

Why an Integrated Control Framework (ICF) ?

Internal Control Responsibilities and Questions about Controls

February 12, 2003

FMI Risk Management Symposium

Flow of Discussions

- Priority of the Clerk of the Privy Council
- Executive Management's Responsibilities and Reporting Obligations (UK, US, Canada)
- An Internal Control Framework – Why it is Important?
 - Internal Control Policy Framework
 - Control Accountabilities & Responsibilities
 - Control Assessment, Monitoring & Performance
- Questions Deputy Ministers and SFO's Should be Asking about Internal Control

Priority of the Clerk of the Privy Council

- The Clerk of the Privy Council has established performance agreements with Deputy Ministers that include strengthened financial management as a priority for sound governance.
- Strengthened financial management is one of the 5 critical areas currently being discussed with Deputy Ministers by TBS.
- A critical component of strengthened financial management is Appropriate Control, and the Deputy Minister is accountable to Canadians and the Clerk to ensure that an effective Internal Control Framework (ICF) is in place and operating in a sound manner within their sphere of control, based upon agreed upon expectations.

United Kingdom (UK) - Executive Management's Responsibilities and Reporting Obligations

- The 1999 UK Internal Control Combined Code requires that public institutions provide internal control reports to ensure that:
 - a balanced assessment of the significant risks and the effectiveness of the system of internal control in managing those risks is reported to oversight Boards;
 - any significant control failings or weaknesses identified should be include the impact that they have had, could have had, or may have, on the organization and the actions being taken to rectify them; and
 - there be openness of communication by management with the oversight Board on matters relating to risk and control.

United States (US) - Executive Management's Responsibilities and Reporting Obligations

- The US has recently enacted new legislation governing Executive Management's responsibilities and reporting obligations
(see <http://www.torlys.com/index2.html>)
- The US Sarbanes-Oxley Act of 2002 requires Executives to make certifications that:
 - organizational financial statements are not materially misstated;
 - audit committee and audit functions are independent;
 - a code of ethics exists and is in use;
 - material changes are disclosed in a timely manner; and
 - management's assessment of internal controls (IC) via an Internal Control Report stating management's responsibility for establishing and maintaining adequate system of internal controls, and providing an assessment of the effectiveness of IC structures and processes.

Canada - Executive Management's Responsibilities and Reporting Obligations

- On an annual basis, the Deputy Minister (DM) and the Senior Financial Officer (SFO) must acknowledge to Canadians and the Clerk management's responsibility for externally published performance and financial information, and for control processes and systems that produce such information.
- This acknowledgement provides Canadians with assurance that a system of internal controls and processes is in place to support the sound stewardship of parliamentary appropriated resources, in accordance with Acts, regulations, and executive orders.
- In this regard, the DM and SFO need to regularly undertake an assessment of their internal control systems and processes to be able to provide such assurances, meet expectations, and report thereupon.

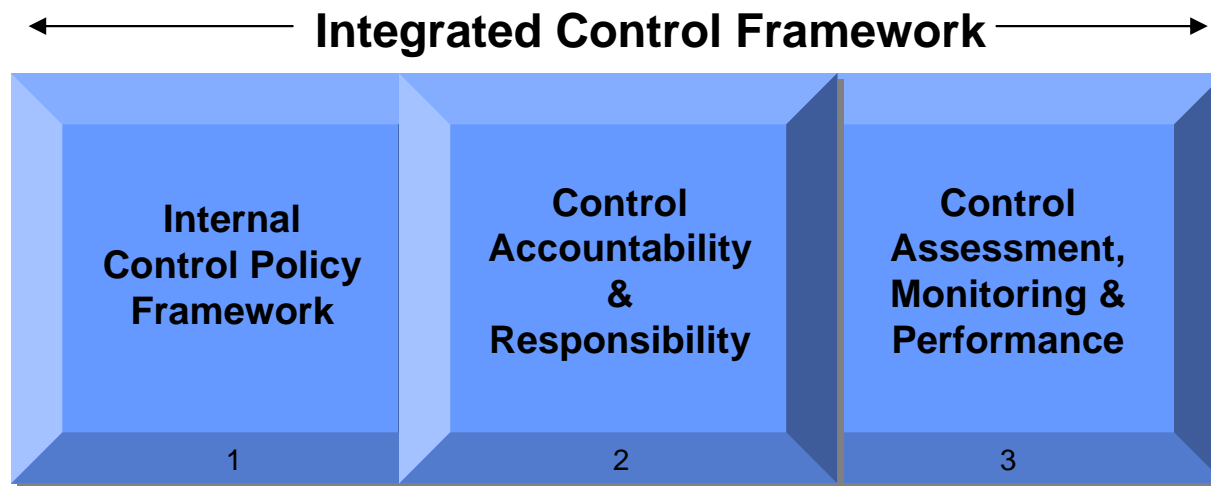
Integrated Control Framework – Why it is Important?

