



Review of the “Cost-effective Internal Control Guidelines – Underpinning Agency Performance”

Invitation to Comment

TOPIC PAPER 2 – OVERVIEW OF CONTENTS

Prepared by Queensland Treasury
August 2008

Introduction

Queensland Treasury is publishing this Topic Paper to contribute to the review and update of the guidance document *Cost-effective Internal Control Guidelines: Underpinning Agency Performance* (the Guidelines). With Queensland's public sector financial legislation being rewritten on a principles-based approach, there will be increased reliance on guidance material to assist agencies with applying the new legislation to their individual circumstances.

This Topic Paper focuses on the proposed contents of the revised guidance material, which will be applicable to all departments and statutory bodies.

All interested stakeholders are invited to review the Topic Paper and provide feedback to fmbregistrations@treasury.qld.gov.au by **Monday 15 September 2008**.

All feedback will be reviewed, and incorporated where it is considered to enhance the project and subsequent Guidelines.

Comments are most helpful if they contain a clear rationale and, where applicable, provide an alternative suggestion.

Enquiries about the Topic Papers should be addressed to either:

Ms Lee Clayton
Financial Management Branch
Queensland Treasury
Tel: (07) 322 42922
email:
lee.clayton@treasury.qld.gov.au

Ms Ruth Bergin
Financial Management Branch
Queensland Treasury
Tel: (07) 322 52783
email:
ruth.bergin@treasury.qld.gov.au

Issues

The current Guidelines cover a variety of issues associated with the implementation of cost-effective internal controls, such as general discussions about the objectives of internal controls, elements of internal controls, the control environment, limitations of internal controls and systems appraisals. In addition, appendices contain some of the more common key internal controls that should be appropriate to most agencies of reasonable size and complexity.

The Guidelines currently contain information from the perspective of internal controls already being in place, rather than assisting agencies in the initial development of internal controls.

While it is acknowledged that all Queensland public sector agencies would have internal controls in place, it is important that these are regularly reviewed to ensure they remain appropriate. In addition, if an agency assumes

additional functions, there may be a need to design new systems and controls.

Proposals

It is proposed that the contents of the current Guidelines be restructured to reflect a full life-cycle commencing with outlining the process for designing appropriate controls to mitigate the risks, assuming that no controls are in place (i.e. identifying goals, undertaking risk assessments, designing and implementing controls and regularly assessing the controls).

The Guidelines will also be updated to reflect changes being incorporated into the new draft financial legislation, for example, the new chief finance officer and head of internal audit roles and the new statement of assurance process.

The following broad headings are proposed for the updated Guidelines:

1. Introduction
2. Prescribed requirements
3. Internal controls
4. Governance
5. Designing internal controls
6. Monitoring/assessment
7. Reporting systems
8. Glossary

A more detailed overview of the proposed contents of the revised Guidelines is contained in Attachment A. However, the contents depicted are illustrative only and not intended to be an exhaustive list at this stage.

Invitation to Comment Questions

1. Do you consider that the proposed contents of the Guidelines will be useful to you and your agency?
2. Are there any additional broad topics that you consider should be addressed in an Information Sheet?
3. Do you have any comments about any specific topic included?
4. Please provide other comments, if any, on the issues outlined in this topic paper.

