Internal Control

Meeting Federal Requirements for Accountability

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Internal Control Is

EVERYONE’S RESPONSIBILITY!
Overview

- Definition of internal control
- Federal Managers Financial Integrity Act (FMFIA) requirements
- Control objectives and control activities
- Risk assessment and management
- GAO’s Standards for Internal Control
- Internal control process
- Internal control review
- Types of internal control finding categories
- The corrective action plan (CAP)
- Internal control reporting
- Why we perform internal control
Lack of Understanding

Unfortunately, internal control is often improperly perceived as:

- A bean counter, financial, or auditing function
- Related only to budgeting and accounting
- Too administrative and not operational
- Not critical to mission accomplishment
- Not important to program managers
- A paperwork exercise
Discussion Question

- How do we better communicate the importance of internal controls?
Accountability

- Use of resources is consistent with agency mission
- Programs and resources are protected from waste, fraud, and mismanagement
- Laws and regulations are followed
- Reliable/timely information is obtained, maintained, reported, and used for decision-making
GAO’s Definition of Internal Control

"An integral component of organization’s management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations"
Sources

- Federal Managers Financial Integrity Act (FMFIA)
- GAO’s *Standards for Internal Control in the Federal Government* (Green Book)
- OMB Circular A-123: Management's Responsibility for Internal Control
- DODI 5010.40: Managers’ Internal Control Program Procedures
Terms to Know

- Assessable unit
- Control activity
- Control objective
- Material weakness
- Reasonable assurance
- Risk
- Testing
Basic Provisions of the Integrity Act

**Agency Heads**

- Report to the president and Congress annually:
  - A statement of reasonable assurance on controls
  - Any material weakness
  - Will report annually on whether financial systems conform to government-wide requirements

**GAO**

- Will prescribe internal controls standards

**OMB**

- Will issue guidelines for agencies
Examples of Control Activities

- Top-level reviews of actual performance
- Reviews by management at the functional or activity level
- Management of human capital
- Controls over information processing
- Physical control over vulnerable assets
- Establishment and review of performance measures and indicators
- Segregation of duties
- Proper execution of transactions and events
- Accurate and timely recording of transactions and events
- Access restrictions to and accountability for resources and records
- Appropriate documentation of transactions and internal control
The Three Major Types of Risk

1. Inherent
2. People
3. Control
# Risk Management Matrix

## Risk Management Matrix

<table>
<thead>
<tr>
<th>Entity:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mission, Goal, Control Objective, or Process—Identify Which</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Preparer:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify Risk(s) — List Separately and Describe</td>
</tr>
</tbody>
</table>

| Control(s) Associated with Risk—Describe All That Apply |

| Testing - Describe Test Methodology |

| Condition of Control after Testing (Effective, Needs Improvement, No Control, or Unnecessary) |

| Status of Corrective Actions for Categories Other Than "Effective" |

| Completion Date of Corrective Action, and New Risk Rating |

| Office or Unit Responsible and Point of Contact |

<table>
<thead>
<tr>
<th>Level of Deficiency:</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Control, (B) Significant, or (C) Material Weakness; Highlight Any B or C Type across Row</td>
</tr>
</tbody>
</table>

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1. Condition of control effective (works as intended and people carrying it out); needs improvement (needs strengthening OR people are not following it); no control in place (needs to be developed); redundant/unnecessary.

2. A corrective action plan (CAP) should be prepared for each key control needing action. This will allow management to track and report on improvements.

3. Management should be able to tell at a glance which goal and objectives are affected by control weaknesses.
Risk Assessment Definitions

- **Risk.** The chance of something happening that will have a negative impact on objectives. It is measured in terms of consequences and likelihood.

- **Likelihood.** A qualitative description of a probability or frequency

- **Consequence.** The outcome of an event expressed qualitatively or quantitatively, being a loss, injury, disadvantage, or gain
### Risk Assessment Matrix

<table>
<thead>
<tr>
<th>CONSEQUENCES</th>
<th>LOW / REMOTE (1)</th>
<th>MODERATE / POSSIBLE (2)</th>
<th>HIGH / PROBABLE (3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH (3)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MODERATE (2)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LOW (1)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1. Payments to contractors will be late.
2. Disbursements exceed appropriation level.
3. All computers are not entered into the inventory records.
4. Supervisor does not sign off on employee time and attendance records.
5. Unauthorized access to sensitive data or systems.
The Five GAO Standards

1. Control environment
2. Risk assessment
3. Control activities
4. Information and communication
5. Monitoring
GAO Standards