- An ICF is a system of effective internal controls. It is a critical component of organizational management and the foundation for secure and sound operations [1].
- A system of durable internal controls supports the achievement of organizational goals and objectives, long-term results targets, and the maintenance of reliable performance and managerial information.
- An ICF also supports organizational compliance with laws and regulations as well as policies, plans, internal rules and procedures, and decreases the risk of unexpected losses or damage to the organization's reputation.

•[1] The design of the ICF was based upon research and best practices as recommended by standard setting bodies - Report of the Independent Review Panel on the Modernization of Comptrollership in the Government of Canada • Criteria on Control (CoCo) Model of the Canadian Institute of Chartered Accountants • Internal Control Standard of the Canada Deposit Insurance Corporation (CDIC) • Framework for Internal Control Systems by the Basile Committee on Banking Supervision • Treasury Board of Canada Secretariat (TBS) Policy on Active Monitoring • TBS Integrated Risk Management Framework • Financial Management Capability Model (FMCM) of the OAG • Standards for Internal Control in the Federal Government - United States General Accounting Office (GAO) - Internal Control • Turnbull Report on the UK Internal Control Combined Code • Sarbanes-Oxley Act of 2002 – United States Congress.

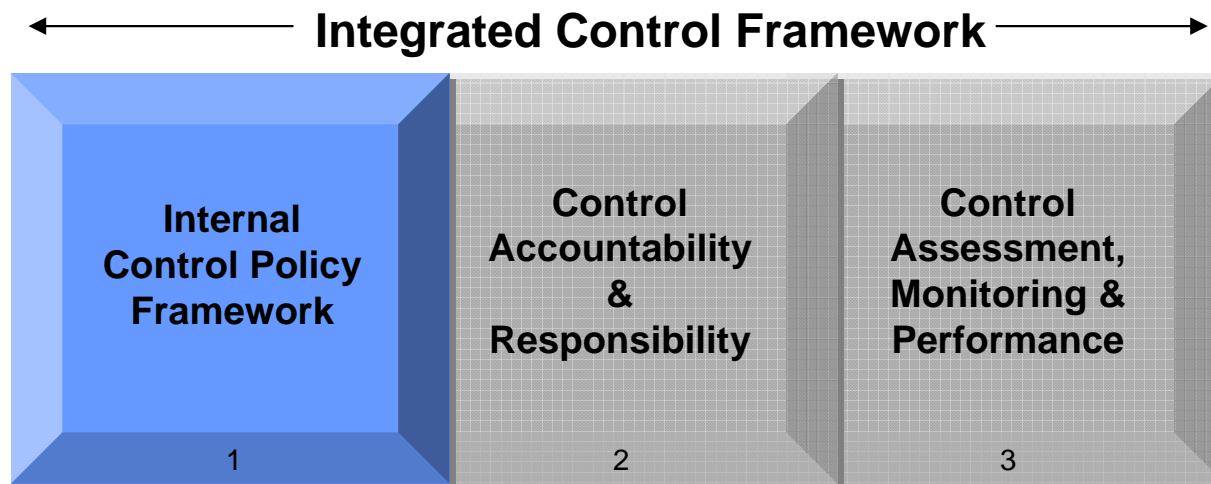
Integrated – The “I” in Integrated Control

