



Assessing Internal Control over Financial Reporting

A Guide for Implementing
Appendix A of OMB
Circular A-123 • Spring 2005

KPMG LLP



Preface

The federal government has long been committed to establishing and maintaining effective internal control in order to prevent fraud, waste, abuse, and mismanagement in its operations. In 1982, Congress enacted the *Federal Managers' Financial Integrity Act* (FMFIA) and the Office of Management and Budget (OMB) issued Circular A-123 to require each agency to establish and maintain internal control systems that would enable obligations and costs to be recorded in compliance with applicable law; funds, property, and other assets to be safeguarded; and revenues and expenditures applicable to agency operations to be properly recorded and accounted for.

In 1995, OMB revised Circular A-123 to require internal control to also support the purposes of the newly enacted *Government Performance and Results Act* of 1993 (GPRA), namely the improvement of program effectiveness and accountability.

The federal government believes that improving accountability is a continuing process. Significant accomplishments during the last few years have been the adoption of quarterly financial reporting and the institution of rapid year-end closing that enable the federal agencies to issue audited financial statements 45 days after fiscal year-end.



The Public Company Accounting Reform and Investor Protection Act of 2002 (also known as the *Sarbanes-Oxley Act*), enacted as a response to the crisis of confidence in the financial integrity of public companies, shows that more may be done. Specifically, the Sarbanes-Oxley Act, in section 404, requires the management of public companies to assess and report on their companies' internal control over financial reporting.

The federal financial management community has concluded that federal managers should adhere to the same high standards expected of corporate managers. OMB has revised Circular No. A-123 to require federal agency managers to specifically assess and report on internal control over their financial reporting. This will not be a simple task. Additional OMB guidance is expected, and the requirements and dialogue on this matter will continue to evolve.

KPMG has prepared this publication to assist federal agency managers in performing the assessment of internal control over financial reporting and prepare the required report.

In developing the guide, we considered our extensive analysis of the processes that enable management of public companies to issue assurance statements on internal control over financial reporting that users may rely upon. This guide does not, however, merely suggest a process that would be performed by a public company. We also drew upon our deep understanding of federal agencies' organizations, operations, and resource constraints.

Hence, this guide is tailored to the needs of the federal government. It also concerns the comprehensiveness and rigor needed to conduct an assessment of internal control over financial reporting that is meaningful and effective.

We encourage managers of each federal agency to use this guide in connection with the development of an approach, specific to each agency's unique activities, resources, and other characteristics, with which management may assess and report on the agency's internal control over financial reporting. Management's assessment depends upon the particular circumstances of each agency; this general guide is merely a resource for consideration and does not constitute specific advice. We also encourage each agency to establish and maintain a dialogue with its inspector general, independent auditors, and others regarding the revised Circular and what is involved in compliance.

KPMG LLP
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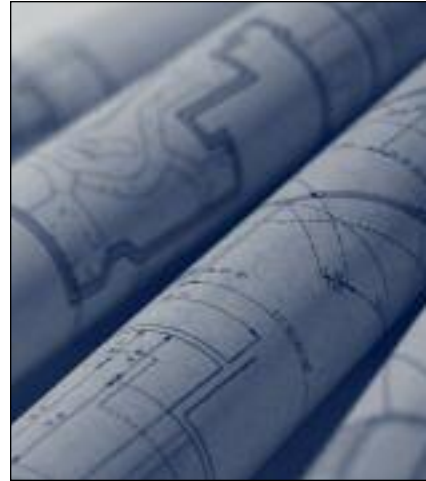
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Introduction

The Office of Management and Budget defines internal control as the steps an agency takes to provide reasonable assurance that the agency's objectives are achieved through 1) effective and efficient operations, 2) reliable financial reporting, and 3) compliance with laws and regulations. OMB issued Circular A-123 in 1982 and revised in 1995 to help federal managers establish and maintain internal control consistent with the provisions of the Federal Managers' Financial Integrity Act and other management statutes. The 1995 version of the Circular required each executive agency to:



- Develop and implement cost-effective management controls for results-oriented management in accordance with standards prescribed by the U.S. Comptroller General
- Transmit an annual assurance statement from the head of the agency to the president and Congress stating whether there is reasonable assurance that the agency's controls are achieving their intended objectives.

In light of new internal control requirements for public companies, OMB has again revised the Circular (in 2004) and retitled it *Management's Responsibility for Internal Control*. The new revision continues the requirements of the 1995 version, but adds a requirement for federal agency heads to provide a separate assurance on the effectiveness of the agency's internal control over financial reporting (ICOFR). That assurance is to be based on the results of a management assessment conducted in accordance with a methodology contained in Appendix A to the 2004 revision to Circular A-123.

Purpose of This Document

The purpose of this document is to provide an approach that management may consider for assessing, documenting, and reporting on ICOFR in conformance with the requirements of the revised OMB Circular A-123, *Management's Responsibility for Internal Control*, Appendix A. The framework for the assessment is *Standards for Internal Control in the Federal Government*, issued by the U.S. Government Accountability Office (GAO) in November 1999¹ (and outlined in the Circular). These standards, frequently referred to as the "Green Book," are based on the *Integrated Framework of Internal Control* issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

Management should tailor its approach based on the agency's specific policies, practices, and resources. However, if the assessment is to reflect the necessary rigor, and the Circular's and Appendix's objectives are to be met, certain elements in the approach should be carefully considered imperative.

The Suggested Approach to a Management Assessment, Documentation, and Reporting on Internal Control over Financial Reporting

The suggested approach management may wish to consider to assess, document, and report on ICOFR entails five phases as described in the following chart.

1. The name of the General Accounting Office was changed to the Government Accountability Office in 2004.

| | |
|--|---|
| 1. Plan and Scope the Evaluation | Establish assessment process. Identify significant financial reports. Define materiality. Identify significant accounts, relevant financial report assertions, and major transaction cycles. Link the accounts and cycles. Determine organizational approach. |
| 2. Document Controls | Document and obtain an understanding of controls for all significant accounts, groups of accounts, and transactions. |
| 3. Evaluate Design and Operating Effectiveness | Evaluate design and operating effectiveness of internal control over financial reporting and document results of the evaluation. |
| 4. Identify and Correct Deficiencies | Identify, accumulate, and evaluate design and operating control deficiencies; communicate findings and correct deficiencies. |
| 5. Report on Internal Control | Prepare management's written assurance on the effectiveness of internal control over financial reporting. |
| 6. Obtain Independent Audit of Internal Control <small>(optional)</small> | Prepare for independent auditor to conduct the internal control audit. |

This step is optional in the Circular.

The ensuing chapters in this document are organized according to the first five phases. Some agencies might decide to undertake a sixth phase, namely the preparation that is needed for an auditor to assess and report on management's assessment of internal control over financial reporting or directly on the internal control over financial reporting. That phase is not addressed in this guide.

It must be emphasized that this suggested approach is for management's consideration in connection with its assessment of ICOFR in accordance with Circular A-123. It is not intended to be a guide for independent auditors to perform an audit of ICOFR. Nor is it a complete guide for management to prepare for an external audit, of management's assertion on ICOFR.

Furthermore, management must accept responsibility for the assessment and results of effectiveness of its ICOFR. It cannot delegate its responsibility for assessing the effectiveness of ICOFR to a third-party service provider. It must be actively engaged in the entire assessment process.

While the five-step process described above illustrates certain steps, management should be aware that it is not a linear process. Many of these steps may take place concurrently throughout the year.

In the first year, certain aspects of the process, such as organizing and planning the process and documenting the flow of transactions, may require a considerable amount of effort. In subsequent years, the assessment process may be considered part of the agency's normal operations.

Agencies are well advised to begin the process as soon as possible. Considerable work must be done, particularly in large, complex, and decentralized agencies, to plan the process and assign the responsibilities. Also, it will be desirable to begin testing certain financial reporting controls on a quarterly basis to allow time for the agency to remedy identified control deficiencies before the end of the year.

Benefits of the Assessment Process

OMB believes that management's assessment, documentation, and reporting on internal control over financial reporting will provide substantial benefits for the federal agencies. First, it believes federal agency managers will find that the assessment and documentation of ICOFR will provide them with a significantly greater understanding of the operating effectiveness of internal control within their organizations. This understanding should provide managers with better assurance over the integrity of their financial information. It may also identify duplicative or ineffective controls that may be eliminated.

Another benefit OMB has suggested is that the testing and documentation of internal control that management performs to support its assessment may be used, and perhaps relied upon, by GAO, the Office of Inspector General (OIG), and external auditors performing financial or performance audits. This use and reliance may translate into a reduction in the extent of testing performed by these auditors and, ultimately, a reduction in the direct and indirect costs of the audits.²

² See remarks made by OMB and CFO Council representatives at the March 2005 Joint Financial Management Improvement Program (JFMIP) conference.

Plan and Scope the Evaluation

It is critical that each federal agency carefully organize and plan its assessment, documentation, and reporting of ICOFR in a manner that enables the process to be performed in an efficient, effective, and meaningful manner and with the necessary rigor. The key organizing and planning steps are:

- Establish the process
- Identify the significant financial reports
- Define materiality
- Identify the significant accounts
- Identify the relevant financial report assertions
- Identify the major transaction cycles
- Link accounts and transaction cycles
- Determine the organizational approach for assessing the controls.

Establish the Process

The first step is for the agency head to indicate that internal control, including ICOFR, is an agency-wide priority. The assessment process will likely involve offices and functions throughout the organization, yet some individuals may perceive the process of evaluating ICOFR as a responsibility of only the accounting or finance office. The agency head should consider communicating to all managers in every function and role that they are responsible



for maintaining strong internal control, and this includes the assessment of the effectiveness of ICOFR. This concern may be communicated (through meetings, memoranda, and other written communication) to the senior management team, operating units' management and other professionals who will need to provide the agency head with assurance on the ICOFR for which they are responsible.

It is recommended that the communication make clear that there is a difference between the overall FMFIA assurance statement that the agencies have been issuing since 1983 and will continue to issue and the assessment of ICOFR required by the 2004 revision to OMB Circular A-123. The overall FMFIA assurance statement addresses the three overall objectives of internal control: effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The assurance statement on ICOFR is a subset of the existing FMFIA assurance statement. It requires management to specifically document the process and methodology used to evaluate the operating effectiveness of ICOFR.

