DEPARTMENT OF COMMERCE

INTERNAL CONTROL HANDBOOK

CHAPTER 7 - INTERNAL CONTROL REVIEWS

This chapter contains Departmental requirements and detailed guidelines relating to the conduct of internal control reviews (ICRs).

7.000 Conducting Internal Control Reviews

7.001 Policy

Internal control reviews shall be completed in accordance with this Handbook. Internal control review teams shall consult with Departmental Office/Operating Unit IC staff and Office of Management and Organization staff regarding technical assistance as provided below. Internal control review reports shall be approved by assessable unit managers, Departmental Office/Operating Unit IC staff, and as appropriate, by more senior Department officials. The reports shall be submitted to OMO by the organizational unit's Internal Control Working Group member.

Furthermore, internal control review schedules shall be determined on a yearly basis, and proposed schedules shall be developed in accordance with this Handbook.

7.002 Definitions

o Internal Controls

Internal control (management control) is a basic function of management. Controls are an integral part of each program and administrative area. Internal control may be defined as safeguards built into a process or work flow that help ensure that plans proceed and resources are used as intended to achieve the best results at the lowest possible cost. Controls may also highlight variances after an activity has been completed (e.g., methods used to detect errors in payroll processing).

Such safeguards exist in all organizations or functional entities whether or not they are recognized as internal controls. Controls are not simply additional work that is imposed on activities from a higher organizational level, but are mostly safeguards that are interwoven within normal activities. Controls are developed and put in place by managers and employees within each activity. When managers or employees take action to assure that activities will proceed, are proceeding, or

have proceeded as planned, controls are at work. The formal identification of these safeguards, determination of whether the controls are actually used, and an evaluation of their adequacy are major goals of an internal control review.

Although the internal control process is supported by legislation (the Federal Managers' Financial Integrity Act of 1982), in reality, it is driven by individual efforts to promote good management.

o Internal Control Reviews

An internal control review is an in-depth examination of management controls that exist within an activity. The review may focus on either administrative or program activities. Each Operating Unit and Departmental Office has the responsibility to perform an established number of internal control reviews each year.

Internal control reviews examine significant control weaknesses that exist within the Department, activities with high inherent risk, or other areas of concern to management. The results of the internal control reviews should be used by managers as a tool to improve the management process within the organization, or to allow them to feel more confident that controls are in place and operating effectively in a vulnerable area.

7.003 Benefits - Internal Control Reviews

Internal control reviews provide a variety of benefits which promote sound management.

o ICRs assure that administrative, financial and programmatic risks have been adequately addressed. (Examples of risks are included in Appendix G of this Handbook.)

o If control gaps or weaknesses exist, the ICR identifies the weakness and recommends action to correct the problem(s) and establish the optimum control system within existing operational and resource restrictions.

o Excess controls that may have accumulated over the years may be identified and eliminated, allowing a more efficient operation.

o Since the ICR process forces managers to consider risks in relation to the cost of instituting or maintaining management controls, operational risks that are not fully covered by safeguards (controls) will remain so because of a logical decision process rather than simple oversight.

- Especially during this period of diminishing resources, the ICR helps managers reassess their control systems to establish the maximum level of control while reducing associated control costs.

- After appropriate ICR recommendations have been implemented, the manager has a reasonable degree of confidence that his/her responsibilities are being carried out according to plan.

- The event cycle(s) under review will be brought in line with GAO's "Standards for Internal Control in the Federal Government" through a formal, systematic approach to control.

Other general benefits that are derived from an ICR include:

- Assisting Operating Units and the Departmental Offices to comply with the requirements of the Federal Managers' Financial Integrity Act and OMB Circular A-123.

- Providing much of the necessary support for end-of-year statements to the Secretary on internal control.

- Contributing to the general management improvement now being experienced in the Executive Branch.

7.004 Roles and Responsibilities

The Management Control Division, Office of Management and Organization, Office of the Secretary (O/S), is responsible for ensuring that the Department's internal control efforts comply with appropriate legislative and regulatory requirements. The Division recommends Departmental internal control policies and provides formal guidance, advice, and technical assistance in all phases of the internal control process.

The Office of Inspector General each year provides the Secretary with an assessment of the Department's compliance with OMB and DOC Internal Control Guidelines. To provide support for this assessment, the OIG staff monitors progress of internal control activity within the Department throughout each year and evaluates, in-depth, selected internal control reviews. On request, OIG staff will also provide technical assistance to ICR teams throughout the course of the review process.

Each Departmental Office/Operating Unit head has the ultimate responsibility for all internal control activity within his/her organization. The Internal Control Manager, a senior manager designated within each Departmental Office/Operating Unit, is responsible

for ensuring that internal control reviews are properly planned, scheduled, and conducted, and that identified weaknesses are scheduled for prompt correction.

Program managers, and SES or Merit Pay managers with responsibility over more than one assessable unit (e.g., a line office director), are responsible for developing and maintaining adequate internal control systems in accordance with OMB and DOC Guidelines and GAO Standards, scheduling ICRs, assuring that ICRs concentrate on areas that will produce the most benefit, and monitoring the progress of internal control reviews and implementation of corrective actions.