Attachment A

**PROPOSED OUTLINE OF NEW
INTERNAL CONTROL GUIDELINES**
(using format outlined in Topic Paper 1)

- Volume 1 – Introduction
 - **Information Sheet 1/1 – Purpose**
 - support accountable officers and statutory bodies with the implementation and assessment of internal controls within the agency
 - **Information Sheet 1/2 – Scope**
 - primarily targeted towards accountable officers and statutory bodies
 - can also be used by other entities, e.g. GOCs, though need to be aware that some documents/requirements listed may not be applicable
- Volume 2 – Prescribed Requirements
 - **Information Sheet 2/1 – New legislation**
 - principles and objectives of new legislation
 - responsibility for compliance with the new legislation
 - **Information Sheet 2/2 – Entity types**
 - definitions of ‘department’, ‘public service office’, ‘statutory body’, ‘statutory authority’
 - **Information Sheet 2/3 – Exemptions**
 - the Act allows for agencies to apply for exemption from the Standard, either in whole or in part, though this should be rare
 - documentation and assessment of the impact will be necessary
 - an end date or review date will be assigned
- Volume 3 – Objectives of Internal Controls
 - **Information Sheet 3/1 – What are internal controls?**
 - definition and general discussion about internal controls
 - embedded in an agency’s business processes
 - **Information Sheet 3/2 – Purpose of internal controls**
 - provide a reasonable level of assurance over the systems in place
 - designed to mitigate risks
 - promote efficiency, reduce the risk of loss, and help ensure financial statement reliability and compliance with laws and regulations
 - **Information Sheet 3/3 – Who is responsible for internal controls**
 - accountable officers and statutory bodies
 - chief finance officer
 - all agency officers

- **Information Sheet 3/4 – Limitations of controls**
 - e.g. changing objectives/business of agency, poorly designed controls, collusion, human nature, cost-effectiveness (potential loss less than cost of controls), human judgement in decision making, simple errors or mistakes

- **Volume 4 – Governance**
 - **Information Sheet 4/1 – What is governance?**
 - objectives of governance?
 - governance framework
 - where internal controls fit into a governance framework

 - **Information Sheet 4/2 – What is a control environment?**
 - objectives of a control environment
 - control environment framework
 - where a control environment fits into a governance framework

 - **Information Sheet 4/3 – Management responsibilities**
 - ‘tone at the top’, e.g. management behaviour, code of conduct, taking action when breaches occur

 - **Information Sheet 4/4 – Chief finance officer**
 - delegation to a person nominated to take on responsibilities of chief finance officer
 - role to establish and review the financial internal controls
 - legislation only mandates this delegation for departments – statutory bodies are encouraged to consider a similar process where possible
 - guidance on some qualifications and experience factors to be considered when appointing a chief finance officer

 - **Information Sheet 4/5 – Head of internal audit**
 - delegation to a person nominated to take on responsibilities of head of internal audit
 - the head of internal audit should have no executive or managerial powers
 - guidance on minimum qualifications and beneficial experience to be considered when appointing the Head of Internal Audit

 - **Information Sheet 4/6 – Audit committee**
 - legislative requirements
 - role of audit committee in governance and internal control frameworks
 - ability for agencies to share audit committees
 - reference to Audit Committee Guidelines

 - **Information Sheet 4/7 – Risk management committee**
 - may be shared with audit committee, or may be separate
 - ultimate responsibility for risk oversight and risk management remains with the accountable officer/statutory body

- **Information Sheet 4/8 – External audit**
 - role of external audit
 - independent
 - maximising the effectiveness of the combined internal and external audit effort requires close coordination

- **Information Sheet 4/9 – Internal audit**
 - the existence of an effective internal audit function strengthens the control environment
 - legislation only mandates the establishment of an internal audit function for departments – statutory bodies are encouraged to consider the advantages of establishing an internal audit function and the decision to establish should be regularly reviewed
 - shared internal audit functions, internal auditing standards, relationship with external audit

- **Volume 5 – Designing Internal Controls**
 - **Information Sheet 5/1 – Risk identification/assessment**
 - agency needs to determine the required outcomes/objectives, and the risks attached to these
 - controls can only be designed after risks have been identified and assessed
 - risk management should be designed to identify, assess, monitor and manage risk, and identify material changes to the risk profile

 - **Information Sheet 5/2 – Control activities**
 - internal control activities are the policies, procedures, techniques, and mechanisms that help ensure that management’s directives to mitigate risks are carried out.
 - to be effective, must be appropriate, function consistently, and be cost effective, comprehensive, reasonable and directly relate to the control objectives

 - **Information Sheet 5/3 – General controls**
 - general discussion about a number of “general controls” relevant to most systems, e.g. segregation of duties, management supervision, rotation of duties, independent checks

 - **Information Sheet 5/4 – Information technology**
 - two broad groupings of information systems control: general control and application control (are interrelated and both are needed to help ensure complete and accurate information processing)