The next step in establishing the process is to assign the responsibility for overseeing the assessment process, which includes the process for implementing corrective action plans to remedy deficiencies in internal control. The agency's **senior management council**, if one exists, would be an appropriate entity to which to assign the responsibility. Alternatives would be the agency's chief operating officer or chief financial officer.

To perform the day-to-day-work, the Circular encourages the agency to establish a **senior assessment team** of dedicated professionals who would report to the senior management council or other responsible official.³ According to the Circular, the team would be responsible for such matters as:

- Ensuring the assessment objectives are clearly communicated throughout the agency
- Ensuring the assessment is carried out in a thorough, effective, and timely manner
- Identifying and ensuring adequate funding and resources are made available
- Identifying staff and securing contractors to perform the assessment
- Determining the scope of the assessment (e.g., the financial reports to be covered by the assessment)
- Determining the assessment design and methodology.

3. Circular A-123, Appendix A, Section III.A.

It is recommended that the team comprise professionals with the appropriate education; experience in agency operations, information technology, accounting, and auditing; and project management skills and experience. Possession of appropriate certifications (e.g., certified public accountant, certified internal auditor, certified government financial manager) would be desirable.

Since a major portion of the agency's control activities is likely to be information technology controls, and integration of the information technology function into the agency's business processes is so important, the agency is encouraged to include on the team individuals from the chief information officer's organization. Their participation would go a long way to ensuring that key technology risks and controls are fully considered during the assessment process.

Establishing a process whereby the senior management council receives reports on a periodic basis on the status of the assessment would provide an opportunity to redirect the process if necessary.

No exemption has been provided for classified or secure activities, which means they should be included in the evaluation process. Steps need to be taken to ensure that persons participating in the evaluations for such activities have the necessary security clearances and the documentation is appropriately classified and handled.

Other organizational steps that should be taken are as follows:

Provide training. The senior assessment team should consider training for all personnel who will be involved in the process. The training would need to be tailored to the level and type of involvement expected from the participants (e.g., senior executives, project managers, and specialists, such as actuaries, statisticians, and economists).

Develop standard templates for documentation. Developing standard workpapers and forms to be used by the project team for the documentation of all processes, testing, and conclusions is another desirable task for the senior assessment team. Standard templates for documentation may be accomplished through a paper-based process or with an automated documentation tool. Standard templates and workpapers will expedite the supervisory reviews.

Provide for documentation of the assessment. Since the Circular requires that the assessment of ICOFR be documented,⁴ a process for obtaining and compiling documentation for the items in the following list should be established.

4. Circular A-123, Appendix A, Section IV.B.

- The establishment of the senior assessment team, its authority, and members
- Contracting actions if contractors are used to perform or assist in the assessment
- Communications with agency management and employees regarding the assessment
- Key decisions of the senior assessment team
- The assessment methodology and guide
- The assessment of internal control at the entity level
- The assessment of internal control at the business process, transaction, or application level
- The testing of controls and related results
- Identified deficiencies and suggestions for improvement

We recommend that the senior assessment team also document the classification of identified deficiencies, the remediation plans for correcting deficiencies, and representations from officials and personnel responsible for monitoring, improving, and assessing internal control.

The documentation may be electronic, hard copy format, or both, and should be readily available for review.⁵

Establish a process to communicate and coordinate with the OIG. The OIG is responsible for performing the audit of the agency's financial statements—even when the audit is performed by a certified public accounting (CPA) firm. Further, even if the OIG or the CPA firm is not performing an audit of the agency's internal control assessment, the OIG and the CPA firm are still required to evaluate and report on the agency's compliance with laws and regulations—including the agency's compliance with FMFIA and the Circular. Since the auditor may rely in part on management's testing of ICOFR, the project team should meet with the OIG and the CPA firm and review the planned assessment process. Obtaining and incorporating the OIG's and CPA firm's views of management's assessment plan may provide the opportunity to design the evaluation in a way that may enable the auditor to perform the audit more efficiently.

Although the OIG or CPA firm may advise on the planning documents, management is responsible for and "owns" the assessment process. While the auditor may choose to reperform some or all of the senior assessment team's testing, it is not required.

5. Circular A-123, Appendix A, Section IV.B.

Finally, if management plans to ask the auditor to provide an opinion on the ICOFR, management should involve the auditor in key aspects of the process, starting at the planning phase. The auditor will benefit from access to the project calendar, since the calendar provides the auditor with an opportunity to maximize the efficiency of the interview and testing processes (e.g., the auditor may choose to attend significant process interviews).

Establish standards for contract support personnel. Agencies that use contractors to perform any aspect of the assessment, such as preparing documentation or performing testing, should consider taking steps to ensure the contractors have the appropriate qualifications. The agency may want the contract to clearly define the scope of performance. The contractor's work may then be reviewed before it is included in management's final assessment.

Establish a basis to communicate, review, remedy, and obtain management concurrence. Management is responsible for documenting the internal control over financial reporting even though the documentation may have been prepared by the senior assessment team or others. A process would need to be established for management to review and comment on the documentation, the team to respond to management's comments, and management to indicate its final decision on the effectiveness of internal control over financial reporting based on the evidence. The senior assessment team would need to retain evidence of the review and approvals through signatures or electronic postings.

Prepare a calendar. The assessment will likely require many interviews and meetings with agency management and personnel. The senior assessment team should consider scheduling these meetings as early as practicable and posting these dates to a calendar. This will allow the owners of the business processes to plan adequate time for the interviews and meetings. It would enable delays in the assessment to be identified quickly and corrected before project deadlines are adversely affected.

The calendar may also be used to schedule adequate testing of monthly and quarterly financial reporting that occurs throughout the year so that the assessment workloads may be balanced throughout the year.

Establish a status reporting process. Status reports are an important tool. By identifying the status of all tasks that relate to the assessment's critical paths, status reports may help ensure that agency personnel affected by the assessment are kept informed of the assessment's progress, the upcoming steps, and any issues that need to be resolved. Status reports should be scheduled and issued on a regular basis. The schedule for issuing the reports should be posted to the calendar.

Identify the Significant Financial Reports

Circular A-123, Appendix A, Section II.B, “Definition of Financial Reporting,” indicates that ICOFR should provide assurance on the internal control related to the annual financial statements as well as other significant internal or external financial reports. Other significant financial reports are defined as “financial reports that may have a material effect on the agency’s significant spending, budgetary, or other financial decisions or that are used to determine the agency’s compliance with laws and regulations.” Examples of these documents may include the agency’s SF-132 (*Apportionment and Reapportionment Schedule*), SF-133 (*Report on Budget Execution and Budgetary Resources*), FMS Form 2108 (*Year-end Closing Statement*), and other key reports that are specific and material to the agency’s financial operations.

At a minimum, agencies should include in the assessment of internal control over financial reporting the agency’s annual and quarterly financial statements, and information used to support those financial statements. In adding other financial reports to the assessment, the senior assessment team should consider the scope of the entity for which the reports are prepared and the decisions that might be affected by the reports, e.g.; the scope for annual financial statements is typically an entire organization; the scope for a budget execution report is a budget account.

Define Materiality

The senior assessment team will likely need to define, on a report-by-report basis, what will be considered a material error or misstatement. A material error or misstatement is an error or misstatement that may occur in the financial report that would impact management’s or users’ conclusions or decisions based on such a report. These definitions will need to be considered by the senior assessment team when it is determining the level of testing or other work required to assess whether the controls are adequate for preventing or detecting errors or misstatements, and for deciding what deficiencies should be reported.

Since the scope of an auditor’s review of financial statements taken as a whole is broader than the scope of individual financial statements used by management or other users, management should consider assessing the levels at which an error or misstatement may occur at a lower level than would be used for the audit. Furthermore, levels of materiality are likely to vary depending upon which aspect of internal control is considered. Management may also want to consider the qualitative aspects of the information. For example, the political sensitivity of budgetary information may make it appropriate to use a lower materiality level when assessing internal control for budget-related financial reports (e.g., the SF-133) than for nonbudget reports.

Management and the senior assessment team should consider presenting their determination of what constitutes material errors and misstatements to the OIG and/or external auditor. Agreement by the OIG and/or external auditor to management's definitions may maximize their ability to rely upon management's assessment process and reduce the nature, timing, and extent of their testing during the financial statement audit.

Identify the Significant Accounts

Using the significant financial reports identified in the earlier step, the senior assessment team should identify the accounts or groups of accounts that individually or collectively may have a material effect on each financial report. Both qualitative and quantitative aspects should be considered in determining the material accounts.

The quantitative characteristics include whether there is more than a remote likelihood that the account may contain misstatements (either an overstatement or understatement) that individually or in the aggregate may have a material effect on the financial report.

The qualitative characteristics may include such matters as:

- Sensitivity of a program or balance
- Importance of a balance or amount to oversight agencies and their reliance on such balance or amount
- Knowledge of past errors
- Susceptibility to loss due to errors or fraud (e.g., intentional manipulation of estimates used in the financial reports or material misappropriation of assets)
- Accounting and reporting complexities associated with the account (e.g., environmental liabilities, actuarial liabilities)
- Likelihood of significant contingent liabilities arising from the underlying activities
- Changes in account characteristics.

Identify the Relevant Financial Report Assertions

The senior assessment team should identify the financial report assertions associated with each of the significant accounts. According to Circular A-123, Appendix A, the following are the types of assertions that may be inherent in the significant accounts:

- **Existence and occurrence.** All reported transactions actually occurred during the reporting period and all assets and liabilities exist as of the reporting date.

- **Completeness.** All assets, liabilities, and transactions that should be reported have been included, and no unauthorized transactions or balances are included.
- **Rights and obligations.** All assets are legally owned by the agency, and all liabilities are legal obligations of the agency.
- **Valuation.** All assets and liabilities have been properly valued, and where applicable, all costs have been properly allocated.
- **Presentation and disclosure.** The financial report is presented in the proper form, and any required disclosures are present.
- **Compliance.** The transactions are in compliance with applicable laws and regulations.
- **Safeguarding.** All assets have been reasonably safeguarded against fraud and abuse.
- **Documentation.** Documentation of internal control testing and all transactions and other significant events are readily available for examination.