Internal control coordinators within each Departmental Office/Operating Unit provide, or make provisions for, necessary training and guidance as the ICR is being planned and conducted. Assistance may also be provided by the Office of Management and Organization, O/S, and the Office of Inspector General, as requested.

Assessable Unit Managers, as listed on DOC Form CD-600 which is maintained by each Operating Unit's internal control staff, have direct responsibility for assuring that internal control systems are in place and operating effectively within their respective assessable units. This includes responsibility for all phases of internal control reviews performed within their units.

Assessable Unit Managers should assure that the internal control review team is selected in a timely manner, the review focuses on the appropriate event cycle(s), and proceeds according to the guidance contained in this Handbook. Their oversight responsibility also includes reviewing ICR recommendations and assuring that appropriate, cost-effective corrective actions are properly implemented.

7.005 Combined Reviews

Some of the steps involved in an ICR are the same as, or similar to, segments of other studies conducted at the Department, e.g., management studies, A-76 Reviews, A-130 Reviews, Information Resource Management Reviews, etc. As conditions warrant, ICRs may be combined with other management studies to conserve resources/prevent duplication of efforts and eliminate repeated disruption to a single activity. However, since some additional complications may arise, managers must carefully consider the feasibility of combining studies to assure that the plan will be workable.

The Management Control Division, Office of Management and Organization, O/S should be contacted by the Departmental Office/Operating Unit IC Manager if a consolidation is planned.

Each internal control review must meet certain requirements. Therefore, a separate ICR report, including completion of appropriate forms, must be prepared in accordance with

the criteria outlined in this chapter. The study team should be particularly concerned with assuring that event cycle risks, control objectives and control techniques are included, adequate testing has been performed, and an adequate evaluation of controls has been completed. The benefits from combining studies will be primarily derived from the initial research/information gathering and operational (process) definition.

Further information on consolidating ICRs with other management studies comprises Chapter 12.

7.100 Conducting an Internal Control Review

An internal control review consists of the following steps:

1. selecting an ICR team;
2. identifying event cycles within the assessable unit and selecting the ICR focus;
3. detailed planning of the ICR;
4. investigating/reviewing background material;
5. documenting the event cycle (narrative description/flowchart);
6. analyzing the general control environment;
7. determining risks within the event cycle(s) selected;
8. developing control objectives;
9. determining existing control techniques;
10. testing internal control techniques;
11. evaluating internal controls; and
12. reporting on internal controls.

Blank internal control review forms referenced throughout this Handbook comprise Appendix F. In addition, sample (completed) IC Forms are included in Appendix G.

7.101 Selecting ICR team members

The number of team members selected by the AU Manager will depend on the scope and complexity of the internal control review. Normally, an internal control team consists of 2-4 employees. (This number is at the discretion of the AU Manager.) Team Members should have some analytical background and expertise in planning and conducting studies and preparing written reports.

Each member should be (or become) familiar with the concept of internal controls, and the requirements of an internal control review. It would be particularly helpful if someone on the study team has previously participated in an ICR. At least one team

member should be a subject matter specialist in the functional area being examined. If possible, for greater objectivity, one member should be selected from outside the event cycle(s) being examined. To be even more beneficial, this team member could be a specialist in an area which may be of particular significance to the area under review, e.g., ADP, budget, accounting, etc.

Assessable Unit Managers have the responsibility to select an ICR team that can provide a quality product in a reasonable time frame. Historically, ICR teams which have had at least one management analyst familiar with the ICR process have produced a quality product over a relatively short time frame.

Many times, internal control teams are not able to work full time on the project. (Depending on the scope of the review, ICRs normally take between 6 to 16 staff weeks to complete.) If the ICR team cannot spend full time on the review, the AU Manager should assist them by formally setting aside part of each week to work exclusively on the ICR until it is completed. Normally, an ICR should not extend beyond a five month time period to help assure that all recommendations will be relevant at the end of the review.

Responsibility: Assessable Unit Manager

Documentation: At a minimum, each team member's name, title, organization, address, and telephone number and prior internal control related experience should be listed as an appendix to the ICR.

7.102 Identifying the Event Cycles Within an Assessable Unit and Selecting the ICR Focus

Each Operating Unit and the Office of the Secretary have been divided into discrete entities called assessable units. In many cases, the assessable units will not be the same as the review component's organizational breakdown.

The assessable unit is the focus of evaluative work in the internal control process. To properly plan the scope of an internal control review, the review team must have a good understanding of the activities and responsibilities of the assessable unit as a whole. This may be done through a review of appropriate mission/functional statements (Department Administrative Order and Department Organization Order), MBOs, briefing books, budget justifications, interviews, and other methods which will describe the work that takes place within the assessable unit. The AU Manager or program specialist should take the lead during this part of the review.

The internal control review need not concentrate on all parts of the assessable unit. Because ICRs are quite detailed, and time consuming, ICRs should focus primarily on areas with known control problems or high inherent risk (activities which are more susceptible to problems because of the nature of their work). For example, ICRs should

be conducted on those activities that affect the health, safety, or financial condition of the public, issue licenses or permits, approve grants or loans, handle sensitive or classified information, or handle cash. Consequently, the assessable unit is subdivided into smaller functional groupings called event cycles. An event cycle consists of sequential steps that, when combined, form a process or single activity within the assessable unit: more succinctly, a single process or type of work. Each event cycle has a distinct beginning point and ending point, and is cyclical in nature. When combined, event cycles reflect all work that is performed within the assessable unit.

