SECTION 2
CHAPTER 5
IDENTIFYING AND CORRECTING DEFICIENCIES

Identifying and correcting deficiencies involves four steps:

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

INTERPRET THE RESULTS

Analyze the results and determine if the error rate on each control exceeded the acceptable error rate as written in the plan or was high enough to allow material errors or misstatements to occur without detection. Beyond just dollar amounts, consider whether a control that is not executed properly or consistently would allow a material error or misstatement to occur and not be detected and the control's importance or significance. Process owners should review and validate detected errors and determine if compensating controls may mitigate the problem. A compensating control is a technique or other effort(s) designed to mitigate the absence of a control or to mitigate a deficiency in control design or operating effectiveness. The sampling plan should allow for the expansion of the sample to determine if the initial error rate is correct when it appears the original smaller sample was not representative of the function of the controls. If, after additional testing, the control is still considered to be not functioning, it should be documented as deficient (i.e., a control that is not functioning nor is mitigated by other controls).

As a final step, process owners should review the likely impact of the control gaps on financial reporting. A control gap exists when a control for a given financial statement assertion does not exist, does not adequately address a relevant assertion, or is not operating effectively. List the gaps in the list of deficiencies and document suggestions for repairing controls and processes. This provides management the opportunity to remedy the deficient controls prior to the Department's assessment date.

CATEGORIZE THE TYPES OF CONTROL DEFICIENCIES

An internal control deficiency[13] 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 deficiency in design keeps the control objective from being met even when the control functions as designed. A deficiency in operation is a properly designed control does not operate as designed or is performed by an unqualified or improperly skilled person. Deficiencies are categorized as follows:[14]

- Simple deficiency - generally an anomaly and creates minimal exposure for management (e.g. missing initials indicating a supervisor's review on 1 of 26 reconciliations sampled).

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[13] Control deficiency and related reportable condition and material weakness are based on the definitions provided in Auditing Standard No. 2 – An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements issued by the Public Company Accounting Oversight Board (PCAOB) and referred to in the Implementation Guide for OMB Circular A-123, Management's Responsibility for Internal Control, Appendix A

[14] Page 38 in CFO Council's *Implementation Guide for OMB Circular A-123, Management's Responsibility for Internal Control, Appendix A*

- Significant deficiency - indicates a history of internal control deficiencies that when consolidated equate to a reportable condition (e.g. only 8 months of reconciliations were performed for the year).
- Reportable condition - significant internal control deficiency, or combination of control deficiencies, that adversely affects Interior'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 more than a remote[15] likelihood that a misstatement in the financial statements, or other significant financial reports, that is more than inconsequential[16] will not be prevented or detected.
- Material weakness - 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 (e.g. reconciliation of several key accounts were not performed throughout the year, only at year-end).

List each control deficiency and note whether it is mitigated by a compensating control. If it is not mitigated or can not be tested then decide if the deficiency is significant enough to report outside Interior. Weaknesses significant enough to report outside Interior must be included in Interior's assurance statement that is included in the PAR. Significant deficiencies identified under FISMA should also be considered material weaknesses to be included in the assurance statement if they might cause a material misstatement to the Department's financial reports included in the assurance statement.

OMB requires that a corrective action plan (CAP) be developed for each material weakness, reportable condition, other control deficiency, and "non-conformances" with the financial system requirements. Refer to Section I Chapter 4 for additional information on CAPs.

ATTEMPT TO REMEDY DEFICIENCIES AND TEST REMEDIED CONTROLS

Attempting to correct control deficiencies as they are identified benefits the Department by improving the controls in the current fiscal year and allowing preparation of the assurance statement without including control deficiencies corrected prior to June 30, or at least reporting they were corrected prior to the end of the fiscal year. Review the Department's plan for correcting 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). If adequate time is available, test the remedied controls to determine whether the design and operation of the controls are effective as of June 30 or September 30.

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

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[15] The term "remote" is defined in the Statement of Federal Financial Accounting Standards (SFFAS) No. 5, Accounting for Liabilities of the Federal Government. as the chance of the future event(s) occurring is slight.

[16] The PCAOB Auditing Standard No. 2 specifies that a misstatement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when combined with other misstatements, would clearly be immaterial to the financial statements. If a reasonable person could not reach such a conclusion regarding a particular misstatement, that misstatement would be more that inconsequential.

CHANGES IN STATUS BETWEEN JUNE 30 AND SEPTEMBER 30

Evaluate internal controls from June 30 to the fiscal year-end to determine areas needing update by considering any weaknesses disclosed at June 30, whether those weaknesses have been corrected, or whether any new weaknesses have been identified. Consider the effects and update the Department's initial report to include all errors constituting a material weakness at year-end.

The process to identify changes in the internal control environment that may impact management's assessed effectiveness of internal controls over financial reporting after June 30:

- Survey departmental and bureau management to identify any potential changes in the internal control environment that require assessment
  - Major changes in the Department's mission or programs
  - Reorganizations or other changes to the Department's organizational structure
  - Significant increases or decreases in staffing levels
  - Turnover of key management or personnel who perform key control activities
- Communicate with persons leading other Departmental assessments, reviews, and audits to determine if any potential material weaknesses were identified that were not detected during the earlier assessment
- Review the results of follow-up testing used to validate the effectiveness of CAPs if material weaknesses were reported as resolved
- Review results of the financial statement audit
- Review results of any program audits performed by the OIG or GAO