Not all assertions will be relevant or significant to all accounts. For example, the valuation assertion would not be relevant to Fund Balance with Treasury since this account is denominated in U.S. dollars.

Since risks are associated with each type of assertion, the team should review each significant account and determine the type of material error or misstatement that may occur for each assertion. This step is critical. The results of the evaluation of these assertions and identification of risks will help determine the types of controls that should be assessed and the tests that will likely need to be performed during the Document Controls and the Evaluate Design and Operating Effectiveness phases.

Identify the Major Transaction Cycles

The next step is to identify the major transaction cycles or classes of transactions that materially affect each of the significant accounts or groups of accounts. A major transaction cycle is a business process for which the quantity and dollar volume of transactions is so great that if a material error occurred in the process, it would affect the agency's decision-making process. For example, disbursement of funds is a major transaction cycle since a material error may affect several accounts, including Fund Balance with Treasury.

Another consideration when identifying major transaction cycles and financial systems is whether the transactions are routine, nonroutine, or represent an accounting estimate.

The following chart lists the typical federal agency transaction cycles. This list is not meant to be all-inclusive, but is for illustrative purposes only. Hence, the senior assessment team may use the list to help select the agency transaction cycles that should be considered for testing.⁶

Common Federal Agency Transaction Cycles

Human Resource Management

- Personnel
- Time and Attendance
- Processing Payroll
- Pension and Postretirement Benefits

Funds Management

- Fund Balance with Treasury
- Cash
- Investments

Procurement

- Requests and Awards
- Receipt of Goods/Services
- Invoicing
- Contract Monitoring
- Contract Closeouts

Property Management

- Capital Acquisition Requests
- Depreciation
- Disposals
- Leases (Operating or Capital)

Inventory Management

- Acquisition Requests
- Distribution
- Consumption of Inventory

Credit Program Management

- Extending Credit
- Loan Servicing
- Estimate Modeling

Revenue Management

- Recording Budget Authority
- Services Provided
- Interagency Agreements

Grants Management

- Requests and Awards
- Monitoring
- Closeouts

Environmental Management

- Evaluation and Reporting of Exposure
- Mitigation
- Prevention

Financial Reporting

- Budget and Management Reporting
- General Ledger Maintenance
- Accounting Policies and Procedures
- Account Analysis and Reconciliation
- External Financial Reporting

Information Technology

- Overall Control Environment
- Program Development
- Program Changes
- Program Access
- System Support and Operation

6. The Improper Payments Information Act (IPIA) requires agencies to review and "...identify programs and activities that may be susceptible to significant improper payments." The senior assessment team should also consider using the IPIA evaluation as a foundation for identifying at least a portion of the agency's business processes for its assessment of ICOPR.

Link Accounts and Transaction Cycles

The senior assessment team should link the significant accounts to the transaction cycles and processes that provide the source data. This step will help the senior assessment team ensure that a transaction cycle has been associated with all significant accounts, and that all significant transaction cycles have been identified. One method of linking significant accounts to transaction cycles is through “mapping.” An example of a map of significant accounts to transaction cycles is included in Appendix 1A to this document.

Determine the Organizational Approach for Assessing the Controls

Federal agencies are large, complex organizations. The agency head providing his or her assurance on internal control over the agency’s financial reporting will most likely need to rely on assurances provided by subordinate managers responsible for the financial reports of components, accounts, etc., within the agency. The senior assessment team should determine which agency managers would need to prepare assurance statements to support the agency head’s assurance statement. This determination may be driven by consideration of the following factors:

- Existing organizational structure
- Nature and size of the agency’s programs and administrative functions
- Number of subprograms and subfunctions in a program or function
- Number of separate organizations operating the program
- Degree of centralization or decentralization for the programs and functions
- Degree of independence of the programs and functions
- Differences in operating systems
- Budget levels
- Number of personnel.

Consideration of these factors may, in turn, affect decision on how to organize the evaluation of the ICOFR. The two most common organization approaches are:

- **Department-wide approach.** The senior assessment team analyzes the agency-wide financial statements; identifies the significant line items; determines which components, programs, or administrative functions contribute to those line items; and decides whose controls should be assessed and reported on to provide sufficient evidence for the agency head to provide assurance on the internal control over the agency’s financial reporting. For instance, the senior assessment team might con-

clude that for a specific line item, assurances are required from only two of the department's several components to support the assessment of internal control over the agency's financial report for that line item. This process would be repeated for all significant reports and all material line items included in the agency's assessment of ICOFR.

- **Individual component approach.** The senior assessment team requires that every component, program, and administrative function submit an individual assessment of internal control over the individual component's financial reports. The assessments would be aggregated by the senior assessment team and weighted in arriving at the agency head's assessment.

Moreover, in federal agencies, the degree of centralization and program independence frequently varies significantly. Since a program or administrative function may operate in several locations and the operating procedures and internal control systems may vary in design or in operation among locations, it may be necessary to perform separate internal control evaluations at the separate locations.

For example, an agency may have locations that are widely dispersed, and some may have relatively few staff. The transaction cycles and related control activities at a large office may differ significantly from those at a small office. Hence the approach to assessing the controls should differ among the locations.

A consideration when deciding the organizational approach to assessing an agency's programs and functions that operate at several locations is whether to identify 1) the locations first and then consider for assessment the financial reporting for each location or 2) the programs and functions first and then, for each multilocation program and function, list and consider the locations at which the financial reporting processes will be assessed.

The senior assessment team may also consider the approach used by the agency's financial statement auditors, particularly if the agency plans to obtain an auditor's opinion on management's assessment of ICOFR. The senior assessment team may consider whether the financial statement auditors conduct their audit using a department-wide financial report approach or an individual component approach. Insight and efficiencies may be gained from applying the same approach, and the auditor's work may be facilitated.

Another factor to consider is the agency's use and the consequent impact of third-party service providers. Third-party service providers are discussed in the following section.

Document Controls

The next phase entails documenting the processes for initiating, recording, and reporting transactions for significant accounts and disclosures in order to identify the controls within each process; assessing the effectiveness of the design of the controls and deciding whether the controls, as designed, would prevent or detect a material error or misstatement related to an account or groups of accounts; and document the assessment process.



This phase entails the following steps:

- Document the major transaction cycles
- Evaluate the control environment
- Evaluate the risk assessment process
- Evaluate the control activities
- Evaluate the information and communication processes
- Evaluate the monitoring processes
- Obtain and document the process owner's concurrence with the documentation of controls.

Document the Major Transaction Cycles

OMB circular A-123 states that the senior assessment team must “document its understanding of the agency's internal control over financial reporting. The form and

extent of documentation depends in part on the nature and complexity of the agency's controls." It also states "the documentation may include organizational charts, flow charts, questionnaires, decision tables, or memoranda."⁷

The first step in this phase, therefore, is for the senior assessment team to document the transaction cycles used for each of the significant accounts, groups of accounts, and transactions and develop an understanding, from beginning to end, of the underlying processes and document flows involved in each transaction cycle. These would be the processes for initiating, authorizing, recording, processing, and reconciling accounts and transactions that affect the financial reports.

The documentation process will help the senior assessment team identify the controls that support the assertions made by management related to those accounts or transactions. It would also help the team identify the places in the processes where an error or a misstatement due to error or fraud may occur. When identifying controls, the senior assessment team should consider the presence of multiple controls within the same transaction cycle. A single control within a transaction cycle would normally not be considered sufficient.

Examples of controls that may be identified by management are listed in the "Evaluate the Control Activities" section of this chapter.

The senior assessment team may obtain an understanding of and document the processes by drawing upon the agency's institutional knowledge, reviewing the agency's policy and procedures manuals, gathering existing forms and documents, and developing process narratives, process flowcharts, and control matrices. **No specific technique or format is required to obtain and document the senior assessment team's understanding.** We recommend, however, that the agency consider using either the process narrative or the flowchart, and then summarize its understanding using the control matrices.

Institutional knowledge. Interviews may be conducted with personnel who have knowledge of the agency's operations to obtain an understanding of the agency's financial and operational business processes. Policy and procedures manuals define the way controls are supposed to function, but interviews with the personnel performing the processes are likely to reveal the way the controls actually operate. Moreover, interviewing the owners of the major classes of transactions may help to identify the controls in place.

Existing policy and procedure manuals. Existing policy and procedure manuals may be reviewed and referred to in the documentation. This would be more effective than creat-

7. OMB Circular A-123, Appendix A, Section IV.

FAQ: Should management document ICOFR for all locations?

Answer: Yes. Agencies should have some level of documentation of ICOFR for all locations, including those not considered significant either individually or in the aggregate. However, the extent of this documentation may vary across locations, and often is based on the financial significance of each location.

Management's documentation may take many forms, including:

- Policy manuals
- Accounting manuals
- Memoranda
- Flow charts
- Job descriptions
- Documents
- Decision tables
- Procedural write-ups
- Self-assessment reports
- Other documentation, as appropriate.

No particular form of documentation is required and the form and extent of documentation may vary depending on the agency's size, complexity, and documentation approach. However, simply having manuals and policies without any reconciliation to the assessment process may not be sufficient. Management should be able to demonstrate how it used the existing documentation in the assessment.

ing new documentation. If the manuals are not current, the senior assessment team should request management to update the manuals.

Existing forms and documents. The documentation process may include obtaining examples of the forms and other documents used by the agency. Evidence of controls may be highlighted on each documented example. For example, a person performing a reconciliation usually initials and dates a reconciliation form when he or she completes the reconciliation. The senior assessment team may obtain a copy of the form, highlight the evidence of the control activity (e.g., initials and date), and include the form with the documentation. This process may enable the testing of controls, review of project workpapers, and recurring annual assessments to be significantly more efficient.