This phase of the ICR allows for some flexibility. Judgment must be used to assure that the event cycle(s) selected will facilitate an ICR. It may be helpful to consider what outputs (end products) are produced within the assessable unit, and then to examine the process used to create the output. Examples of event cycles are listed below and on Form CD-603 in Appendix G.

Personnel	Research
o staffing	o project selection
o classification	o research design
o incentive awards	o conduct of experiments
o training	o publication/distribution of research findings

Once all event cycles have been defined, the cycle(s) that will be addressed by the ICR must be selected. Many times, the AU Manager will know which area (event cycle) warrants an ICR, i.e., a control problem has been previously recognized. However, some AU Managers must select an event cycle (or two) to be reviewed without knowledge of a pre-existing problem. The assessable unit may have been selected for review because of its high inherent risk or other general concerns recognized by higher level management.

Which event cycle(s) should be reviewed? The process(es) which fulfills the assessable unit's most important responsibilities should be the focus of the review - the heart of the activity. In program areas, the key activities (processes) associated with carrying out the assessable unit's responsibilities should be reviewed, not ancillary administrative tasks. If event cycles seem to be of equal importance, the event cycle(s) which affects the greatest amount of money or has the most important control implications should be reviewed. Generally, team members should not select for an internal control review an event cycle that has been the object of a recent management review (i.e., ICR, OIG/GAO Audit, etc.)

The ICR should identify risks and define and evaluate controls within the entire event cycle(s), not just one segment of the process. All requirements of this chapter should be understood before the ICR coverage has been determined.

Responsibility: AU Manager and ICR team

Documentation: Form CD-603 and narrative discussion of the selection process. Sample Interview Record, included in Appendix G, or equivalent, for each interview

NOTE: Notify your Departmental Office/Operating Unit's internal control staff when a draft has been completed for this step in the process. The Operating Unit staff is responsible for notifying the Department's OMO staff/or the Office of Inspector General at this time.

7.103 Detailed Planning of the ICR

After the ICR team has determined which event cycle(s) will be included in the review, a detailed plan of the ICR should be completed. Form CD-604 (see Appendix F) has been developed to assist in the planning process. Each section should be considered separately, and a realistic time frame determined. (The ICR process should be completely understood before time frames are assigned to the various parts of the review.) Form CD-604 should be submitted to the Departmental Office/Operating Unit's Internal Control Manager and the Management Control Division, OMO, for tracking purposes.

Responsibility: ICR team, with concurrence by the AU Manager and, if appropriate, Program Manager

Documentation: Form CD-604

7.104 Investigating/Reviewing Background Material

This section outlines the procedure for defining the process or work flow that constitutes the event cycle, and sets the stage for the ICR team to begin identifying controls that exist within that process. This phase will also provide an adequate basis to develop a flowchart of the process under review, Step 5 of the ICR process. The flowchart (see Appendix H) will serve as a stable point of reference when determining risks, control objectives, and control techniques.

After the event cycle(s) has been selected, team members must become familiar with the process being examined and the environment in which it exists. This investigation will be more complete than the relatively general investigation initially undertaken to determine the event cycles within the assessable unit. The investigation will

focus directly on the event cycle(s) selected for review and will be quite detailed. The following items are examples of documents that should be reviewed at this stage of the ICR:

enabling legislation	regulatory requirements
functional statements	long range plans
organizational charts	personnel data
delegation of authority	position descriptions
agency directives/guidance	management reports
GAO/OIG Reports	issue papers
vulnerability assessments	forms used in the process
budget data	workload data
existing process flow charts/narrative descriptions	operating policies and and procedures (manuals, circulars, handbooks, memos

Throughout this review, the focus of attention should be on documenting and evaluating internal controls that exist within the event cycle(s) selected.

The review of background information should be augmented by interviews of relevant employees, as necessary. Interviews should be conducted to help clarify the process within the event cycle and to support the information gathered through initial research. Employees who are directly involved in, and/or are responsible for, the daily operations should be selectively interviewed to assist in developing a valid flowchart of the process(es) under review.

Interview questions should be developed in advance, and should give the manager/employee an opportunity to explain the operations and existing problems, rather than simply to respond "yes" or "no" to a series of questions. Again, questions should focus on not only the process, but also the formal and informal controls that are currently in place. Generally, interviews should not extend beyond one hour.

Responsibility: ICR team

Documentation: Narrative description of items reviewed. Sample Interview Record, or equivalent, for each interview

7.105 Documenting the Event Cycle (Narrative description and Flowchart)

To properly examine the system of controls that exists within an event cycle, the review team must use a stable point of reference. A narrative description of the work that takes place and a flowchart will provide a firm basis for a logical, structured examination of

controls within the event cycle(s). These conceptual aids will assist the ICR team in evaluating all controls throughout the event cycle.

Using knowledge gained from the background investigation, the study team should write a short narrative description of each step, in sequence, that occurs within the process under review. The description of each step may only be a few words; the important aspect of this exercise is to make sure that each significant phase of the process (as it occurs within the event cycle) is covered by this description and, therefore, will be adequately addressed in the ICR. Normally, the work flow includes an input, a processing phase, and an output.

