla.sa.gov.au

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9. Grievances

Any grievances in relation to this policy or its application should be forwarded in writing addressed to the Chief Executive Officer of Council.

10. Document History

Council Meeting	Resolution No.	Description
May 19	C	Adoption of Policy