Transaction cycle narrative. A transaction cycle narrative is a written summary of an agency's process. It describes, for

Lesson Learned:

Existing policy and procedures manuals are generally not comprehensive enough to stand on their own as management's documentation of its understanding of ICOFR since these documents normally identify procedures and do not identify controls. These manuals would need to be supplemented with additional process narratives, process flowcharts, or control matrices.

each transaction, the initiation point, the processing, and the completion point. The transaction cycle narrative identifies key controls in the process. Key controls (referred to in the Circular as "significant controls"⁸) are those controls designed to meet the agency's control objectives and cover management's financial statement assertions. In other words, they are the controls that management relies upon to prevent and detect material errors and misstatements.

The senior assessment team may consider developing transaction cycle narratives in sufficient depth to ensure that a reader familiar with ICOFR may understand the process, but not so detailed that the narrative is redundant with existing documentation. Also, since most cycles have many controls, the senior assessment team may number the controls and identify them by control type (e.g., management review, reconciliation). Senior assessment team supervisors and the process owners should review the transaction cycle narratives and ensure that the key controls identified are appropriate and completely address the identified risks.

The format for a transaction cycle narrative and the information that may be included in the narrative is presented in Appendix 1B.

Transaction cycle flowchart. Transaction cycle flowcharts are not only an efficient way to document the key controls in an agency's process but they also provide an effective way to confirm the accuracy of the transaction cycle narrative with the process owners.

Flowcharts also help to identify if more than one control accomplishes the same objective of reducing the risk of an error or misstatement within a process. If redundancies are apparent, the agency has an opportunity to eliminate the inefficiencies and thereby streamline the process.

8. OMB Circular A-123, Appendix A, Section III C 6.

The senior assessment team may use the process flowcharts to identify and document their understanding of the key controls. The key controls may be included in the transaction cycle flowcharts and marked with the control numbers assigned in the process narrative.

An example transaction cycle flowchart is included in Appendix 1C.

Control matrices. Control matrices provide another efficient means to document and understand the key controls that address specific risks. A control matrix 1) lists the assertions and risks for an account or line item and the key controls that cover the assertions and 2) cross-references the controls to the risks they address. It also provides information about the type, level, frequency, objectives, and significance of the controls. This information enables reviewers to determine quickly if there is an identified risk for which there is no key control that addresses the risk. The senior assessment team may then review the risk with the process owners to ensure the risk is valid. If the risk is determined to be valid, a related control should be present. If there is no related control, a gap in the ICOFR exists that must be remedied.

For example, a control matrix for Fund Balance with Treasury identifies that there are two assertions associated with the line: the existence and occurrence of transactions assertion (that transactions are properly recorded in the agency's accounting system) and the completeness assertion (that all transactions that were recorded by Treasury are properly recorded in the agency's accounting system). It also identifies the risks that need to be mitigated in order to prevent improper management decisions. There may be an overstatement of Fund Balance with Treasury, which, if other controls are not present to prevent a disbursement in excess of budget authority, may lead to a violation of the Anti-Deficiency Act; or there may be an understatement, which might lead management to curtail spending and deliver fewer program services than authorized, and this would have a negative impact on program effectiveness.

Control matrices also enable the reviewers to identify risks for which more than one key control has been identified, decide if that redundancy might not be needed, and if it is not, recommend elimination of the redundancy in the interests of streamlining.

An example of a control matrix is included in Appendix 1D.

Evaluate the Control Environment

The control environment is the organization structure and culture created by management and employees to sustain organizational support of internal control. The control environment is the foundation for all other components of internal control. It influences the control consciousness of the people working in the organization.

Considerations in the Control Environment

When considering the control environment, the senior assessment team might ask the following questions:

- Have standards for integrity and ethics been established?
- Has management considered competency levels, skills, and knowledge required for particular functions and performance of internal controls?
- Does management’s philosophy and operating style reflect control-consciousness?
- Does the organizational structure and assignment of authority promote clear understanding of reporting relationships and provide for appropriate segregation of duties?
- Do human resources policies contribute to ensuring the competency and integrity of personnel?

The senior assessment team may conduct interviews and consider the subcomponents of the control environment listed below and determine the extent to which management is committed to establishing and maintaining effective internal control. Each of these subcomponents may be documented in the team’s workpapers to show evidence of the tools management is using to achieve the control environment objectives.

Since many of the aspects of control environment are determined by management’s leadership style, all interviews should be documented, preferably in narrative form. This provides

evidence of the due diligence performed by the team in assessing the general control environment and the “tone at the top” of the agency. Documentation prepared as a result of this evaluation may include the team’s conclusion as to whether each of the following aspects of the general control environment is adequate.

Management’s philosophy and operating style. Management’s philosophy and operating style sets the tone within the organization. Although philosophies, operating styles, and management actions may differ among the organization’s various functions and locations, the actions taken throughout the year by each entity’s leadership will influence the attitudes and actions of others in the organization.

Many aspects of management’s philosophy and operating style become apparent during the interviews the team conducts to evaluate the control environment. However, evaluations of management’s philosophy and operating style should continue throughout the assessment.

Delegating authority and responsibility. The senior assessment team should obtain an understanding of the processes management uses to delegate authority and responsibility and hold subordinate managers and other personnel accountable. The team should evaluate whether the organization's policies and procedures provide a basis for accountability and control, and that these policies and procedures set forth the employees' respective roles and responsibilities within the organization.

Organization structure and resources. The senior assessment team should evaluate the organization's structure, using its organization charts and other sources of information. The evaluation should consider whether the agency is appropriately structured in light of its legislation and other considerations and has resources adequate to provide effective and accurate financial reporting.

The adequacy of resources may be determined from reviews of budget documents, reviews of OIG reports, and interviews with senior management. This evaluation should be at a high level, and aimed at determining whether there are sufficient personnel resources to perform the control activities. A system of controls that is appropriately designed is only effective if implemented consistently. If personnel resources are inadequate, control activities may not take place consistently throughout the year, resulting in control deficiencies. The review team's conclusions should be corroborated by interviews with the agency's senior leadership and the respective process owners.

Commitment to competence. The senior assessment team should evaluate whether executives, managers, and personnel who contribute to the financial reporting process (i.e., both operational and financial personnel) maintain a level of competence that allows them to accomplish their assigned duties as well as understand the importance of developing and implementing effective internal controls. The team should also evaluate whether management identifies the knowledge and skills required for the various jobs and is willing to provide the needed training, counseling, and performance appraisals.

Human capital policies and practices. The senior assessment team should evaluate whether the organization's human capital policies and practices enable it to recruit, develop, promote, and retain competent people with whom the organization may carry out its plans, achieve its goals, and contribute to accurate financial reporting.

Integrity and ethical standards. Management's actions affect whether the agency has a culture of integrity and ethical behavior. These actions would be documented in agency policies that establish personnel requirements and financial disclosure requirements. They would be evidenced by a workforce that realizes it is required to act in the public interest, and by the tools the agency provides to help employees achieve this goal.

The team should review the operation of the OIG hotlines and personnel systems that track violations, and the types of actions taken by the agency when ethics violations are reported. This would include documenting, on a sample basis, ethics violations identified during the year to determine whether the agency is 1) adhering to appropriate and documented resolution procedures, and 2) communicating to its personnel information regarding the violations in order to ensure the culture of integrity and ethical behavior is maintained and supported.

Relationship between the organization and central oversight agencies and Congress.

An organization's integrity and behavior is usually affected by the relationship between the organization and the central oversight agencies and Congress. The senior assessment team should evaluate these relationships. Particular attention should be directed to the oversight agencies' levels of expectation for financial, operational, and program success; the metrics used to evaluate success; and the agencies' attitude toward the metrics.

Compliance with applicable laws. The senior assessment team should consider the agency's experience with and attitude toward compliance with statutory requirements and other government-wide initiatives that contribute to the operating effectiveness of ICOFR. The most pertinent statutes would be the:

- **Federal Managers' Financial Integrity Act.** Consideration should be given to the agency's existing process to establish, maintain, and report on internal controls. The senior assessment team should determine whether the agency's existing FMFIA assessment process has identified any weaknesses in the agency's operating effectiveness of ICOFR.
- **Federal Financial Management Improvement Act (FFMIA).** FFMIA requires agencies to have financial management systems that substantially comply with the federal financial management systems requirements, standards promulgated by the Federal Accounting Standards Advisory Board (FASAB), and the U.S. Standard General Ledger at the transaction level. The senior assessment team should consider whether and how any violations of FFMIA affect the team's assessment of the operating effectiveness of ICOFR.
- **Chief Financial Officers Act (CFO Act).** The CFO Act requires agencies to both establish and assess internal control related to financial reporting. The Act, along with the Government Management Reform Act and Accountability for Tax Dollars Act, requires the preparation and audit of financial statements. In this process, auditors report on internal control and compliance with laws and regulations related to financial reporting. Agency management should consider the results of these audits in its assessment of the operating effectiveness of ICOFR.

- **Inspector General Act (IG Act).** The IG Act provides for independent review of agency programs and operations. Through their audits and reviews, the IGs report material weaknesses and other deficiencies in internal control related to financial reporting (and other matters) and noncompliance with laws and regulations. Agency managers should use these reviews to identify and correct problems resulting from inadequate or poorly designed controls, and to integrate appropriate controls into new programs.
- **Federal Information Security Management Act (FISMA).** Agencies are required to provide information security controls proportionate with the risk and potential harm of not having those controls in place. Agency heads are required to annually report on the effectiveness of the agencies' security programs. The senior assessment team should consider whether any "significant deficiencies" or other findings from the agency's FISMA assessment impact the operating effectiveness of the agency's ICOFR.
- **Improper Payments Information Act (IPIA).** The IPIA requires agencies to identify programs and activities that may be susceptible to significant improper payments. Agencies are required to annually submit estimates of improper payments, corrective actions to reduce the improper payments, and statements as to whether the agency's current information systems and infrastructure may support the effort to reduce improper payments. The senior assessment team should consider the instances of improper payments when assessing the effectiveness of ICOFR.
- **Single Audit Act, as amended.** Nonfederal entities that receive or administer grant awards of federal monies are required to obtain audits of their annual financial statements. The federal agencies that provide the awards are supposed to review the audit findings and assure that appropriate corrective actions are taken. The senior assessment team should consider how the agency addresses this responsibility.