The description should incorporate all work that is done within the event cycle. The team should determine the significant action/event which begins the process and the action/event which ends the process. After these boundaries have been established, the remaining steps will become more readily apparent. The description should include the employees involved (by title), the forms that are completed and their points of distribution, reviews/approvals that take place, physical location of the activity, and other similar information that will help clarify the process.

Once the narrative description has been completed, a flowchart may be developed for the process. The primary focus of the flowchart should be on the activity that takes place within the event cycle. The flowchart need not be extremely sophisticated, but should mirror the steps outlined in the narrative description. Tips on flowcharting, flowcharting symbols and examples are included in Appendix H.

After the ICR team feels comfortable with the flowchart, the process should be confirmed with the operational manager(s) or other personnel involved in the actual work. All factual errors must be corrected before continuing to the next stage of the ICR.

Responsibility: ICR team, operational manager(s)

Documentation: The narrative description and flowchart (Sample Interview Record, or equivalent, should be provided for each interview)

7.106 Analyzing the General Control Environment

The environment in which an event cycle operates has a major impact on the effectiveness of its internal control system. Poor training or lack of adequate delegation of authority may negate the effectiveness of even the best control system. Therefore, an analysis of the control environment is an important phase of an internal control review.

The general control environment is assessed by:

- o reviewing documented policies and procedures;
- o conversing with management and other personnel involved in the event cycle under review;
- o examining position descriptions, training plans, etc.;
- o observing practices; and
- o drawing upon the assessable unit managers' familiarity with the operation.

The review should be presented in the final ICR report and consist of an assessment of the following elements.

- o Organization Structure
  - oo Is the organization chart current?
  - oo Are employees' responsibilities clearly divided so as to avoid duplication, overlap, or conflicts?
  - oo Does the organizational structure foster the achievement of the assessable unit's objectives?
  - oo Are functional statements accurate and consistent with the organizational structure?
- o Personnel
  - oo Are position descriptions in writing, current and consistent with functional statements?
  - oo Do all employees have accurate and up-to-date performance standards?
  - oo Is there periodic performance review and counseling of all employees?
  - oo Are there sufficient training opportunities to ensure all employees are competent to perform work assigned?
- o Delegation of Authority and Responsibility
  - oo Are all appropriate delegations current and in writing and systematically maintained in a single file or manual issuance?

- oo Do assigned responsibilities properly reflect the separation of duties concept (e.g, T&A clerk can not approve his/her own time sheet.)?

o Policies and Procedures

- oo Are policies and procedures current and in writing?
- oo Are policies and procedures clearly stated and systematically communicated (manuals, handbooks, DAOs, etc.)?
- oo Are policies and procedures flexible enough to accommodate unusual circumstances?

o Planning, Budgeting, and Reporting

- oo Are activities formally planned?
- oo Are reports on the activities of the event cycle timely, accurate and relevant?
- oo Do progress or performance reports show comparison with: (a) planned performance, (b) budget allowances and/or (c) past performance?
- oo Is there a formal performance measurement system in place?

o Organizational Checks and Balances

- oo Are there clearly established levels of operational and financial accountability?
- oo Are employees accountable only for matters within their control?

o ADP Considerations

- oo Are ADP reports/products, or computer-generated information from outside sources, on time? Are ADP reports accurate?
- oo Do ADP systems and/or personal computers have adequate physical and system safeguards, e.g., restricted access to computer area, password security, off-site back-up, etc. Is security consistent with

the nature of the information maintained confidential, proprietary, secret?

oo Do ADP reports provide useful management information?

If deficiencies are noted during the assessment, improvements for the general control environment should be listed in the recommendations section of the final report and/or at the end of Form CD-607, "Evaluation of Management Controls" (see Appendix F).

Responsibility: ICR team, review by AU manager

Documentation: Narrative description of the general control environment (Each of the major areas should be discussed in one or two sentences.)

7.107 Determining Risks Within the Event Cycle(s) Selected

All administrative and program areas have some degree of risk (See Appendix L, Glossary of Terms). A statement of risk will be related to a negative event or situation that would occur if all or a part of the process under review was not carried out as planned. What could go wrong? This phase of the ICR should also include an evaluation of the impact of the risk. Who would be affected? What would be the magnitude? The ICR team needs to consider all risks, even to persons or situations outside the assessable unit. Each risk identified will describe an event or situation that the organization does not want to occur.

The determination of risks that exist within the event cycle(s) under review will be one of the most important phases of the ICR. Control systems are developed in response to risks that exist within event cycles. Risks should be developed without considering controls which are currently in place. Even though the ICR team may believe that controls are in place to adequately address a given risk, the risk should still be identified and examined during the ICR. By doing so, the team is confirming the existence of good management practices within the event cycle and covering all significant risks in the review.

