

SECTION 1 CHAPTER 1 OVERVIEW

Legislative and regulatory requirements for federal agencies to establish and maintain adequate internal control programs are not new; they date back almost fifty years. The historical evolution of the internal control program is characterized by a number of key events that have had a significant influence on the current program as it operates today.

The Department's internal control organizational structure provides for the involvement and interaction of many personnel; their respective roles and responsibilities help contribute to a successful Departmental internal control program. Management recognizes the importance of internal controls to ensure efficient and effective programs and operations within their organizations.

BACKGROUND AND AUTHORITY

The Congress, the Office of Management and Budget (OMB), and the Government Accountability Office (GAO) have directed agencies to establish and maintain sound internal control systems as a primary means of improving accountability, effectiveness and efficiency in achieving program goals and objectives, and in preventing fraud, waste, and mismanagement. The Department promotes the continuous monitoring of internal controls as part of daily program and operations management to strengthen management accountability and enhance and improve program performance and operations.

The Federal Managers' Financial Integrity Act (FMFIA), OMB Circular A-123, "Management's Responsibility for Internal Control," which was revised December 21, 2004, requires agencies to conduct an ongoing review of internal controls and to report annually on the adequacy of agencies' program and operation internal control systems. Under authority provided by the Government Management Reform Act (GMRA), the Department's annual assurance statement on compliance with the FMFIA is incorporated into the Department's Annual Performance and Accountability Report (PAR). Appendix A to OMB Circular A-123 requires the submission of an additional assurance statement as of June 30 each year regarding financial reporting. The Chief Financial Officers (CFO) Act and Government Performance and Results Act (GPRA) reinforce the need for having effective internal controls. Department managers should establish environments where internal controls are understood, encouraged, practiced, and implemented.

The basic authority for establishing and maintaining agency controls is established in the Accounting and Auditing Act of 1950 (U.S.C. 3512), as amended by the FMFIA.

DEPARTMENT'S GPRA GOAL FOR INTERNAL CONTROL

The Department's overall GPRA goal for the Internal Control Program is twofold: (1) To ensure that a sound system of internal controls exists in all programs, organizations, and functions that meets the objectives and requirements of FMFIA and OMB Circular A-123, as revised; and, (2) To implement an effective, efficient, and systematic approach to assessing internal controls that integrates other management improvement initiatives within the Department. The Department's Management Excellence goal for improved accountability is to obtain an unqualified audit for DOI's eight bureaus, the Departmental offices, and the Department's consolidated financial statements. The timely correction of identified deficiencies is essential to improving the efficiency and effectiveness of DOI's programs and operations, and to achieving integrity and accountability goals. The current Departmental annual performance measure for internal control calls for correction of 100% of audited financial statement and FMFIA material weaknesses on schedule each year. Timely correction of material weaknesses will be accomplished through implementation of corrective action plans and more frequent monitoring of bureaus' progress by the Office of Financial Management (PFM), bureau senior management, the Senior Management Council, and internal control coordinators (ICCs).

Performance goals and measures are intended to enhance decision making and accountability; provide information on how a program is operating; and relate program results to organization or program mission, goals, and objectives. The Department's annual performance goal reflects these objectives and promotes management accountability as required by the GPRA.

ORGANIZATIONAL STRUCTURE

DOI has established an integrated organizational structure to implement the Internal Control Program. This structure starts with the Secretary, descends to the program assistant secretary, to the bureau director, and finally to the program manager. Roles and responsibilities of key components of the Internal Control Program are described below.

ROLES AND RESPONSIBILITIES

The Secretary - establishes internal policy direction for the Internal Control Program, issues an assurance statement on financial reporting in June of each year, which is updated in September, and submits the annual Performance and Accountability Report to the President and the Congress, which includes an annual assurance statement on FMFIA, in November of each year.

The Assistant Secretary-Policy, Management and Budget (Assistant Secretary-PMB) and Chief Financial Officer (CFO) - has operational responsibility for the Internal Control Program. The Chief Financial Officers Act of 1990 placed responsibility for internal controls with the agency CFO to ensure the Department's compliance with OMB Circulars A-123 and A-127, the FMFIA, the CFO Act, the FFMA, and the GPRA.

Inspector General (OIG) – is responsible for performing routine evaluations of internal controls within the scope of internal audits, as part of the OIG overall program of audits and

investigations, and reporting the results in its audit reports. In addition, the OIG annually reviews bureaus' administrative and accounting controls as part of its financial statement audits.