Evaluate the Risk Assessment Process

The senior assessment team should evaluate management's processes for determining the level of risk related to ICOFR and deciding upon actions to address those risks. Starting with the agency's process for complying with the Government Performance and Results Act, this would include determining how the organization establishes objectives, identifies the risks that would prevent achievement of the objectives, estimates the significance of the risks in relation to financial reporting, assesses the possible existence of the risks in the current environment, and continues to monitor changes to the environment that may increase or reduce the risks. The results of this assessment at the agency-wide level will drive the extent of testing and review that needs to be performed at the process, transaction, and application levels.

The assessment may recognize that the following circumstances or events may affect risk and therefore should be taken into consideration:

- Complexity or magnitude of the programs, operations, and transactions
- Decentralized versus centralized operations or accounting and reporting functions
- Extent of manual processes or applications
- New or amended laws, regulations, or accounting standards
- Changes in the operating environment
- Significantly new or changed programs or operations
- New personnel or significant personnel changes
- New or revamped information systems
- New technology
- Existence of related-party transactions
- Need for accounting estimates.

The senior assessment team should consider tracing the identified risks to the business processes to ensure they are being properly addressed.

Evaluate the Control Activities

Control activities, frequently referred to simply as controls, include policies, procedures, and mechanisms that help ensure the control objectives are met and that management's assertions in the financial reporting are valid. Control activities include preventative or detective controls. They may be either manual or automated.

Examples of control activities that might be present include:⁹

- Top-level reviews of actual performance
- Reviews by management at the functional or actual level
- Management of human capital
- Controls over information processing
- Physical controls over vulnerable assets
- Establishment and review of performance measures and indicators
- Segregation of duties

9. Pages 12–16 of the GAO's *Standards for Internal Control in the Federal Government* (report AIMD-00-21.3.1), issued November 1999.

- 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.

Appendix 2 contains a table that identifies, for different accounts and line items and assertions, different types of control activities that may be used to prevent or detect control weaknesses.

It is important to note that reviews by management are normally not a sufficient control to mitigate risk. Reviews by management should be coupled with another control technique to sufficiently mitigate risk.

As part of the evaluation, the senior assessment team should consider identifying any manual controls that are either redundant or secondary to a primary automated control. Redundant or secondary controls that are not effective or not providing management with a desired level of risk mitigation may be candidates for elimination.

There are also three unique elements of control activities that need to be evaluated: information technology controls, third-party service providers, and fraud.

Information technology controls. Federal agencies rely extensively on information technology (IT) processes and controls to perform their missions, manage and report financial information, and fulfill other organizational responsibilities.¹⁰ To support its assessment of ICOFR, the senior assessment team needs evidence that the applicable information technology system components are operating effectively. Applicable system components are those components that affect significant accounts or disclosures and other relevant financial assertions. They include calculations, accumulations, interfaces, and reports.

The following elements of information technology controls will likely need to be evaluated:

- **General IT policies and procedures.** General IT policies and procedures are controls that permeate throughout the IT organization. They relate to key areas such as IT strategic planning, budgeting, roles and responsibilities, segregation of duties, resource management, and third-party providers.

¹⁰ The senior assessment team should consider integrating the entity's overall responsibilities for assessing IT controls as part of the evaluation of information technology controls for ICOFR. The entity's processes to comply with FFMA and FISMA could serve as a foundation for documenting and evaluating the entity's information technology controls over financial reporting.

- **IT general controls:**
 - **Systems development and change management.** The ultimate goal of ICOFR is to ensure the integrity of reported financial data. System development and change management controls help ensure that IT systems perform their intended functions in an unimpaired manner, free from unauthorized or inadvertent manipulation, and are able to achieve data completeness, accuracy, and timeliness.
 - **Availability.** Losing the capability to process, retrieve, and protect data may significantly affect a federal organization's ability to accomplish its mission. If key financial systems are subjected to an outage, an organization's ICOFR program may be adversely affected. The key elements related to data availability that need to be considered are business continuity, contingency planning, and environmental and hardware maintenance controls.
 - **Information security.** An entity-wide security program should be in place that develops security policies, assigns responsibilities, monitors the adequacy of security-related controls, and otherwise manages security risks. A related concern is that access controls for general support systems and applications provide reasonable assurance that computer resources such as data files, application programs, and computer-related facilities and equipment are protected against unauthorized modification, disclosure, loss, or impairment.
- **IT application controls.** The senior assessment team should include the identification and evaluation of key automated controls ("application controls") during the assessment and evaluation of the design and operating effectiveness of key controls.

Third-party service providers. Many federal agencies use service organizations to process financial data. The senior assessment team should determine the service organizations that are used by the federal agency and evaluate whether the activities or functions performed by these service providers are significant to the entity's ICOFR. If the activities or functions are significant, the senior assessment team will likely need to evaluate the evidence that describes the operating effectiveness of the service provider's controls.

A service provider and its auditors might issue a report, based on Statement of Auditing Standards No. 70 (SAS 70), *Service Organizations*, which may be helpful. There are two types of reports:

- **Type I Report:** A Type I report covers the design of a service provider's controls.
- **Type II Report:** A Type II report covers both the design and the operating effectiveness of the service provider's controls.

If the senior assessment team may obtain only a Type I report for the service provider, the team will need to perform tests of the entity's controls to assess the operating effectiveness of the ICOFR related to the activities or functions performed by the service provider.

A Type II report for the service provider represents additional evidence about the effectiveness of the controls at the service provider as long as the following matters are addressed to the team's satisfaction.

- **Type of opinion.** The senior assessment team should determine if the auditor's opinion is unqualified (i.e., controls are designed effectively and operating as designed). If the opinion is not unqualified, the senior assessment team should obtain an understanding of the nature of the auditor's findings and how these findings may affect the operating effectiveness of the agency's ICOFR.
- **Period of time covered.** The senior assessment team should determine whether the Type II report covers a sufficient portion of the assessment period to provide the agency's management with evidence of the operating effectiveness of ICOFR for the entire assessment period. If a significant period of time has passed between the end of the time period covered by the service auditor's test of controls and the date of management's assessment, the senior assessment team should perform procedures to determine whether any information in the SAS 70 Type II report should be updated to reflect significant changes in the service organization's controls since the date of the SAS 70 report.
- **Scope of the report.** The senior assessment team should evaluate the report to ensure that it covers all key controls that need to be tested in order to provide the agency's management with evidence of the operating effectiveness of ICOFR over the activities or functions performed by the service provider.
- **Consistency of results with management's review of the service provider.** The senior assessment team should evaluate whether the results listed in the Type II report are consistent with the results from management's day-to-day review of the accuracy of the service provider.

Fraud. Care should be taken to ensure that the controls needed to prevent, detect, and correct fraudulent financial reporting are identified and documented. Typically, these would be the controls related to estimates and to assets that, due to their liquidity, are highly subject to misappropriation or theft.

For example, an agency that implements a program to improve the value of its loan portfolio may knowingly bias the assumptions for its credit reform estimates and cause the program to have achieved positive results. Controls such as an independent verification of and

Considerations in the Information and Communication Process

When considering the information and communication process, the senior assessment team might ask the following questions:

- Is information provided to the appropriate people in sufficient detail and at the appropriate time?
- Are developments of or revisions to information systems planned, coordinated, and responsive to information needs?
- Does management demonstrate support for the development of necessary information systems?
- Does management ensure appropriate user involvement in the development of processes and systems?
- Are employees' duties and control responsibilities communicated effectively?
- Is information communicated across the entity to enable people to effectively discharge their responsibilities?
- Is the information necessary to prepare financial statements in conformity with generally accepted accounting principles recorded in and maintained by the entity's information systems?

concurrency with the estimating methodology and the data elements of the estimating assumptions are likely to prevent fraudulent financial reporting.

Fraudulent reporting resulting from misappropriation or theft of liquid assets may be prevented by such safeguard controls as restriction of access, requirements for authorizations, and separation of duties.

Evaluate the Information and Communication Processes

Information related to financial reporting should be communicated to relevant personnel at all levels within the organization. The information should be relevant, reliable, and timely.

To that end, the senior assessment team needs to evaluate the organization's financial reporting processes to determine whether information is based upon integrated systems or the same source information; whether the information is

recorded and communicated in a form and within a time frame that enables managers, operating personnel, and others within the organization who require the information to carry out their internal control, operational, and other responsibilities; and whether the

information is made available to persons external to the organization, as appropriate. This evaluation should be documented in the team's workpapers. The documentation should include the evidence reviewed, inquiries performed, and the conclusion as to whether the process is effective. If the process or aspects of the process are deemed ineffective, the team will need to document this conclusion for remediation by management.

Other matters to evaluate are the communication of employees' control-related duties and responsibilities and the manner in which incoming external communications are handled. These responsibilities are usually documented in position descriptions, policy and procedures manuals, written memos and letters that identify and confirm actions taken, meeting agendas, meeting minutes, and oral communications.

Evaluate the Monitoring Processes

Monitoring the effectiveness of internal control should occur in the normal course of business for all federal agencies. The senior assessment team should evaluate whether each agency is performing its own, independent monitoring and evaluation of the ICOFR environment and identifying and correcting deficiencies in a timely fashion throughout the year. Aspects for the senior assessment team to consider would be:

Considerations in the Monitoring Process

When considering the monitoring process, the senior assessment team might ask the following questions:

- Are periodic evaluations of internal control performed with appropriate scope and frequency; and are appropriate follow-up actions taken?
- Do personnel, in carrying out their duties, obtain evidence that the internal control is functioning?
- Is there ongoing supervision and review of transactions by management?
- Does management adopt internal control recommendations made by the OIG, independent auditors, and GAO?
- What mechanisms exist for capturing and reporting identified internal control deficiencies?

- **Ongoing monitoring activities.** The senior assessment team may evaluate whether the agency's ICOFR includes regular management and supervisory review, comparisons between planned and actual performance, and reconciliations between systems as a part of the regular assigned duties of personnel who affect the agency's financial reporting.
- **Performing separate evaluations.** Management cannot rely solely upon the results of the OIG or GAO to monitor the effectiveness of its ICOFR. Hence, the senior assessment team should evaluate whether the agency has processes and resources in place to perform its own ongoing testing to monitor the operating effectiveness of ICOFR. Processes the team may look for would be inquiries of unusual matters, detail testing of selected transactions, and periodic analysis of trends.
- **Reporting deficiencies.** The senior assessment team should evaluate whether the agency maintains a process for reporting deficiencies in the operating effectiveness of ICOFR to the appropriate level of management, undertakes corrective action in a timely fashion, and has a process in place to track the status of corrective actions.