Since each event cycle is different, unique controls are developed to counteract risks that exist within individual event cycles. Risks that are considered during an ICR are not only those related strictly to the negative aspects of fraud, waste, abuse and mismanagement. The narrow definition of these terms should be expanded to address the proper execution of normal, daily operations. The ICR team must consider risks associated with failing to properly carry out the event cycle's operational responsibilities. Reviews of this nature will concentrate on promoting good management practices within the event cycles examined and, over time, collectively improve the Department's overall management process. This means determining:

- What is done in the event cycle (the process as described earlier in a narrative and flowchart form);

- What would be the consequence of not performing each separate step of the process as intended; and

- What unique risks are associated with the event cycle(s) (e.g., unique safety and security considerations or the ramifications of not complying with program specific legislation or regulatory mandates)? As examples, National Weather Service programs may be concerned with safety considerations, since hydrogen gas is used in their weather balloons; procurement operations would be concerned with adequate competition; the payment process would be concerned with the Prompt Payment Act; or research activities would be concerned with the accuracy of their data/conclusions, since these conclusions may have a major impact on the private sector (such as research on the impact of fluorocarbons on the earth's atmosphere). Where sensitive documents or valuables change hands in the cycle, adequacy of security should be reviewed.

The ICR team, in conjunction with the AU Manager, must make a realistic determination regarding potential risks that exist within the process under review, and also must recognize the associated impact of each risk. By definition, each step that has been included in the flowchart has some level of importance in the process, and some safeguard(s) should exist to help assure that each significant step is completed as intended. The unique control considerations noted above should also be included in the event cycle's list of risks.

After the full list of risks has been developed, the risks should be reviewed by the AU Manager. The AU Manager should assure that historic or current problems and concerns have been addressed in the list of risks. A set of possible event cycle risks has been included on Form CD-605 (formerly IC-18) in Appendix G.

Responsibility: ICR team, review by AU Manager

Documentation: Form CD-605

NOTE: Notify your Departmental Office/Operating Unit's internal control staff when a draft of CD-605 has been completed in the process. The Departmental Office/Operating Unit staff is responsible for notifying the Department's OMO staff/or the Office of Inspector General at this time.

7.108 Developing Control Objectives

Simply stated, control objectives are the opposite of the risks that have been previously identified--conditions that you do want to occur. The control objectives developed in this phase of the ICR will be used as your point of reference to identify and evaluate control techniques. Therefore, control objectives should be complete, clearly defined, and, to the maximum extent possible, measurable.

Event cycles will always have a series of control objectives. If only one objective seems to cover all risks, either the event cycle has been defined improperly (it does not cover a full process), or all risks have not been identified. Each identified risk must have a corresponding control objective.

Mission objectives and control objectives are not synonymous. Almost without exception, mission objectives are too broad to be used as control objectives. However, mission objectives, functional statements, and other such descriptions may be used to assure that each important facet of the event cycle was considered in this process. Control objectives must be described in greater detail than mission objectives and must be directly related to the risks that have been identified.

Examples of control objectives are included on Form CD-605 (formerly IC-18) in Appendix G.

Responsibility: ICR team

Documentation: Form CD-605

7.109 Identifying Existing Control Techniques

Control techniques are the safeguards that managers put in place to help assure that operations proceed according to plan and are protected from fraud, waste and abuse. Effective control techniques allow the assessable unit manager to feel confident that his/her responsibilities are being carried out properly.

Control techniques are the action items in the control process. Each event cycle will have many control techniques (safeguards) already in place. Because most controls are so closely associated with an event cycle (the process under review), managers may have difficulty in conceptually separating the control techniques from the process itself. Some common examples of control techniques are listed below. They will help the ICR team understand exactly what should be identified in this phase of the ICR.

Common Control Techniques

-Use of standardized forms
-Written procedures
-Routine maintenance
-Annual asset inventory
-Financial planning
-Use of MBO scheme
-Selection criteria
-Log books
-Audits
-Grant/loan site visits
-Review & signature of approving official
-Progress reports
-Eligibility criteria
-Use of receipts
-Computer passwords
-Quality/timeliness standards
-Background checks
-Supervision
-Peer reviews
-Training programs

-Comparison of historical and current data
-Security review prior to release of data
-Distribution of information per mailing list
-Examination of equipment prior to acceptance
-Use of mathematical techniques to validate conclusions
-Formal notification of policy changes
-Computer matching

When identifying control techniques, the ICR team must address each control objective that has been identified. Each control objective may have several control techniques associated with it. Again, the control techniques are the things that are routinely performed to make sure that the process under review proceeds according to plan, and that associated legislative and regulatory mandates are fulfilled. The flowchart that was developed earlier should be used as a conceptual aid during this phase of the ICR. It will assist the study team in systematically identifying the various control techniques that exist within the event cycle(s). Sample control techniques are included on Form CD-605 in Appendix G.

Responsibility: ICR team, review by AU Manager

Documentation: Form CD-605

7.110 Testing Internal Control Techniques

Once the internal control techniques have been identified, the internal control review team must determine if, in fact, each of these techniques is routinely being used and whether they are achieving the stated objectives. The ICR team must formally determine if each control technique is being used through a structured testing exercise. The testing will focus on whether or not the control techniques identified on Form CD-605 exist or

are being used. Testing will not focus on the procedural aspects of event cycle operations as described in the flowchart; rather, testing will focus on written requirements and actions (control techniques) which management has put in place or routinely performs to make sure that these operations proceed as intended.