Program Assistant Secretaries/Solicitor – Program assistant secretaries and the Solicitor have responsibility over the various bureau programs within their purview, and are encouraged to establish internal control and audit follow-up councils or oversight groups in their respective organizations to coordinate and monitor the internal control and audit follow-up requirements for their bureaus' programs. Such councils or oversight groups may be used to implement the responsibilities for internal control which, at a minimum, are: (1) Institutionalizing the internal control process within their organizations; (2) Establishing priorities in identifying, correcting and reporting of internal control material weaknesses and accounting non-conformances; (3) Ensuring that funding to correct identified deficiencies is addressed in the budget formulation and execution process; and (4) Establishing a quality assurance process that permits the responsible official to provide reasonable assurance to the Secretary that the objectives of the FMFIA are being achieved. Program assistant secretaries also have Department-wide responsibilities for internal control as members of the Senior Management Council. Specific duties of the Council are defined in this section.

Bureau and Office Heads – Bureau heads and/or senior-level management officials are responsible for establishing and maintaining the system of internal control within their bureaus/offices. This includes determining that the system of control is consistent with standards prescribed in OMB Circular A-123, which are drawn in large part from GAO's "Standards for Internal Control in the Federal Government." This also includes determining that the systems of control are functioning as intended; properly documented, modifying the control systems, as appropriate, for changes required; and ensuring that the type, number and quality of control evaluations conducted are sufficient to provide assurance in disclosing the existence of any internal control weakness and/or accounting systems non-conformance. Bureau heads are also responsible for:

- Determining on an annual basis which programs or administrative functions should be subject to a formal review in order to supplement management's judgment as to the adequacy of internal controls;
- Ensuring internal control guidelines issued by the Departmental Offices of Financial Management, Acquisition Management (PAM), Chief Information Officer (OCIO), and other Departmental offices are implemented;
- Allocating adequate resources to evaluate their systems of control;
- Developing procedures, documentation, training, and reporting requirement necessary to review, establish, maintain, test, improve, and report on control systems within their bureau programs and operations;
- Reporting to the Assistant Secretary-PMB and the Senior Management Council, in consultation with their Assistant Secretary, internal control deficiencies identified in audit reports, internal reviews, and from other sources;
- Specify employee accountability by including program specific internal control elements and standards in all managers' performance evaluations; and

- Ensuring timely correction and validation of all identified program and operational deficiencies whether material and/or nonmaterial;

Program Managers – Are responsible for insuring compliance with requirements for internal controls for their programs. Specifically, they must undertake within their programs, the duties listed above for bureau directors and office heads.

Senior Management Council (SMC) - within DOI, the responsibilities of the Senior Management Council are implemented by the DOI Internal Control and Audit Follow-up Council which is chaired by the Assistant Secretary-PMB and is comprised of all program assistant secretaries, the Solicitor, the Inspector General (ex officio), Deputy Assistant Secretary for Business Management and Wildland Fire, the Chief Information Officer, and Senior Procurement Executive. The Council provides senior-level oversight of the Internal Control and Audit Follow-Up programs, resolves issues related to both programs, and decides reporting issues for the Department’s Annual Performance and Accountability Report. Specifically, the council will:

- Ensure DOI’s commitment to an appropriate internal control environment;
- Approve DOI’s implementation plan for assessing and reporting on internal controls over financial reporting;
- Assess and monitor correction of deficiencies in internal control;
- Identify and ensure correction of systemic weaknesses;
- Review and approve management’s annual assertion on effectiveness of internal controls over financial reporting;
- Recommend to the Assistant Secretary-PMB which control deficiencies are material to disclose in the annual FMFIA assurance statement and PAR;
- Oversee implementation of corrective actions related to material weaknesses; and
- Determine when sufficient action has been taken to declare a reportable condition or material weakness corrected.

Senior Assessment Team (SAT) – The duties of the Senior Assessment Team as defined in Circular A-123 are assigned to the DOI Management Initiatives Team (MIT) which is chaired by the Assistant Secretary-PMB and comprised primarily of Deputy Assistant Secretaries and Bureau Deputy Directors. Duties of the MIT in implementing the Circular are to:

- Ensure assessment objectives are clearly communicated throughout the agency;
- Ensure adequate funding and resources are made available to comply with the new requirements of the Circular;
- Ensure assessments are planned, conducted, documented and reported upon in a thorough, effective, and timely manner;
- Identify staff and/or secure contractors to perform assessments;
- Determine the scope of assessments and materiality thresholds in accordance with the new requirements of the revised Circular; and
- Determine or approve assessment design and methodology for each entity and the Department.

Office of Financial Management (PFM) is responsible for: (a) Providing staff assistance to the Assistant Secretary-PMB and the Senior Management Council; (b) Recommending internal control policies and procedures; (c) Providing oversight and guidance to the bureaus/offices concerning the review, evaluation, and maintenance of effective controls; (d) managing, directing, and evaluating the Department's reporting under OMB Circulars A-123 and A-127, the FMFIA, the FFMIA, and the CFO Act.