- **Define** the minimum level of quality acceptable for internal control in the government
- **Provide criteria** against which all management systems are to be evaluated
- **Apply** to all aspects of an agency’s operations, programs, financial activities, and compliance
- **Provide a general framework** for management to develop detailed policies, procedures, and practices to fit its agency's operations and ensure that they are built into and are an integral part of operations
- **Emphasize** that the standards are reflected in and are an integral part of operations
Overview of Internal Control Process

1. Organize the Process
2. Segment the Agency
3. Conduct Risk Assessments
4. Develop Management Control Plans and Update Annually
5. Conduct Internal Control Reviews
6. Take Corrective Actions
7. Track Internal Control and Corrective Action Plans
8. Prepare Reports on Results
Purpose of Internal Control Review (ICR)

An ICR allows management to determine if:

- A positive and supportive control environment exists
- Laws, regulations, and other directives such as policies and procedures are being implemented as directed
- Material weaknesses are indicated
- Controls exist and are cost-effective
- Corrective actions are needed
- Its agency might be vulnerable in areas covered by the ICR
Major Steps in an Internal Control Review

Step 1
- Identify areas to be reviewed along with any associated risks

Step 2
- Plan and carry out specific ICRs on key areas and risks

Step 3
- Determine the condition of controls and what to report
Types of Internal Control Deficiencies

- Control deficiency
  - Design deficiency
  - Operation deficiency
- Reportable condition
- Material weakness
  - DOD 2013 AFR lists 33 MWs
What Is a Material Weakness?

1. Significantly impair components of ability to achieve its objectives
2. Result in use of resources in way that is inconsistent with DOD mission
3. Violate statutory or regulatory requirements
4. Result in significant lack of safeguards against fraud, waste, abuse, and mismanagement. Includes unauthorized use of property and misappropriation of funds.
5. Impair ability to obtain, maintain, report, and use timely information for decision-making
6. Permit improper ethical conduct or a conflict of interest
Determining Material Weaknesses

- Management makes final determination
- Evaluate weakness against accepted considerations and score each as *significant* or *insignificant* to determine if weakness is material
  - Examples: frequency of actual or potential loss, impact on information security, current or likely media attention, diminished credibility of management
- Funding threshold depends on:
  - Nature and characteristics of the weakness
  - Level of the organization where it exists
Correcting Material Weaknesses

- Take timely action
- Set milestones with completion dates
- Periodically assess progress
- Follow up
DoD Levels of Material Weaknesses

Installation or Activity Level
- Requires the attention of the head of an installation

Major Command or Field Activity Level
- Permeates a major command or one or more of its installations/activities
- Requires component head attention

Component Level
- Permeates a component or one or more of its major commands or activities
- Requires component head attention

DoD Level
- Merits OSD attention or exists in a majority of components
- Those not resolved at the SECDEF level are reported in the annual Statement of Assurance
RPTG Levels in DoD

- Office of the Secretary of Defense
- Military departments
- Joint Chiefs of Staff
- Combatant commands
- Office of the Inspector General
- Defense agencies
- Field activities
- Other organizational entities
Statement of Assurance

- Represents the agency head’s informed judgment as to the overall adequacy and effectiveness of internal controls within the agency

- Must take one of the following forms:
  - Statement of assurance (unqualified)
  - Qualified statement of assurance (qualified)
  - Statement of no assurance
What Are We Assuring?

- Operations are effective, efficient, and meet objectives
- Financial and performance reporting are reliable and timely
- The agency complies with laws and regulations
- Programs are managed with integrity and follow high ethical standards
- The agency is protecting its assets
- The agency's approach considers the five standards of internal control
FMFIA and OMB Circular A-123 Reporting Requirements

- Section 2 – Internal Accounting and Administrative Controls
- Section 4 – Financial Management Systems
- Internal Controls over Financial Reporting (ICOFR)
Sources of Information

- Leadership knowledge gained from daily operations of DOD
- Reviews conducted for purpose of assessing Internal Control
- OIG and GAO reports
- Program Evaluations
- Audits of financial statements
- Reviews of financial systems under OMB circular A-123, App D
- Annual performance plans and reports pursuant to GPRAMA
- Annual reviews and reports under IPIA, IPERA, and IPERIA
- Other financial and performance audit reports
- Other reviews relating to DOD operations
Benefits of Internal Control

- Provides management with added confidence regarding achievement of objectives
- Provides feedback on how effectively component is operating
- Helps reduce risks related to achieving components objectives
- Safeguarding of assets
Questions and Closing

- Visit us at Management Concepts booth #320