As an example, a control technique may be "purchase orders may be processed only if they contain an approved authorizing signature." The study team would examine a representative sample of purchase orders to determine if the purchase orders selected have an appropriate authorizing signature.

As another example, a headquarters program may "perform semi-annual monitoring visits." The internal control test would be to formally verify if these monitoring visits took place every six months and if the visits were consistent with preestablished criteria designed for the review. An internal control test would not include visiting a field location and performing the semiannual review.

This testing phase is equivalent to the testing performed in a scientific experiment. A theory may seem logical from the scientist's general knowledge of his/her discipline, but cannot be truly accepted unless properly tested. Although the same level of certainty is not required when testing controls, the principle is similar.

Employees may not be aware of a control technique, or of its importance, or may not have adequate time to complete the control action. Without proper support and management emphasis, control systems will deteriorate over time. The testing phase of the ICR will either confirm that controls are in place and are operating as intended, or will point out areas where improvements may be needed in the control system.

Testing may be performed by using standard sampling methods (i.e., random, stratified, etc.) or, as appropriate, by observation. In either case, the test must be planned in advance, test results recorded, and test data maintained for future review. Form CD-606 provides an outline for recording summary information that should be retained for each test.

The exact number of items that must be tested/examined will depend on (a) the number of items that the team may potentially test (the universe), (b) the importance of the control technique, and (c) the resources available. As an example, a banker may always want the vault locked at the end of the work day, but will allow a bank teller to have a cash drawer that is not balanced at the end of the day, since the days transactions will be reconciled in the accounting department later. So, even though a locked vault and a balanced cash drawer are both important to the control system, tests developed for these control techniques should require different levels of assurance that the techniques are in place and operating effectively.

Enough testing should be conducted to allow a reasonable degree of confidence that the results are accurate, and in line with the relative importance of the control action. If a fairly limited number of tests are performed and the results do not confirm whether or not the technique is being used, an increased level of testing may be warranted. Ultimately, the amount of testing completed during an ICR will depend on the study team's judgment.

If field activity is included in the event cycle, adequate testing of controls in the field must be accomplished. To the extent possible, this testing should be combined with other trips to field locations. This may be done by planning ahead to take advantage of previously scheduled visits. Another option would be to have an employee in the field be part of the ICR team and perform the testing.

If the test of a control technique would be unreasonably expensive, a less direct test may be considered. In such a situation, the study team must determine if surrounding evidence exists to support a conclusion regarding whether or not the control action is performed. In a very few cases, because of excessive resource requirements, a questionnaire or interview session(s) may be substituted for a formal test, with advanced approval of the Management Control Division, O/S.

Responsibility: ICR team

Documentation: CD-606 and sample Individual Test Records, or equivalent

NOTE: Notify your Operating Unit's internal control staff that you have completed this step in the process. The Operating Unit staff is now responsible for notifying the Department's OMO staff/or the Office of Inspector General at this time.

7.111 Evaluation of Internal Controls

After the general control environment has been defined and the existing controls identified and their usage tested, the control system must be evaluated. Even if the general control environment is satisfactory and the control techniques currently in place are being used, the study team cannot necessarily conclude that the existing control system is adequate. It must be evaluated to make sure that the best system possible is in place, given existing resources, to counteract the existing risks.

Control systems within an assessable unit should meet two objectives: (a) they should comply with standards established by GAO; and, (b) they should meet the management needs of the assessable unit. If properly developed, a control system will meet both requirements.

The General Accounting Office has established specific standards for internal control in the Federal government. (See Figures 4 and 5.)

When evaluating control systems, the ICR team should ascertain whether or not these GAO standards have been met for each event cycle reviewed and, if not, should make appropriate recommendations to promote compliance.

The evaluation of controls will involve more than determining whether or not the existing controls meet the GAO standards. The ICR team must also consider how well the control system fosters good management. The testing phase has allowed the team to determine whether or not the control techniques are actually in place and being used. However, the ICR team must also make an assessment regarding the appropriate level of control for each control objective. Are there too many, or perhaps, too few controls?

The relative importance of each objective should be reflected in the controls that are put in place. If a control objective must be met, the control techniques employed should be developed accordingly. However, absolute, or near absolute, assurance is seldom required. Before control techniques are put in place to bring about absolute assurance that an objective will be met, the costs and relative benefits must be carefully considered. As control systems approach absolute assurance, they become quite time-consuming and expensive. A manager may have nearly complete confidence in his/her control system, but the necessary cost or processing time may be unreasonable. Controls should help make sure that operational plans are met without substantially reducing efficiency.

The ICR process should allow the study team to step back and objectively evaluate the controls that exist within the assessable unit, and to determine if they meet the managerial needs of the unit. This evaluation should include an assessment of both the level of control associated with each objective, and whether or not the control techniques that exist actually promote compliance with the objective. Are safeguards at the right spots? Do they work, or is the action superfluous?

The study team should evaluate each control objective separately. Will the control techniques currently in place provide a reasonable level of confidence that the objective will be met? If not, the study team should recommend additional or different control techniques to improve the control system and address the identified control weakness(es). These recommendations should be included in the final report and, if implemented, will allow the AU Manager to feel more confident that his/her operational responsibilities will be effectively met.