Office of Acquisition and Property Management (PAM) is responsible for developing and issuing control evaluation guidelines for the acquisition, Federal assistance and property management functional areas; assessing the results of bureau control evaluations in these areas; and providing to PFM annually a summary assessment of the adequacy of bureau controls in these functional areas. PAM is also responsible for overseeing, monitoring, and assessing and recommending for approval to PFM the completion of bureau corrective action plans addressing acquisition and property management material weaknesses, and advises PFM and Assistant Secretary-PMB regarding the closure of bureau/office recommendations.

Office of the Chief Information Officer (OCIO) is responsible for developing and issuing control evaluation guidelines for conducting reviews of information technology general support systems and major applications; assessing the results of bureau control evaluations in these areas; and providing to PFM annually a summary assessment of the adequacy of bureau controls in these areas. OCIO also reviews corrective action plans for identified IT deficiencies, and advises PFM and Assistant Secretary-PMB regarding the closure of bureau/office IT recommendations.

Department's Office of Environmental Policy and Compliance (OEP), Office of Human Resources (OHR), Office of Civil Rights, and Office of Budget (POB) are responsible for issuing guidance to assist bureaus in conducting control evaluations of their respective functional areas and correcting identified deficiencies.

Office of Planning and Performance Management (PPP) is responsible for developing and issuing guidelines on the preparation of strategic plans, annual performance plans, and annual performance reports. Guidelines include using internal control reviews to fulfill GPRA requirements for program evaluations and data verification and validation. PPP also is responsible for review and clearance of GPRA documents prior to publication, and collaboration with PFM on the selection of GPRA goals and measures for the Performance and Accountability Report.

NOTE: Several other components, for example Human Resources and Ethics, of the Department also play a key role in the management of the internal control processes of the DOI. These components include the Chief Financial Officers Council, the Executive Steering Committee for the Finance and Business Management System, and the various specialty groups that meet regarding specific matters (Finance Officers' Partnership, Acquisition Council, etc.).

See 340 DM 1 (pages 3 to 6) in Exhibit 1 for detailed information on the roles and responsibilities of the Assistant Secretary - PMB, Inspector General, Assistant Secretaries/Solicitor, Bureau Heads, PMB internal control coordinators and others in the Department's internal control process.

CALENDAR OF EVENTS

A generalized Department-wide calendar for each step of the internal control process is shown in Addendum A. Annual updates to this schedule providing specific due dates are prepared by PFM and transmitted in a yearly guidance memorandum to program assistant secretaries, heads of bureaus and offices, and internal control coordinators.

INTERNAL CONTROL PROCESS

The Internal Control Program consists of six major components.

1. Developing and Updating the Annual Internal Control Review Plan

The Internal Control Review Plan (ICRP) is an annual written plan which summarizes a bureau's components; identifies the relative priority ranking of each component (high, medium, or low risk activity); establishes the type of control evaluation to be conducted and the year in which the evaluation is to be completed; and fixes the responsibility for conducting the evaluation as planned. This plan provides a system for verifying and maintaining key controls in the Department's processes through careful planning, continued inspection, and corrective action where required.

2. Conducting Internal Control Assessments

An Internal Control Assessment is a systematic and comprehensive evaluation of a system to determine whether the internal controls are adequate to provide reasonable assurance of meeting the component's objectives efficiently and effectively while safeguarding government resources. All internal control assessments require testing to determine compliance with GAO control standards. The Department uses two types of control evaluation: the Internal Control Review (ICR) and the Alternative Internal Control Review (AICR). Emphasis should be placed upon using the type of review which best provides assurance that the control is in place and working effectively.

An Internal Control Review is an evaluation of key internal controls over all significant areas or activities of a component to determine if they are operating as intended. These evaluations must be supported by documentation, i.e., the individual(s) who conducted the testing and the date, the methods used to test the controls, controls tested, sample items, results, any deficiencies detected, and corrective action(s) taken.

An Alternative Internal Control Review provides the opportunity to narrow the scope of the review and focus attention on areas or activities of a component which have the highest potential

for ineffective or inefficient operation or loss of government resources. Examples of an AICR include OIG and GAO audit reports, program evaluations, GPRA annual assessments, Congressional reports, bureau internal studies relating to operations, and reviews of financial systems and applications.

The Department's automated assessment tool can be a more efficient and less resource intensive alternative to a traditional internal control assessment. The automated approach utilizes standard assessment templates for common administrative programs and functions along with supplemental procedures, as necessary (see Chapter 2 for more information on the automated assessment approach).