- An “Integrated” Control Framework is one that encompasses three key elements, including:



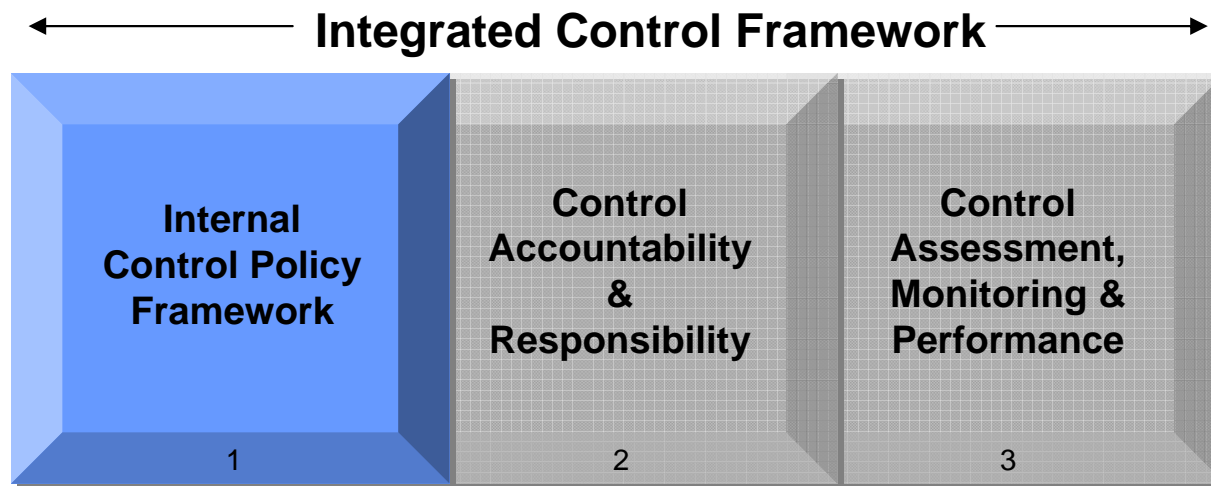
1. Internal Control Policy Framework (ICPF);
2. Control Accountabilities & Responsibilities; and
3. Control Assessment, Monitoring & Performance.

1 - Integrated Control Policy Framework (ICPF)



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- An Internal Control Policy Framework is the foundation of an integrated approach to control within Modern Comptrollership.



- An ICPF reflects all the elements of an organization (including its resources, systems, processes, culture, structure and tasks) that, taken together, support people in the achievement of the organization's objectives.

1 - Integrated Control Policy Framework (ICPF)

- The Control Environment establishes the organizational climate for ensuring that effective controls are developed and implemented to assist management in the achievement of organizational objectives.
- The Control Environment includes four key elements:
 - Strategy and Commitment;
 - Capability;
 - Performance Management; and
 - Active Monitoring.

1 - Integrated Control Policy Framework (ICPF)

- **Strategy and Commitment** refers to:
 - those criteria that provide a sense of the organization's direction, including mission, vision, strategy, risk management, policies, planning and performance targets.
 - commitment sets out the identity and values and provides for senior's management's commitment to achieve objectives.
 - strategy and commitment address ethical values, organizational policies and senior management support for operational activities.
 - thus, executive management is actively concerned with sound corporate governance and understands and diligently discharges its responsibilities by ensuring that the organization is appropriately and effectively guided, managed and controlled.