Obtain and Document the Process Owner's Concurrence with the Documentation of Controls

The senior assessment team should have all transaction cycle narratives, flowcharts, and control matrices reviewed and approved by the agency personnel responsible for the respective transaction cycles and other business processes or for performing the contract activity. All process owner's comments should be retained by the senior assessment team and marked to indicate how the comments were resolved. Each comment should result in either a change to the documentation or, if no change occurs, acknowledgement by the process owner that, after further explanation from the senior assessment team, the comment is not relevant. Upon completion of addressing the comments, the process owner should be asked to sign and date the documentation to show that management has accepted the documentation as a correct representation of the process and controls.

Evaluate Design and Operating Effectiveness

The Evaluate Design and Operating Effectiveness phase requires testing all key controls that are needed to support management's assurance statement on ICOFR. It entails three steps:

- Assess the design of key controls
- Define and document the testing approach
- Test the key controls.

Assess the Design of Key Controls

The senior assessment team should assess the key controls to determine whether they are suitably designed to prevent or detect material errors or misstatements related to an account or group of accounts. The senior assessment team may assess the design of key controls through interview, inquiry, and/or observation of the controls. The assessment should include selecting transactions subject to the control and assessing whether the design of the control, assuming the control is properly executed, would detect any errors or misstatements.

The reviewer should document the results of the assessment of design in a memorandum that includes 1) the name and contact number of any person interviewed, the specific items selected for assessment, the results of the assessment, and his or her conclusion regarding whether the control is designed properly (i.e., would it detect an error or misstatement if properly applied) and 2) should it be considered effective, moderately effective, or not effective. The documentation memorandum should



FAQ: How does management determine whether a control is designed effectively?

Answer: Tests of design are performed to determine whether controls, if operating properly, may effectively prevent or detect misstatements in the entity's financial records. Tests of design are usually performed by inquiry and observation; or inspection of documents, such as reports and completed forms; or through on-screen prompts, such as errors or warnings.

Tests of design typically address the:

- Type of control, including configuration, management review, and authorization
- Nature of the control (i.e., automated or manual, preventive or detective)
- Frequency of the control (e.g., daily, weekly, monthly)
- Experience and competence of the individual performing the control
- Error investigation and correction procedures, including the timeliness of such procedures.

It is important to note that inquiry alone ordinarily is not sufficient to support design effectiveness.

note an identifying number, amount, and date for each transaction reviewed. It should be written in sufficient detail to enable another professional with similar experience and knowledge of the organization to reperform the assessment using the same items.

If a control over a significant account or group of accounts is missing, or if it is determined that the design is not suitable in relation to the associated risk, the senior assessment team will not need to test the control for the purpose of concluding on control effectiveness. These controls should be noted in a list of deficiencies and suggestions for improvement. The list should also contain space for the senior assessment team to note the disposition of the deficiencies. The senior assessment team may want to further test transactions subject to these controls to determine if there was any actual loss, fraud, error, improper payment, or noncompliance resulting from the deemed ineffectiveness.

Define and Document the Testing Approach

The design of the controls is one consideration. For controls to be effective, they must function as designed. This requires testing of the operation of the key controls that were identified in the transaction cycle narratives, flowcharts, and control matrices and then deemed significantly effective or moderately effective during the assessment of the design of controls. (As stated in the previous section, controls deemed not effective do not have to be tested.) The purpose of the test would be to determine the extent to which the controls were applied, the consistency of their application, and who applied them.

To ensure that all key controls are tested, a testing approach should be determined. The testing approach should define the nature, timing, and extent of testing necessary to provide sufficient evidence to support management's assertion. This would require that the transaction cycle narratives, flowcharts, and control matrices be reviewed; the controls that will be tested be listed in a test program; the nature, timing, and extent of testing for each control be defined in the test program; and the controls in the test program be cross-referenced back to the narratives, flowcharts, and control matrices to ensure that all key controls will be subject to testing.

The testing should address both manual and information technology controls. For any given transaction cycle, and assuming an effective information technology control environment, the senior assessment team may place greater reliance with less testing on automated controls than on manual controls.

Nature of testing. In developing the test program, the senior assessment team should define a testing procedure for each key control. The following would be considered acceptable tests:

- Inquiries of appropriate agency personnel
- Inspection of documents, reports, or electronic files indicating performance of the control
- Observation of the application of a specific controls
- Reperformance of the application of the control by the senior assessment team.

Inquiry and observation are less persuasive forms of evidence than inspection and reperformance.

Timing of testing. The senior assessment team should schedule the testing to occur throughout the year; although for some controls, more or less rigorous testing may be appropriate. Also, some controls should be tested quarterly to coincide with the agency's

FAQ: When testing operating effectiveness, what factors should management consider in determining how much testing to perform?

Answer: The amount of testing depends on a number of factors. However, it should be comprehensive enough to support management’s assessment of the effectiveness of ICOFR. This should include considering all relevant assertions for each account and disclosure included in the scope of management’s assessment. In general, management’s testing should be more extensive than that of an independent financial statement auditor.

When determining the extent of testing procedures, management should take into account the nature of the control, its frequency of operation, and the overall significance of the control.

The extent of testing also depends on the risk of failure of the control being tested. Risk of failure is defined as the risk of a material misstatement arising from the failure of a control. If management believes there is a high risk of failure, management should consider expanding the extent of testing for that control.

continued on next page

processes to prepare and submit quarterly financial statements to OMB. This approach allows the senior assessment team to obtain evidence throughout the fiscal year and manage the workload effectively.

Certain financial reporting controls may operate only at year-end, which means there is only one opportunity for testing. If the test fails, there is no opportunity for remediation. Financial reporting processes that traditionally have been performed only at year-end should be considered for implementation during the quarterly financial reporting process. If one of the controls fails, time may still be available for remediation and verification. For example, if an agency calculates its allowance for the uncollectible portion of public accounts receivable only at year-end, the agency should consider calculating the allowance quarterly.

Extent of testing. The extent of testing should be developed by the senior assessment team,

documented in the test plan, and signed off by the affected process owners. Included in the plan should be an identification of the locations at which tests will be made for controls performed at multiple locations. The selection of locations for testing should consider the risks of error and materiality.

Sampling may be used to limit the number of transactions and other items tested, yet ensure the testing is adequate for the conclusions that will be drawn. This requires the use of a sampling approach that provides for sufficient evidence to support management's assurance statement.

There are two types of sampling: statistical and judgmental. Statistical sampling may be considered for tests of complex controls. For instance, if the control is performed in several locations, or is performed a significant number of times during the year, statistical sampling may be the most

Factors that affect whether the control may represent a higher risk of failure include:

- Changes in the volume or nature of transactions
- Changes in the design of controls
- The degree to which the control relies on the effectiveness of other controls (e.g., the control environment or IT general controls)
- Changes in key personnel who perform the control or monitor its performance
- The degree to which the control relies on performance by an individual rather than automation
- The complexity of the control

It is management's responsibility to determine the extent of testing—or sample sizes—that it considers sufficient to support its assessment of the effectiveness of ICOFR.

Management should base its decision on all of these factors.

efficient testing approach. The GAO and AICPA offer statistical sampling approaches for financial statement audit purposes.

The senior assessment team may use the GAO or AICPA guidance, choose to apply judgmental sampling, or select some combination of approaches that would be appropriate for the process. Developing an adequate and representative sampling plan may require the use of a qualified statistician who may define expected error rates and the level of confidence obtained based on actual error rates.

Test the Key Controls

The senior assessment team should test the effectiveness of the controls to determine if the controls are operating effectively and may be relied upon to ensure the assertions are valid. The level of error the senior assessment team is willing to accept should already be documented in the testing plan.

The determination of whether the controls have been applied throughout the period of testing may be accomplished by the senior assessment team selecting a sample of transactions processed throughout the period, based on the sampling plan. The sample should be selected from the complete population of the transactions for which controls are to be tested. The completeness of the population should be verified by comparison with the original data source.

Testing the controls requires reperforming the transactions or controls or applying other test techniques to the selected transactions and determining if the controls performed as designed and expected. The evidence of performance of the controls should be documented with sufficient information for the senior assessment team members to be able to reperform selected tests from the sample, if desired.

Identify and Correct Deficiencies

The next phase in the assessment process is to identify and correct deficiencies. It comprises four steps:

- Interpret the results
- Categorize the types of control deficiencies
- Attempt to remedy deficiencies and test remedied controls
- Evaluate controls between June 30 and September 30.

Interpret the Results

ICOFR is subject to cost-benefit constraints; no system is designed to provide absolute assurance that errors or misstatements will not occur. Hence, the senior assessment team will need to apply judgment to decide whether the rates of errors resulting from ineffective controls are high enough to allow material errors or misstatements to occur and not be detected by agency personnel. These materiality levels and acceptable error rates would have been defined during the Plan and Scope the Evaluation phase.

Also, since the purpose of control testing is to determine if a control is conducted properly and consistently, control testing normally is not solely concerned with dollar amounts, but rather with the execution of the control and the control's relative importance or significance within the class of transaction. Nonetheless, the senior assessment team should consider whether a control that is not performed properly or consistently would allow a material error or misstatement, with



either an individual transaction or a combination of transactions, to occur and not be detected by agency personnel.

The senior assessment team should discuss the test results for every noted error with the process owners to determine whether the error is valid, and if so, whether there are compensating controls that mitigate the problem. This may result in a decision by the senior assessment team to determine if the initial error rate is correct by expanding the sample, but only if expanding the sample is appropriate according to the original sampling plan. If, after additional testing, the control is still considered to be not functioning, it should be documented as a deficiency (i.e., a control that is not functioning and is not compensated for by other controls).

The final step would be for the senior assessment team to discuss the potential impact of the control gaps on financial reporting with the process owners and document the gaps, performance opportunities, and recommendations for control remediation and process improvement. These control gaps should be noted in the list of deficiencies and suggestions for improvement. This provides management the opportunity to remedy the deficient controls prior to the agency's assessment date.