 - **Information Sheet 5/5 – Revenue systems**
 - include any prescription removed from new Standard
 - consideration points when establishing systems

 - **Information Sheet 5/6 – Expenses systems (excluding payroll and HR)**
 - include any prescription removed from new Standard
 - consideration points when establishing systems
 - corporate card guidelines and leasing – leasing guidelines

- **Information Sheet 5/7 – Payroll and HR systems**
 - include any prescription removed from new Standard
 - consideration points when establishing systems
- **Information Sheet 5/8 – Assets systems (excluding PPE)**
 - include any prescription removed from new Standard
 - consideration points when establishing systems
- **Information Sheet 5/9 – Property, plant and equipment systems**
 - include any prescription removed from new Standard
 - consideration points when establishing systems
 - non-current asset policies

Information Sheet 5/10 – Liability systems

- include any prescription removed from new Standard
- consideration points when establishing systems
- **Information Sheet 5/11 – Taxation compliance systems**
 - include any prescription removed from new Standard
 - consideration points when establishing systems
- **Information Sheet 5/12 – Commitments systems**
 - include any prescription removed from new Standard
 - consideration points when establishing systems
- **Information Sheet 5/13 – Contingencies systems**
 - include any prescription removed from new Standard
 - consideration points when establishing systems
- **Information Sheet 5/14 – Performance management systems**
 - include any prescription removed from new Standard
 - consideration points when establishing systems
- **Information Sheet 5/15 – Financial management practice manuals and other agency specific manuals**
 - reasons for / advantages of establishing manuals e.g. consistency in application; communicating what is to be done, and how; and training new staff
 - level of documentation depends on circumstances and needs
 - used by auditors when attesting to the effectiveness of internal control
 - frequency of reviews of manuals

- **Volume 6 – Monitoring/assessment**
 - **Information Sheet 6/1 – Importance of regular monitoring and assessment**
 - integral part of internal control
 - changes in strategic objectives may lead to gaps in controls, redundant controls or duplicated controls
 - where risks and objectives change frequently, reviews of internal controls will need to be more frequent
 - becoming more important focus world-wide, e.g. Sarbanes Oxley Act requires each annual report to contain an “internal control report”
 - **Information Sheet 6/2 – Ongoing v separate evaluations**
 - monitoring is accomplished through ongoing monitoring (built into the normal, recurring operating activities, and includes regular management and supervisory activities), separate evaluations (scope and frequency will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures) or a combination
 - **Information Sheet 6/3 – Statement of assurance**
 - legislative requirements
 - how testing/review can be undertaken e.g. systems appraisals
 - sample of an annual Statement of Assurance
 - **Information Sheet 6/4 – Decentralised agencies/functions**
 - challenge of monitoring and obtaining assurance over controls in regional areas, e.g. checklists, certifications
 - **Information Sheet 6/5 – Outsourced arrangements (e.g. Shared Service Agency)**
 - how to obtain and give assurance over outsourced processing arrangements
 - **Information Sheet 6/6 – Audit findings**
 - internal and external audit findings
 - monitoring should ensure that audit findings and recommendations are adequately and promptly resolved
 - **Information Sheet 6/7 – Rectification**
 - as soon as deficiencies noted, rectification measures should be developed and implemented
- **Volume 7 – Reporting systems**
 - **Information Sheet 7/1 – Management reporting**
 - what is management reporting?
 - type of information
 - budget v actual comparisons

- **Information Sheet 7/2 – Financial statement preparation**
 - prescribed requirements
 - Financial Reporting Requirements
 - Non-current asset policies
 - strategies for timely completion of financial statements
- **Information Sheet 7/3 – Consolidation of controlled entities**
 - needs early coordination to ensure financial information received
- **Information Sheet 7/4 – Role of internal and external audit in financial statement preparation**
 - roles/cooperation, working with management
 - advantages of internal audit being involved in financial statement preparation process
- **Information Sheet 7/5 – Annual reports**
 - Annual Report Guidelines
- **Volume 8 – Glossary**
 - glossary of terms used in guidelines