1 - Integrated Control Policy Framework (ICPF)

- **Capability** refers to:
 - the ability to carry out the necessary business activities competently.
 - capability includes the adequacy of resources (human, technical, physical and financial); responsibility, authority and accountability; and training.
 - thus, executive management plans, allocates resources, actively manages and operates the organization in a sound and prudent manner, and ensures human resources are appropriately skilled and trained.

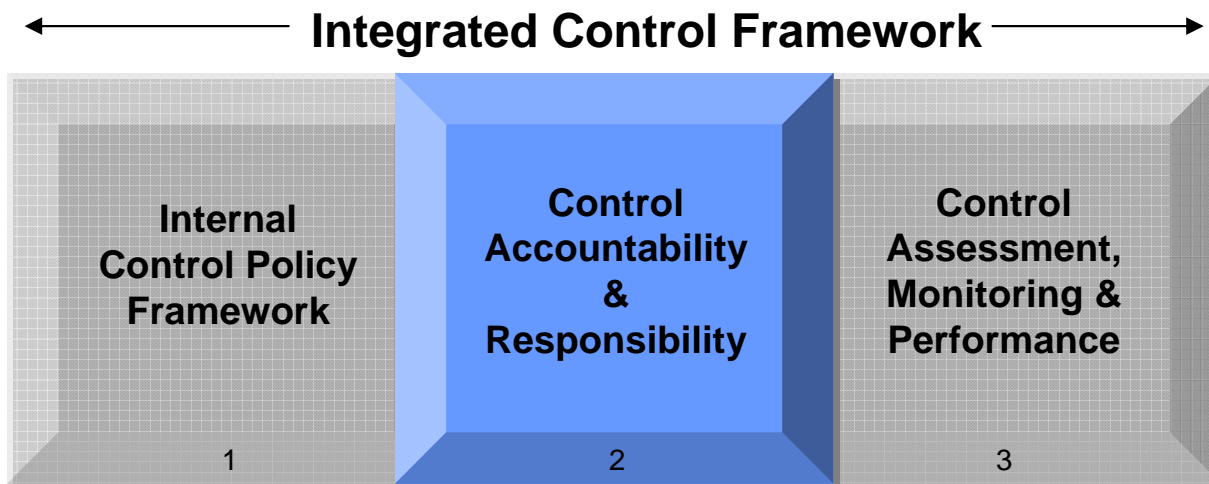
1 - Integrated Control Policy Framework (ICPF)

- **Performance Management** refers to:
 - the ongoing management, measurement and analysis of activities, information, progress, and performance toward goals and objectives.
 - thus, organizational and procedural controls are in place, supported by an effective management information system to measure performance and allow management to pursue any necessary remedial action against risk.

1 - Integrated Control Policy Framework (ICPF)

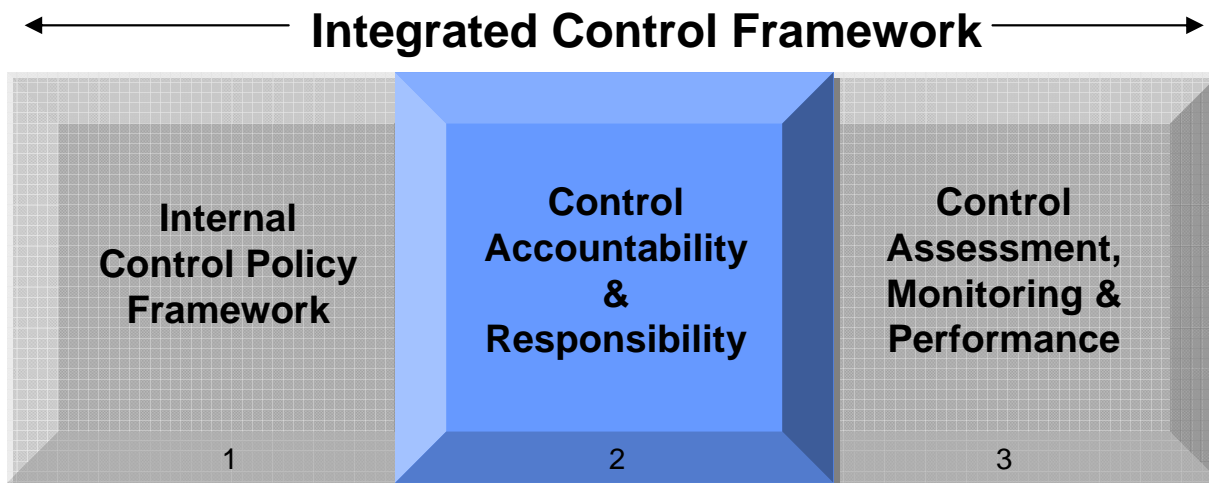
- **Active Monitoring** refers to:
 - the continuous learning, transformation and verification of controls to ensure business activities have been carried out in accordance with established policies and procedures.
 - this would include independent verification (e.g. Internal and External Audit), management reviews and senior management oversight.
 - to answer two fundamental questions:
 - **Did we do it?** and
 - **Can we do it better?**
 - this element thus supports the requirement for “active” monitoring by departments of the effectiveness of organizational and procedural controls.