Categorize the Types of Control Deficiencies

As described in Circular A-123, Appendix A, Section II.D, a control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect errors or misstatements on a timely basis. A control deficiency may result from either of the following:

- **Design deficiency**, i.e., a control necessary to meet the control objective is missing or an existing control is not properly designed, so that even if the control operates as designed, the control objective is not always met.
- **Operation deficiency**, i.e., a properly designed control does not operate as designed or the person performing the control is not qualified or properly skilled to perform the control effectively.

A reportable condition is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles to such a degree that there is a more than remote likelihood that a misstatement of the entity's financial statements, or other significant financial reports, that is more than inconsequential will not be prevented or detected.

A material weakness in ICOFR is a reportable condition, or combination of reportable conditions, that results in more than a remote likelihood that a material misstatement of the financial statements, or other significant financial reports, will not be prevented or detected.¹¹

The senior assessment team should list each control deficiency and note whether it is mitigated by a compensating control. If the team cannot successfully test a compensating control, it must decide if the deficiency is significant enough to report outside the agency. Weaknesses significant enough to report outside the agency must be included in the agency head's assurance statement that is included in the Performance and Accountability Report.

"Significant deficiencies" identified under FISMA should be considered material weaknesses to be included in the assurance statement if those significant deficiencies may cause a material misstatement to the agency's financial reports included in the assurance statement.

OMB requires that corrective action plans be developed for all material weaknesses, reportable conditions, other control deficiencies, and "non-conformances" with the financial system requirements.¹²

Attempt to Remedy Deficiencies and Test Remedied Controls

Many agencies will attempt to correct control deficiencies as they are identified. Remediation of controls benefits the agency by 1) improving the effectiveness of the controls in the current fiscal year and 2) allowing the agency to prepare the assurance statement without including control deficiencies that have been remedied prior to June 30, or at least reporting that they have been remedied after June 30 but prior to the end of the fiscal year.

The senior assessment team should review the agency's plan for remedying deficiencies to ensure that sufficient time is available to both complete the remediation and retest the controls prior to either the assessment date (June 30) or the fiscal year-end (September 30). It should then test the remedied controls over a period of time that is adequate for management and the senior assessment team to determine whether the design and operation of the controls are effective as of June 30 or September 30 of the current fiscal year.

This testing should be tracked on the assessment calendar to ensure that it covers transactions in the proper period. Any testing that cannot be completed for the appli-

11. OMB Circular A-123, Exhibit 1.

12. OMB Circular A-123, Section V.

cable period in time for the results to be reported in management's September 30 assurance statement should not be performed since there would be no benefit for the year to which the report pertains.

Evaluate Controls Between June 30 and September 30

Management should update its evaluation of the internal controls from June 30 to its fiscal year-end September 30. In that process, management needs to consider any weaknesses disclosed at June 30, whether those weaknesses have been corrected or whether any new weaknesses have been identified. Management should consider the effect on their initial report and update that report, if necessary. For example, if the senior assessment team identifies any errors when testing year-end controls, the team should consider whether those errors constitute a material weakness. If so, the agency head would be required to update its assurance statement with information obtained as of September 30.

The following is a list of indicators to assist the team in making a determination about whether new material weaknesses have developed between June 30 and September 30.

- Major changes in the agency's mission or programs
- Reorganizations or other changes to the agency's organizational structure
- Significant increases or decreases in staffing levels
- Turnover of key management personnel or personnel who perform key control activities
- Results of the financial statement audit
- Results of any program audits performed by the OIG or GAO.

Report on Internal Control

The last phase in the assessment process is for the agency head to report on the effectiveness of ICOFR. It comprises two steps:

- Arrive at the overall conclusion
- Prepare management's assurance statement on ICOFR.

Arrive at the Overall Conclusion

Management must arrive at a conclusion as to the operating effectiveness of the agency's ICOFR. The conclusion should be based on the results of the assessment performed at the entity-wide level and of assessments made at the component, process, transaction, application, and other subordinate levels. A sample letter that may be used by the heads of these subordinate activities to provide assurance to the agency head on the ICOFR under his or her control is provided in Appendix 3.

Management will need to state its conclusion in one of the following forms:

- **Unqualified statement of assurance.** Recognizes there are no material weaknesses to be reported.
- **Qualified statement of assurance.** Recognizes there are one or more explicitly noted material weaknesses.
- **Statement of no assurance.** Recognizes there are pervasive material weaknesses to be reported.



Prepare Management's Assurance Statement on ICOFR

The final step in the Report on Internal Control phase is for management to prepare an assurance statement on the ICOFR that is to be included in the agency's annual Performance and Accountability Report. The purpose of the statement is to report the results of management's assessment of the effectiveness of ICOFR as of June 30 of that fiscal year (but updated to September 30 if appropriate because of existing weaknesses that are corrected or new weaknesses that are identified between June 30 and September 30).

The assurance statement must include the following:

- A statement of management's responsibility for establishing and maintaining adequate ICOFR for the agency
- A statement identifying OMB Circular A-123, *Management's Responsibility for Internal Control*, as the framework used by management to conduct the assessment of the effectiveness of the agency's ICOFR
- An assessment of the effectiveness of the agency's ICOFR as of June 30, including an explicit conclusion as to whether ICOFR is effective

Additional information should be included in the assurance statement if one of the following has happened.

- If a material weakness is discovered as of June 30, but corrected as of September 30, the statement should identify the material weakness and the corrective action taken and state that the material weakness has been resolved by September 30.
- If a material weakness is discovered after June 30, but prior to September 30, the statement should be updated to include the subsequently identified material weakness.

The assurance statement should be accompanied by a summary of the corrective action plans for the material weaknesses and system "non-conformances." The summaries should include a description of the material weaknesses, the status of corrective actions, and the timelines for completion. (The corrective action plans need not be reported for reportable conditions not included in the FMFIA report, but they do need to be tracked internally.)

To assist management in developing its assurance statement, the following sample assurance statements are included in Appendix 4. These statements should be modified to an agency's individual reporting needs.

- Appendix 4A: Unqualified Statement of Assurance (No Material Weaknesses Reported) as of June 30
- Appendix 4B: Qualified Statement of Assurance (One or More Material Weaknesses Reported) as of June 30
- Appendix 4C: Statement of No Assurance (Pervasive Material Weaknesses) as of June 30
- Appendix 4D: Update as of September 30 from a Qualified Statement of Assurance to an Unqualified Statement of Assurance
- Appendix 4E: Update as of September 30 from a Statement of No Assurance (Pervasive Material Weaknesses) to an Unqualified Statement of Assurance
- Appendix 4F: Update as of September 30 from an Unqualified or Qualified Statement of Assurance to Include One or More Additional Material Weaknesses Not Reported as of June 30

Appendix 1A. Example Documentation

Example Map of Significant Accounts to Transaction Cycles

| Financial Statement Line Item | Transaction Cycle |
|-------------------------------------|---|
| Fund Balance with Treasury | <ul style="list-style-type: none">• Funds Mgmt. |
| Investments | <ul style="list-style-type: none">• Funds Mgmt. |
| Accounts Receivable, Net | <ul style="list-style-type: none">• Revenue Mgmt.• Grants Mgmt. |
| Property, Plant, and Equipment, Net | <ul style="list-style-type: none">• Procurement.• Property Mgmt. |

Appendix

1B. Example Documentation

Components of a Transaction Cycle Narrative

Transaction Cycle Name:

For example, “funds management”

Transaction Cycle Owners

Identify the individuals responsible for carrying out the transaction cycle.

Transaction Cycle Objectives

Identify the objective for the transaction cycle in specific terms, e.g., obtain and record the agency’s Fund Balance with Treasury.

Inputs

List the documents or transactions that initiate the transaction cycle, e.g., enactment of the agency’s appropriations law, along with transmittal of the Treasury Appropriation Warrant, are primary inputs to the funds management transaction cycle.

Activities

List the actions that produce the outputs of the cycle, e.g., the monthly reconciliation of the agency’s Fund Balance with Treasury is a major activity of the funds management transaction cycle.

Outputs

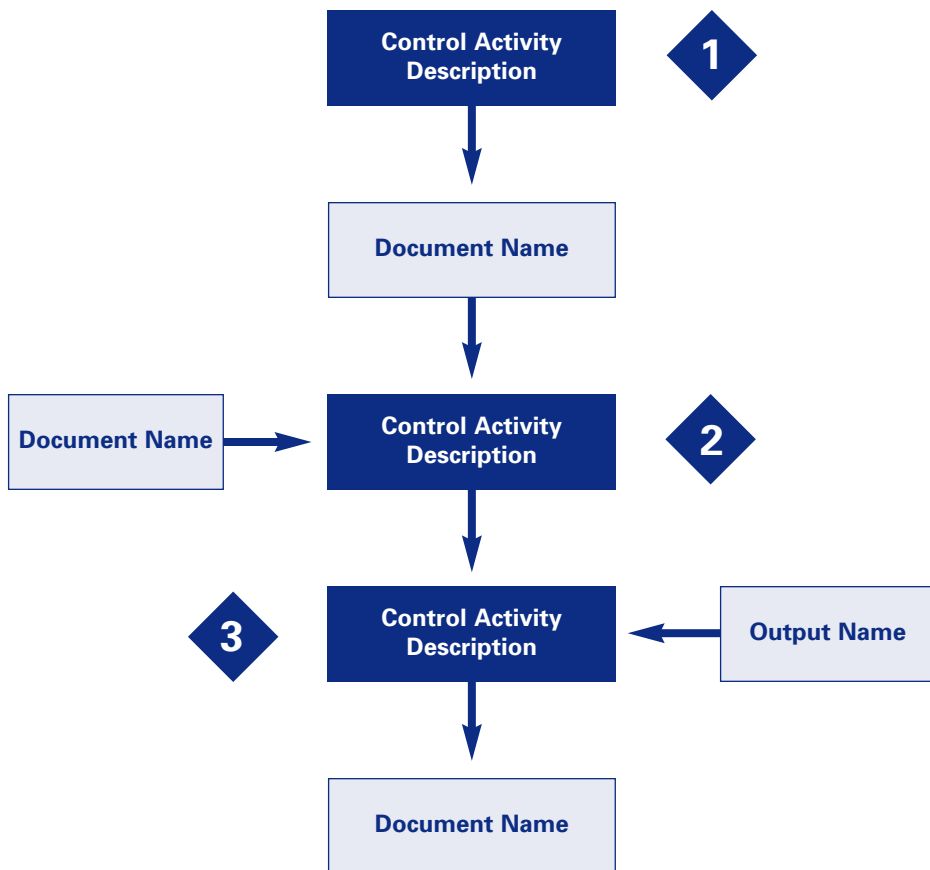
List the end result of the cycle, i.e., the deliverables, information, or resources that are produced (e.g., the Standard Form 224, Statement of Transactions, is an output of the funds management transaction cycle).

