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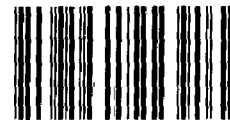
**Report To The Director,  
Defense Mapping Agency**

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**Defense Mapping Agency's First-Year  
Implementation Of The Federal  
Managers' Financial Integrity Act**

GAO conducted a review of 22 federal agencies' efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse across the spectrum of federal government operations through annual agency self-assessments of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by the Defense Mapping Agency in its first year of experience with this new act. The report focuses on the Agency's efforts to evaluate internal controls, review accounting systems, and improve the evaluation processes as a result of identified problems.



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NATIONAL SECURITY AND  
INTERNATIONAL AFFAIRS DIVISION

B-202205

Rear Admiral E. A. Wilkinson, Jr.  
Director, Defense Mapping Agency

Dear Admiral Wilkinson:

This report summarizes the results of our review of the Defense Mapping Agency's (DMA's) efforts to implement and comply with the Federal Managers' Financial Integrity Act of 1982. This act was designed to strengthen the controls over, as well as the accountability for, all funds, property, and other assets within the executive agencies. This review was part of a governmentwide assessment of the act's first-year implementation.

In our review we found that DMA made progress in implementing internal control and accounting system compliance evaluation processes and reporting under the act. DMA, however, experienced some problems in its effort to comply with the act and implement the Office of Management and Budget's (OMB's) guidelines. Details on the purpose of the act and our objectives, scope, and methodology are contained in appendix I.

FEDERAL MANAGERS' FINANCIAL  
INTEGRITY ACT

The Federal Managers' Financial Integrity Act requires each executive agency to establish and maintain internal accounting and administrative controls (referred to as internal controls) and to perform continuing evaluations of these controls. Each executive agency head is required to submit annual statements to the President and the Congress concerning the adequacy of the agency's systems of internal accounting and administrative controls. It also requires each agency to report annually on whether its accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General of the United States. We believe that full implementation of this act will enable the heads of executive

agencies to identify their major internal control and accounting problems and improve controls essential to the development of an effective management control system and a sound financial management structure for their agency.

The Department of Defense (DOD) established 24 reporting centers--DMA being one of these centers. DOD's implementing guidance required the heads of these centers to report each year to the Secretary of Defense. These reports were used in compiling the Secretary of Defense's December 28, 1983, statement to the President and the Congress on DOD's compliance with the act.

In accordance with the act, the Director, OMB, has established guidelines for the agencies' evaluation of their systems of internal controls. These guidelines provide a basic approach to evaluating, improving, and reporting on internal controls. OMB recommends the following process as an efficient, effective way to perform the required evaluations:

- Organize the internal control evaluation process.
- Segment the agency (divide an agency into organizational and/or functional components) to create assessable units.
- Conduct vulnerability assessments to determine the risk of waste, loss, unauthorized use, or misappropriation.
- Review internal controls. These are referred to as internal control reviews (detailed reviews of internal control systems to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost-effective manner).
- Take corrective action.
- Report on the adequacy of internal controls and plans for corrective action.

DMA's internal control evaluation process and planned improvements to this process are discussed in the following sections.

DMA'S INTERNAL CONTROL  
EVALUATION PROCESS

DMA established an internal control evaluation process that was used as a basis for the agency head's report to the Secretary of Defense. Based on its first-year's experience, DMA drafted or planned changes that should improve its evaluation process in future years.

Process supporting the  
first-year report

DMA began its internal control evaluation process in June 1982 in response to DOD Directive 7040.6, dated March 24, 1982. This directive implemented OMB Circular A-123, issued on October 28, 1981, which prescribed internal control policies and standards for executive departments and agencies. Thus, DMA had already segmented its organization and completed most vulnerability assessments before the Federal Managers' Financial Integrity Act was approved in September 1982 and before OMB issued its implementing Internal Control Guidelines in December 1982. DMA assigned units the responsibility to perform internal control reviews and the units completed several of these reviews before issuing its first annual report on internal controls in November 1983.

DMA's Instruction 7040.6, on internal controls

--assigns overall responsibility to DMA's Comptroller;

--requires each component to assign internal control responsibility to a specific official;

--explains key roles, defines important terms, sets objectives and standards for internal controls;

--establishes how the agency will be segmented;

--provides instructions on the completion of vulnerability assessment forms and schedules a completion date;

--describes the method for conducting internal control reviews; and

--assigns DMA's Inspector General responsibility for independently checking internal controls during inspections.

DMA segmented according to its 7 organizational units (headquarters group and 6 organizational components, such as the Office of Distribution Services and the Hydrographic/Topographic

Center), and 6 program/functional areas (for example, contracting, supplies and service, and imprest funds). These were used to create a matrix from which each unit identified the areas where vulnerability assessments would be performed. However, each unit was authorized to further segment its organization for the performance of vulnerability assessments.

DMA headquarters did not perform any vulnerability assessments because agency officials viewed this group to be a policy or planning activity that should not be included in the internal control evaluation process. The remaining 6 units performed a total of 140 vulnerability assessments--121 assessments by July 31, 1982, and 19 additional assessments for fiscal year 1983. The results of the initial 121 vulnerability assessments were the primary base for developing a listing of potential internal control review areas. This listing included only those areas that had multiple unit application or impact.

DMA's Comptroller selected seven of these potential review areas for in-depth internal control reviews. This selection was based on priorities established by vulnerability assessments and recommendations from the units. In September 1982 these areas were assigned to units. Each assigned unit formed teams that performed the internal control reviews on an agencywide basis. Four internal control reviews, resulting in 30 recommendations, were completed by September 30, 1983; two internal control reviews, which were not considered in preparing the first report, were completed by December 31, 1983; and the seventh internal control review will be completed by the end of fiscal year 1984.