2 - Control Accountability & Responsibility



2 - Control Accountability & Responsibility

- Control Accountability & Responsibility are critical for an effective internal control system, which sets out the roles, responsibilities, accountabilities and supporting systems of controls for executive management, senior management and all other personnel.



2 - Control Accountability & Responsibility

- Executive management should define the process to be adopted for its review of the effectiveness of internal control.
- This should encompass both the scope and frequency of the reports it reviews during the year, and also the process for its annual assessment, such that it will be provided with sound, appropriately documented, support for its statement on internal control in the organization's Performance Report and Public Accounts.
- A review of the effectiveness of internal control is an essential part of executive management control accountabilities and responsibilities, where:
 - executive management will need to form its own view on effectiveness of controls after due and careful enquiry based on the information and assurances provided to it; and
 - senior management is accountable to the executive for monitoring the system of internal control and for providing assurance that it has done so.

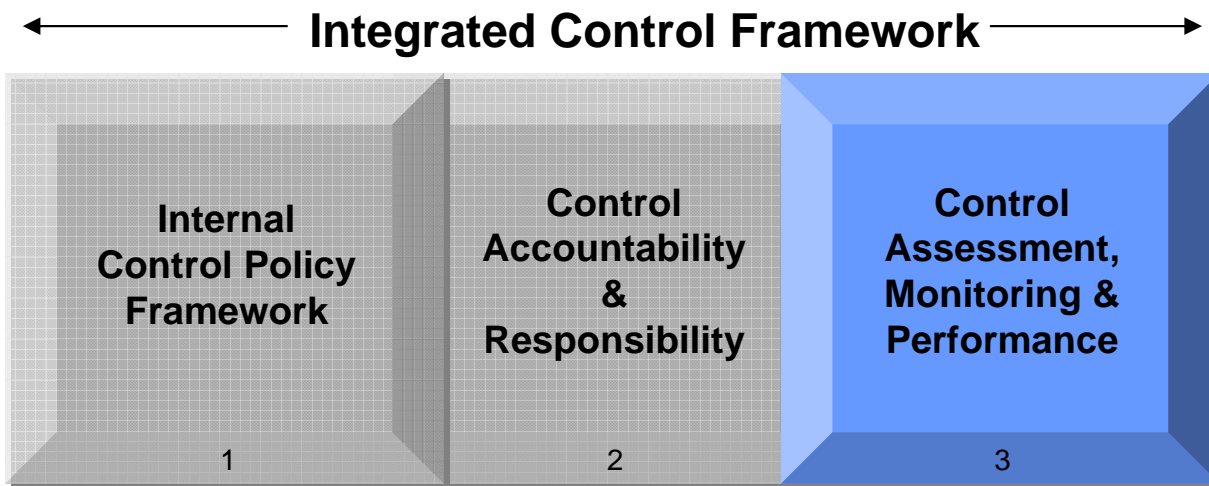
2 - Control Accountability & Responsibility