Transaction Cycle Controls

Identify the controls that have been established to prevent or detect errors or misstatements in initiating, authorizing, recording, processing, and reporting of significant classes of transactions. Number the controls and identify them by type.

Appendix 1C. Example Documentation

Transaction Cycle Flowchart



1, 2, and 3. Indicate here or elsewhere whether the control is a key control.

Appendix

1D. Example Documentation

Control Matrix

Transaction Cycle: _____

| Assertions | Risk to Be Mitigated | Key Control Activities |
|---|--|---|
| <p>Identifies the report assertions the controls cover. One control activity may cover more than one assertion.</p> | <p>Identifies the risks that need to be mitigated by the controls.</p> | <p>Describes the key controls that are in place to mitigate identified risks.</p> |
| Control Number | Control Type and Method | Level of Control |
| <p>Cross-references the controls to flowcharts and cycle narratives.</p> | <p>Identifies the type of control (e.g., management review, separation of duties) and whether the control is automated or manual.</p> | <p>Identifies whether the control is preventive, detective, or corrective in nature.</p> |
| Frequency | Objective | Significance of Control |
| <p>Identifies the frequency of the control activity, e.g., daily, monthly, semi-monthly, quarterly, annually, or as needed.</p> | <p>Indicates whether the control activity relates to the financial, operational, or compliance with laws and regulations aspect of the agency.</p> | <p>Indicates whether the control is a key or non-key control. Key controls are those controls designed to meet the agency's control objectives and cover management's financial statement assertions. Only key controls are tested.</p> |

Appendix

2. Example Documentation

Sample Control Activities for Preventing and Detecting Control Deficiencies

| Account or Line Item | Assertion | Type of Control Activity |
|--------------------------------|------------------------------------|--|
| Fund Balance with Treasury | Existence and occurrence | Accurate and timely recording of transactions, account reconciliation |
| Accounts Receivable | | Timely invoicing for services/goods provided Compliance with the Debt Collection Improvement Act |
| Debt Payable | Completeness | Reconciliation with the Treasury Bureau of Public Debt |
| Accounts Payable | | Separation of duties between accepting delivery and processing invoices Compliance with the Prompt Payment Act |
| Property, Plant, and Equipment | Rights and obligations | Periodic inventory and reconciliation of inventory to property records |
| Loans Receivable | Valuation | Annual credit reform reestimates |
| | Presentation and disclosure | Review and reconciliation processes Compliance with OMB guidance on form and content of agency financial reports |
| Expenditures | Compliance | Review and approval of disbursement requests at the activity level prior to executing the transaction to ensure sufficient budget authority Reconciliations to agency financial records |
| Inventories | Safeguarding | Physical controls that safeguard inventory and limit access to authorized officials |
| Financial Data | | User identifications and passwords |
| All Accounts and Line Items | Documentation | Library-related mechanisms for both hard copy and online versions Documentation version management |

Appendix

3. Example Documentation

Sample Assurance Letter from a Designated Senior Official to the Agency Head

Dear [Agency Head]:

In accordance with your delegation of responsibilities to me, I have directed an evaluation of the internal control over financial reporting of [Agency] in effect during the year ended June 30, 200X. This evaluation was conducted in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*, dated December 21, 2004.

In evaluating internal control over financial reporting at [Agency], I directed my staff to:

- Identify the financial reports that have a material effect on [Agency's] financial decisions
- Identify the accounts in each selected report that are material to the report
- Identify the transaction cycles that generate the information for these accounts
- Document and obtain an understanding of those transaction cycles
- Evaluate the agency's control environment, risk assessment process, information and communication processes, and monitoring process
- Identify the control activities in each transaction cycle
- Assess the design of the controls to determine whether they would prevent or detect errors or misstatements in the selected financial statements
- Test the controls that are considered suitably designed and assess whether they are functioning as designed.

Based on the results of this evaluation, the [Agency] may provide reasonable assurance that internal control over financial reporting as of June 30, 2xxx, was operating effectively, **with the exception of the following material weakness(es) that was (were) found in the design or operation of the internal controls over financial reporting.**

- **Insert title(s) and description(s) of material weakness(es)**

[Or, if an unqualified assurance statement may be made, replace the bolded statement above with the following: "and no material weaknesses were found in the design or operation of the internal controls over financial reporting."]

Name of Designated Senior Official

Appendix

4A. Sample Assurance Statement

Unqualified Statement of Assurance (No Material Weaknesses Reported) as of June 30

Fiscal Year 2xxx

Annual Assurance Statement on Internal Control over Financial Reporting

The [Agency's] management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The [Agency] conducted its assessment of the effectiveness of the [Agency's] internal control over financial reporting in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*.

Based on the results of this evaluation, the [Agency] may provide reasonable assurance that internal control over financial reporting as of June 30, 2xxx, was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

Head of the Agency

Date

Appendix

4B. Sample Assurance Statement

Qualified Statement of Assurance (One or More Material Weaknesses Reported) as of June 30

Fiscal Year 2xxx

Annual Assurance Statement on Internal Control over Financial Reporting

The [Agency's] management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The [Agency] conducted its assessment of the effectiveness of the [Agency's] internal control over financial reporting in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*.

Based on the results of this evaluation, the [Agency] may provide reasonable assurance that internal control over financial reporting as of June 30, 2xxx, was operating effectively, with the exception of the following material weakness(es) that was (were) found in the design or operation of the internal controls over financial reporting.

- **Insert title(s) and description(s) of material weakness(es)**

Head of the Agency

Date

Appendix 4C. Sample Assurance Statement

Statement of No Assurance (Pervasive Material Weaknesses) as of June 30

Fiscal Year 2xxx

Annual Assurance Statement on Internal Control over Financial Reporting

The [Agency's] management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The [Agency] conducted its assessment of the effectiveness of the [Agency's] internal control over financial reporting in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*.

Based on the results of this evaluation, the [Agency] is unable to provide reasonable assurance that internal control over financial reporting as of June 30, 2xxx, was operating effectively. The [Agency] noted the following material weaknesses that were found in the design or operation of the internal controls over financial reporting.

- **Insert title(s) and description(s) of material weakness(es)**

Head of the Agency

Date

Appendix

4D. Sample Assurance Statement

Update as of September 30 from a Qualified Statement of Assurance to an Unqualified Statement of Assurance

Fiscal Year 2xxx

Annual Assurance Statement on Internal Control over Financial Reporting

The [Agency's] management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The [Agency] conducted its assessment of the effectiveness of the [Agency's] internal control over financial reporting in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*.

Based on the results of this evaluation, the [Agency] was able to provide reasonable assurance that internal control over financial reporting as of June 30, 2xxx, was operating effectively, with the exception of the following material weakness(es) that was (were) found in the design or operation of the internal controls over financial reporting.

- **Insert title(s) and description(s) of material weakness(es)**

The [Agency] has taken corrective action to resolve the material weakness(es) noted above, and has reevaluated its internal control over financial reporting. Based on the results of this evaluation, the [Agency] may provide reasonable assurance that internal control over financial reporting, as of September 30, 2xxx, was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

Head of the Agency

Date

Appendix 4E. Sample Assurance Statement

Update as of September 30 from a Statement of No Assurance (Pervasive Material Weaknesses) to an Unqualified Statement of Assurance

Fiscal Year 2xxx

Annual Assurance Statement on Internal Control over Financial Reporting

The [Agency's] management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The [Agency] conducted its assessment of the effectiveness of the [Agency's] internal control over financial reporting in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*.

Based on the results of this evaluation, the [Agency] was unable to provide reasonable assurance that internal control over financial reporting, as of June 30, 2xxx, was operating effectively. The [Agency] noted the following material weaknesses that were found in the design or operation of the internal controls over financial reporting.

- **Insert title(s) and description(s) of material weakness(es)**

The [Agency] has taken corrective action to resolve the material weaknesses noted above, and has reevaluated its internal control over financial reporting. Based on the results of this evaluation, the [Agency] may provide reasonable assurance that internal control over financial reporting, as of September 30, 2xxx, was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

Head of the Agency

Date

Appendix

4F. Sample Assurance Statement

Update as of September 30 from an Unqualified or Qualified Statement of Assurance to Include One or More Additional Material Weaknesses Not Reported as of June 30

Fiscal Year 2xxx

Annual Assurance Statement on Internal Control over Financial Reporting

The [Agency's] management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The [Agency] conducted its assessment of the effectiveness of the [Agency's] internal control over financial reporting in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*.

Based on the results of this evaluation, the [Agency] may provide reasonable assurance that internal control over financial reporting as of June 30, 2xxx, was operating effectively, **with the exception of the following material weakness(es) that was (were) found in the design or operation of the internal controls over financial reporting.**

- **Insert title(s) and description(s) of material weakness(es)**

[Or, if an unqualified assurance statement was made, replace the bolded statement above with the following: "and no material weaknesses were found in the design or operation of the internal controls over financial reporting."]

Since that evaluation was performed, the [Agency] has updated its evaluation of internal control over financial reporting. Based on the results of this evaluation, the [Agency] cannot provide reasonable assurance that internal control over financial reporting, as of September 30, 2xxx, was operating effectively. The [Agency] noted the following material weaknesses that were found in the design or operation of the internal controls over financial reporting.

- **Insert title(s) and description(s) of material weakness(es)**

Head of the Agency

Date

KPMG LLP

Contacts

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