The ICR team may wish to consider new ways of approaching the event cycle's control system. As many organizations face the reality of reduced budgets, managers must re-evaluate the way work is conducted within their programs. Effective control systems must be maintained, but they must be considered in the light of budget realities.

Therefore, some restructuring of control systems may be considered during the internal control review. As an example, many programs within the Department involve monitoring firms or state governments which receive Federal money. Most control systems have traditionally involved visiting each recipient at least annually to assess its compliance with Federal or Departmental regulations. Many programs may be forced to reduce the existing level of monitoring. If such reductions are necessary, they must be accomplished in a way that will still provide the highest level of control at the least cost. This means evaluating historical workload and identifying trends that would allow staff to monitor the grants, loans, etc. that seem to have the highest probability of non-compliance or other problems. In this way, a manager could reduce the coverage for recipients that will most likely be successful, and concentrate on those categories that have historically had problems. The manager, in this example, may also wish to increase the criteria for acceptance of a grantee or the level of review at the processes' inception, since he/she knows that controls connected with monitoring grants or loans have been reduced.

Although budget realities may cause a manager to accept a higher level of risk, controls may be put in place to help concentrate limited resources in those areas that have historically proven most vulnerable. Form CD-607 (see Appendix F) should be used to document the results of the ICR team's evaluation of controls and make appropriate recommendations for control improvements.

Responsibility: ICR team, AU Manager

Documentation: A short description of the evaluation process which should include: (1) whether or not the control system in place met each of the GAO Standards, (2) whether or not the control techniques currently in place provide an adequate level of confidence that the control objectives will be met, (3) a list of the major strengths and weaknesses in the control system, and (4) a list of recommendations to strengthen the control system or correct the weaknesses noted during this evaluation. (The last point may be done by referencing Form CD-607.)

7.112 Reporting on Internal Controls

The final report will be the method used not only to communicate the findings of the internal control review, but also to relate exactly what was reviewed and how it was done. Since the report will be reviewed by people with limited knowledge of the assessable unit's operations, as well as managers within the Departmental Office/Operating Unit, the report must address both audiences. The final report should be approximately 8-12 pages in length, not including appendices.

Figure 4

GAO STANDARDS FOR INTERNAL CONTROLS IN THE FEDERAL GOVERNMENT

(GAO Accounting Series, 1983)

SPECIFIC STANDARDS	EXPLANATION
DOCUMENTATION	Documentation involves developing and maintaining written descriptions of: o Internal control objectives and techniques. o Workflow and operational procedures. o Other important management/control activities. This standard requires that the documentation be complete, accurate, and readily available for examination.
RECORDS: Recording of Transactions	Records differ from documentation. Documentation is the written description of what should be. Records are the written descriptions of what actually happened. Records should contain information on: o All resources expended. o The execution of required processes or procedures e.g., was approval granted?). o Results achieved. This standard requires that up-to-date records are kept on all aspects of a procedure or event. Additionally, this standard requires that records be classified in a way that permits easy access for report writing and review/audit.
AUTHORIZATION: Execution of Transactions	Authorization simply means that procedures are in place to prevent personnel from exceeding their authority or, in other words, "stepping out of bounds." This standard requires that only authorized persons: o Make decisions about undertaking work and committing resources. o Carry out the work assignments.

Figure 5

GAO STANDARDS FOR INTERNAL CONTROLS IN THE FEDERAL GOVERNMENT (GAO Accounting Series, 1983)

SPECIFIC STANDARDS	EXPLANATION
STRUCTURE: Separation of Duties	The structure of the organization can support the internal control objectives by separating key duties such as: authorizing, processing, recording, and reviewing. For example, the same person should not authorize a payment, then write and sign the check for that payment. This standard requires that key duties and responsibilities be separated among individuals.
SUPERVISION	Supervision is the assignment, review, and approval of work. This standard requires that a system of supervision is in place for: o ASSIGNING WORK -- A system must exist for communicating duties, responsibilities, and accountabilities assigned each staff member. o REVIEWING WORK -- A system must exist for reviewing each member's work, as necessary. o APPROVING WORK -- A system must exist for approving work at critical points. In addition, this standard also requires that supervisors provide the necessary guidance and training needed to reduce loss of resources and increase achievement of results.
SECURITY: Access to Resources	Security means limiting access to Government resources to authorized individuals. Resources include: funds, inventory, information, space, equipment, ADP time, etc. This standard requires that systems be in place to reduce the risk of unauthorized use or loss of Government resources. Specifically, this standard requires: o LIMITED ACCESS -- Access to Government resources be restricted to authorized persons. o ACCOUNTABILITY -- The accountability for the custody and use of resources is assigned and maintained. o REVIEW -- Periodic reviews should occur in order to account for all assigned resources.

The report should follow the outline listed below.

- Introduction - Begin with a statement telling the reader that the report has been generated as a result of an internal control review within the relevant assessable unit. A short description of the purpose/objective(s) of an ICR should be included. Also, a description of the assessable unit (i.e., dollars, number of full-time-equivalent employees (FTE), organizational location, and functional responsibilities) is desirable. The report should include the reason why the assessable unit was chosen for review within your Departmental Office/Operating Unit, program, or organizational area.