- **Executive Management** – Accountabilities and Responsibilities:
 - understand the major risks run by the organization, set acceptable levels for these risks and ensure that senior management takes the steps necessary to identify, measure, monitor and control these risks;
 - assess the effectiveness of the related system of internal control in managing the significant risks, having regard to any significant failings or weaknesses in internal control that have been reported;
 - consider whether necessary actions are being taken promptly to remedy any significant failings or weaknesses;
 - consider whether the findings indicate a need for more extensive monitoring of the system of internal control; and
 - ensure effective channels of communication exist to ensure that all personnel fully understand and adhere to policies and procedures affecting their duties and responsibilities, and that other relevant information is reaching the appropriate personnel.

2 - Control Accountability & Responsibility

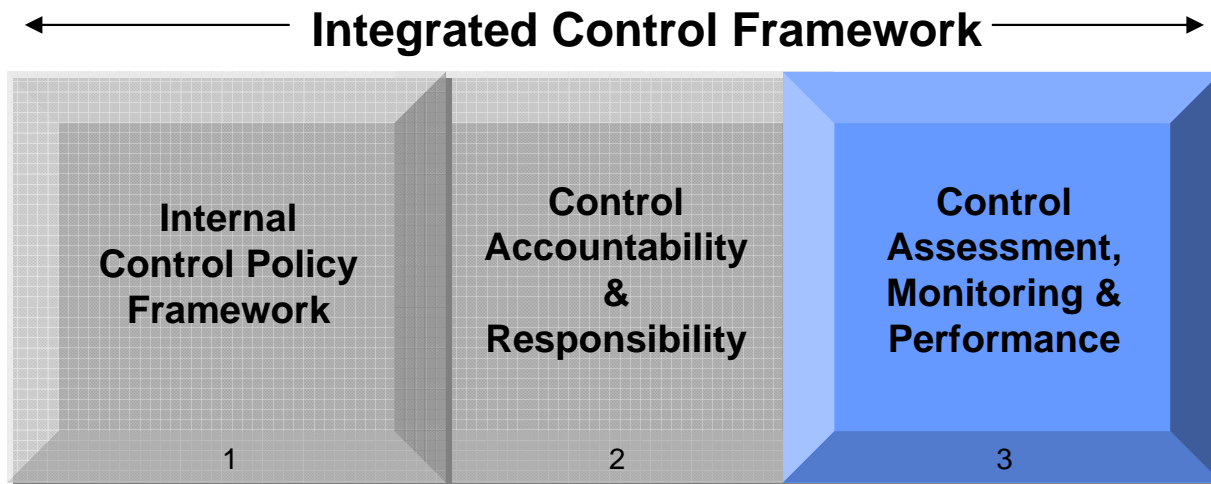
- **Senior Management** – Accountabilities and Responsibilities:
 - ensure that an effective control structure is established, with control activities defined at every Business Line level;
 - ensure that mechanisms are established for: top level reviews; appropriate activity controls for different Business Lines and Directorates; physical controls; checking for compliance with financial management regulations; a system of approvals and authorizations; and, a system of verification and reconciliation;
 - ensure an assessment mechanism is in place to cover all risks facing the organization (including financial risk, operational risk, asset and liability management risk, systems risk; legal risk and reputational risk); and
 - ensure that internal controls are revised to appropriately address any new or previously uncontrolled risks.

3 - Control Assessment, Monitoring & Performance



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- Control assessment, monitoring & performance are required to independently provide the DM and SFO with assurance that a system of internal controls is in place to support the effective and efficient utilization of Appropriated resources.
- Executive management should undertake an annual assessment for the purpose of making its public statement on internal control.