3. Monitoring Quality Control Over Evaluations

The quality control process includes all internal control evaluations including AICRs, ICRs, and Departmental Functional Reviews (DFRs). This involves verifying and maintaining a desired level of quality by careful planning, continued inspection, and corrective action where required. Quality control can be accomplished through the use of the following tools:

- a. Review Tracking System
- b. Internal Control Review Committee
- c. Peer Review
- d. OIG/GAO Audit
- e. Internal Control Coordinators

4. Developing and Implementing Corrective Actions

The determination of weakness materiality is at the discretion of Bureau management. Following the identification of weaknesses during the internal control assessment, material weakness corrective action plans must be developed and implemented. The culmination of the internal control process is not the preparation of evaluation reports; it is the improvement of program and functional services through the timely correction of control weaknesses. There are five types of control weaknesses:

Internal 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 misstatements on a timely basis.

Reportable Condition – A control deficiency or combination of control deficiencies that in management's judgment should be communicated because they represent significant weaknesses in the design or operation of internal control that could adversely affect the organization's ability to meet its internal control objectives.

While there is no requirement to report to the next higher management level, reportable conditions must be corrected and monitored. If the agency head determines the deficiency to be significant enough to be reported outside the agency, it shall be

considered a material weakness and must be reported and tracked.

Material weaknesses – 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. The two types of material weaknesses are:

- **FMFIA overall** – Reportable conditions in which the agency head determines to be significant enough to report outside of the agency.
- **Financial reporting** – 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.

Non-conformance - A condition in which financial management systems do not substantially conform to financial systems requirements. Financial management systems include both financial and financially-related (or mixed) systems. The OIG often terms this as a Non-compliance issue.

Non-material weaknesses - Control problems that can be corrected at the bureau level without the approval or attention of the next higher level of management.

The annual reporting of material weaknesses should comply with the format specified by PFM. Types of material weaknesses, at a minimum, to be included in the report are:

- Conditions which could lead to substantial damage or loss of a significant public asset or natural, biological, cultural or historical resource;
- Conditions which significantly impair the fulfillment of the Department's or Bureau's mission;
- Conditions which indicate systemic deficiencies across bureaus or in the Department's central support systems;
- Conditions that could lead to inaccurate or incomplete information being provided in areas of major importance to operations or policy;
- Conditions which result in an audit qualification on a financial statement;
- Waste, Fraud, and Abuse: An inherent program or administrative functional material weakness that makes the program or activity susceptible to fraud, waste and abuse;
- Inability to Carry Out Your Mission: A systemic deficiency caused by ineffective program or management support, financial systems, policies, and/or procedures established by a bureau or reporting entity to carry out a major program or administrative function;
- Health and Safety: A material weakness that is seriously detrimental to the public health or safety, a program or administrative activity, service delivery, national security, economic growth, privacy, or citizen's rights; and/or

- **System Security:** A material weakness that could result in significantly impaired service, program failure, significantly reduced program effectiveness or efficiency, public injury or loss of life, unreliable decision-making data, reduced confidence in government, and unauthorized disclosure, manipulation or misuse of sensitive information such as personal, financial management, or programmatic data maintained in computerized systems.

Bureaus must establish and maintain a follow-up system, record and track material and non-material weaknesses and non-conformance corrective actions, and monitor related progress against scheduled completion dates.

5. Reporting

Preparing and Issuing an Annual Assurance Statement on Financial Reporting

The Annual Assurance Statement for Internal Control over Financial Reporting is required beginning in fiscal year 2006. This assurance statement is a subset of the overall Statement of Assurance (item 6) and is based on the results of management's assessment as of June 30, conducted in accordance with the requirements of OMB's Circular A-123, Appendix A. Any changes to the conditions reported in the as of the June 30 Assurance Statement, whether positive (corrected weakness) or negative (additional identified weakness), is to be reported on an updated statement as of September 30.

Preparing and Issuing an Annual Assurance Statement on Compliance with FMFIA

The Annual Assurance Statement is required in the annual FMFIA reporting process. Bureau and office heads prepare an annual assurance statement that is submitted through their respective program Assistant Secretary to the Assistant Secretary – Policy, Management and Budget. Bureau assurance statements form the basis for the Secretary's Annual Assurance Statement which is submitted to the President and the Congress as part of the Department's Annual Report on Performance and Accountability (PAR). Annually, PFM will provide a sample assurance statement template.

6. Verifying and Certifying Corrective Actions

The final component in the Department's Internal Control Process involves verifying and certifying that corrective actions have been taken. For all non-material control deficiencies, reportable conditions, and material weaknesses, the responsible program official is accountable for ensuring that planned corrective action(s) are completed and that the identified weaknesses or non-conformances are resolved. This certification should be incorporated into the bureau internal Corrective Action Tracking System reporting process.

A more detailed explanation of these steps is provided in later chapters of the handbook.