- Scope - Describe the event cycles that exist within the assessable unit, which ones were targeted for review, and why. The process(es) which were reviewed should be described as follows: FTE, budget, input, processing, output, as well as the event cycle's significance to the mission of the organization and the total dollar amount involved (including pass through money). Briefly mention other Departmental or government organizations which may be involved in the process and their roles. This section should also address the focus of the review -- internal controls.

- Methodology - Briefly describe how the internal control review was conducted. Describe the various steps, as outlined in this chapter, and the actions taken during each step. For example:

  Investigation/review of background material - the study team reviewed appropriate regulatory mandates and Departmental guidelines, functional statements, organizational charts, procedure manuals, prior management reports, and OIG and GAO Audits, and conducted interviews. A more detailed description and supporting documentation of this phase of the study is contained in the ICR work papers.

  Unique problems that were encountered during the review should be discussed in this section. Also, a description of the resources (FTE and dollars) used to complete the review should be noted.

- General Control Environment - Include a narrative discussion of each question related to the General Control Environment. Facts should be presented wherever possible, (e.g., the organization chart and position descriptions were updated during a June 1988 reorganization).

- Findings and Conclusions - Present the results of the internal control review in this section. The findings and conclusions should highlight the control

weaknesses, and emphasize the strengths found in the control system(s) examined.

This portion of the report should also discuss the control system(s) as it relates to the specific GAO Standards and the requirements of good management. A paragraph should be included for each of the six special GAO standards.

In addition, you may wish to note significant concerns/problems that were encountered during the review. In conclusion, the ICR team should make a statement regarding whether or not they have "reasonable assurance" that controls are in place and operating effectively within the event cycle(s) examined.

- Recommendations - Note all problems and associated corrective actions that are recommended by the study team and the Assessable Unit manager. The recommendations should be listed separately with the responsible official/employee and the completion date noted. Recommendations may be referenced in the narrative and presented exclusively on CD-607, "Evaluation of Management Controls." Appendices should include:

  A. Listing of Team Members;
  B. Detailed Narrative Description and Flow Chart; and
  C. Internal Control Forms (CD-603 through CD-607)

  The recommended corrective actions should be concise, described clearly, and have a definite completion date. Recommendations such as "improve monitoring - ongoing" are not adequate. In this example, a more appropriate recommendation would be "issue new procedures to improve loan monitoring - July 1988." The action which causes the control improvement should be the focus of the recommendation.

Responsibility: ICR Team, AU Manager

Documentation: ICR - Final Report

7.200 Problems Outside the Control of the AU Manager

An ICR is a good opportunity to surface control problems that may exist between the assessable unit and other government operations, i.e., intra-agency or interagency activity. If another organization is reducing the effectiveness of the event cycle's system of control, this fact should be brought out. An appropriate recommendation should be developed to address the problem, e.g., initiate a meeting to discuss the problem(s), send a memo,

etc. The AU Manager may not have the authority to alter the other organization's operations, but should be able to initiate a dialogue to resolve the problem(s) or raise it to a higher organizational level so that some concrete action will result.

The recommendation included in the final report should be the action that the AU Manager will complete, not simply a description of what the study team may want another organization to change. Since the AU Manager is most familiar with the problem, he/she is in the best position to describe it, explain the desired corrective measures, and support his/her cause through to fruition. The mere mention of a problem in an ICR report will not guarantee that it will be corrected. Someone (in this case, the AU Manager) must accept the responsibility to promote the necessary improvements.

7.300 ICR Report - Submission Process

After completion, the ICR Report should be reviewed/approved as described in Chapter 8, "Internal Control Quality Assurance," of this Handbook.

As described in Chapter 8 the review sequence will depend on the organizational hierarchy within your Departmental Office/Operating Unit, but will most likely consist of a review by the following:

- o Assessable Unit Manager;
- o Program/line office director; and
- o Working Group Member or Internal Control Manager.

Only the final report, including appropriate internal control forms (Forms CD-603 through 607) should be submitted for review with other working papers made available on request. The report should not include interview records and Individual Testing Records.

As the report progresses through the Departmental Office/Operating Unit's review process, some control issues/recommendations may be addressed by management. If higher level management disagrees with the recommendations developed by the ICR team or believes other actions warrant the use of scarce resources, an additional section (page) should be added to the ICR report which describes the recommendation(s) that has been denied during this review process. Certainly, management has the right to allocate resources consistent with its own list of priorities. One goal of the ICR process is to promote such communication so that managers may logically consider their risks in relation to their present resources, and establish control systems that make good managerial sense. If, after due consideration, a manager decides to accept the risk of not upgrading controls, or reducing control, this fact should be noted in the final report.

The ICR report should reflect the decision process that occurred during the review phase rather than simply remove the recommendation. Thus, the full evaluative work of the

ICR team will be consistent with the working papers, and the report will contain all real control issues for future reference.

As a final action, the Internal Control Manager should forward the ICR Report to the Assistant Secretary for Administration's Office of Management and Organization for review. A copy should also be sent to the Office of Inspector General's internal control staff. The working papers/documentation that must be retained have been discussed throughout this Chapter, and a list of such documentation comprises Appendix I.

Responsibility: Program Manager and Internal Control Manager

Documentation: If management decides not to implement all recommendations, a paragraph should be added to the final report which notes the recommendation(s) affected and provides a short rationale for the decision