3 - Control Assessment, Monitoring & Performance

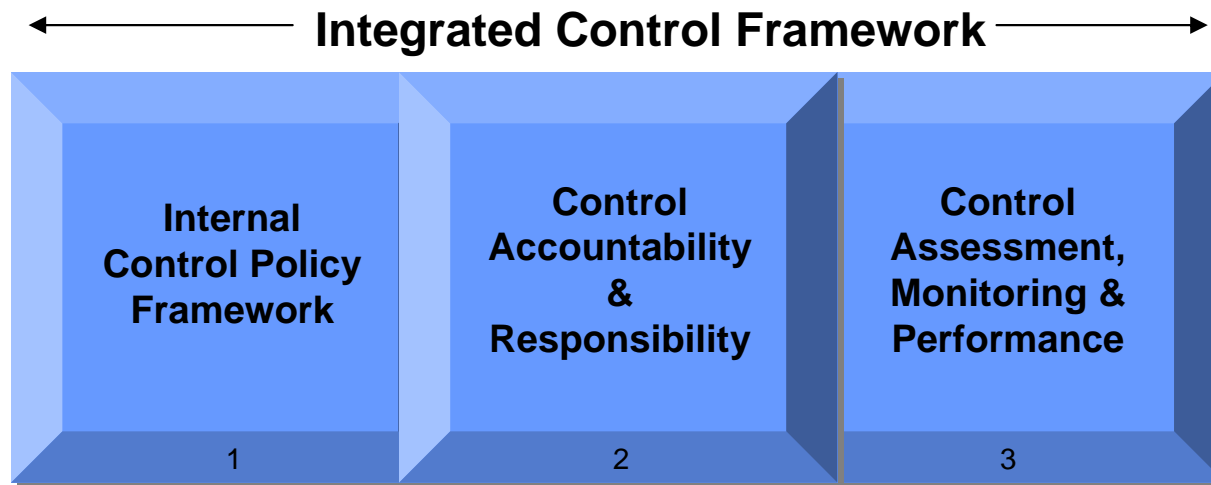
- Control assessment mechanisms need to be designed to answer two fundamental questions about whether a system of internal controls is in place, including:
 - **Did we do it?** and **Can we do it better?**
- To answer the question - *Did we do it?* - addresses the fundamental need to ensure that the department has a system of IC's in place and that in fact the internal controls are being applied in accordance with the standards set out in the ICPF.
- To answer the question – *Can we do it better?* - goes beyond process internal controls and speaks to the effectiveness of the embedded use of Organizational and Procedural controls across the department, within the context of the Control Environment. This question also challenges managers to actively identify areas where controls can be strengthened and broader management issues improved.

3 - Control Assessment, Monitoring & Performance

- The Annual Assessment should consider the following matters:
- the changes since the last annual assessment in the nature and extent of significant risks, and the organization's ability to respond to changes in its business and the external environment;
- the scope and quality of management's ongoing monitoring of risks and of the system of internal control, and the work of the internal audit function and other providers of assurance;
- the extent and frequency of the communication of assessment results to build up a cumulative assessment of the state of control in the organization and the effectiveness with which risk is being managed;
- the incidence of significant control failings or weaknesses that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the organization's financial performance or condition; and
- the effectiveness of the organization's public reporting processes.

Questions DM's Should be Asking about Control

Control Questions



Questions DM's Should be Asking about Control

- Example Questions regarding **the Control Environment**:
 - Does the Executive have clear strategies for dealing with the significant risks that have been identified? Is there a policy to manage these risks?
 - Do the organization's culture, code of conduct, human resource policies and performance reward systems support the business objectives and risk management and internal control system?
 - Are authority, responsibility and accountability defined clearly such that decisions are made and actions taken by the appropriate people?
 - Do people in the organization (and in its providers of outsourced services) have the knowledge, skills and tools to support the achievement of the organization's objectives and to manage effectively risks to their achievement?
 - Are the significant internal & external operational, financial, compliance and other risks identified and assessed on an ongoing basis?
 - How are processes/controls adjusted to reflect new or changing risks, or operational deficiencies?

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