The agency started a follow-up system to track internal control review recommendations under a draft instruction and memorandum. This system was formalized by DMA Instruction 7650.3, dated November 3, 1983, and the tracking was automated in January 1984.

#### Planned improvements for the process

We believe DMA's process represents a reasonable effort for the first year. However, DMA has since drafted new guidance that, in our opinion, should substantially improve the process in future years. Also, DMA is developing a new internal control evaluation process training program. These improvements address such circumstances as the need to:

- Identify and consider all agency elements or functions. For example, the first-year process excluded Hydrographic/Topographic Center's field offices, motorpool, book library, silver recovery functions, and minicomputers.
- Adequately document vulnerability assessments. There was inconsistency in completing the forms used by DMA to document the vulnerability assessments. Some did not identify the preparer and/or describe the methodology used in conducting the assessment.
- Establish a system to track planned corrective actions of internal control weaknesses identified during the vulnerability assessments. Such a tracking system had not been established and management had to assume that corrective actions had been or were being taken.
- Provide vulnerability assessment and internal control review training. During the first year, no internal training was provided and participation in external training was limited.
- Provide guidance on the methodology for assessing and reviewing automated data processing controls, particularly, for general and application controls. The original guidance did not address these areas.

DMA'S ACCOUNTING SYSTEMS  
COMPLIANCE EVALUATION PROCESS

Section 4 of the Federal Managers' Financial Integrity Act requires that each agency report annually on whether its accounting system conforms to the accounting requirements prescribed by the Comptroller General. The determination of this conformance is referred to as an accounting system compliance evaluation. DMA reported to the Secretary of Defense that it has an inventory of three accounting systems--Civilian Payroll System, Base Level Material Accounting System, and the General Accounting and Finance System. These systems were developed and are maintained by the Air Force but are operated by DMA. To determine whether its systems comply with the Comptroller General's principles and standards, DMA elected to rely on the accounting systems compliance evaluations conducted by the Air Force. DMA did not perform its own evaluations of its operating accounting systems.

DMA's rationale was that the Air Force developed and maintains the accounting system software and operations directives. We believe this rationale is appropriate if DMA (1) does not

change the accounting system software and (2) evaluates the manually performed portions of the accounting systems, such as controls over computer input and output which are not included in the Air Force systems. During the first year, however, DMA did not evaluate the manual portions of its accounting systems or document whether software changes had been made.

DMA officials plan to strengthen their accounting system evaluation in 1984 by adding the following steps to their guidance:

- Identification and evaluation will be made of the manually performed processing functions that support automated systems.
- Responsible managers will submit (1) annual certifications that the accounting software has not been altered or (2) a statement of the results from testing the accounting system changes, in conformance with the Comptroller General's principles and standards, if the software has been altered.

#### INSPECTOR GENERAL'S ROLE

At the request of the Office of the Secretary of Defense, DOD's Office of the Assistant Inspector General for Audit reviewed DMA's internal control evaluation and accounting systems compliance determinations. The Inspector General's Office found that DMA had not identified all assessable units or properly documented the vulnerability assessments. DMA, however, was in the process of correcting these problems. The Inspector General's Office also found DMA's evaluation process for accounting systems to be reasonable. The results of this review were provided to DMA for consideration in preparing the first-year report to the Secretary of Defense.

#### DMA DIRECTOR'S ANNUAL REPORT

Your annual report to the Secretary of Defense was issued on November 8, 1983. It adequately described the process used during the first year to evaluate DMA's internal control and accounting systems compliance evaluation. In addition, this report stated that there were no significant internal control weaknesses.

Of the three accounting systems, the report cited two systems--Civilian Payroll System and Base Level Material Accounting System--as fully complying with the Comptroller General's accounting principles and standards. The General



Accounting and Finance System was cited as being deficient in five areas--depreciation accounting, contingent liabilities, general ledger, property accounting, and accrual for centrally-managed contracts. The Air Force's plan for correcting these deficiencies by 1988 was also presented in the report.

CONCLUSION

We believe that DMA's planned changes to their implementation processes should improve compliance with the act and make future annual reports more meaningful. Because of these plans, we are not making recommendations at this time. We will, however, follow up in the second year to determine the status and impact of these changes on the overall process.

AGENCY COMMENTS

In its March 27, 1984, comments on a draft of this report, DOD concurred with our findings. They stated that (1) new vulnerability assessment guidance is expected to be issued in April 1984, (2) training to conduct internal control reviews and vulnerability assessments will be held during May 1984, and (3) plans were issued in March 1984 to strengthen its certification and evaluation of accounting systems. DOD's response is presented in appendix II.

We are sending copies of this report to the Director, OMB; the Secretary of Defense; the Chairmen, Senate Committee on Governmental Affairs; House Committee on Government Operations, and the Senate and House Committees on Appropriations, Armed Services, and the Budget.

We appreciate the courtesy and cooperation DMA personnel extended us during our review.

Sincerely yours,

  
Frank C. Conahan  
Director



C o n t e n t s

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ABBREVIATIONS

ADP	Automated Data Processing
DMA	Defense Mapping Agency
DOD	Department of Defense
GAO	General Accounting Office
OMB	Office of Management and Budget



DMA'S IMPLEMENTATION OF THE FEDERAL MANAGERS'  
FINANCIAL INTEGRITY ACT FOR ITS  
FIRST REPORT--BACKGROUND

FINANCIAL INTEGRITY ACT

The Congress, in 1982, enacted the Federal Managers' Financial Integrity Act, 31 U.S.C. 3512(b) and (c), in response to continuing disclosures of waste, loss, unauthorized use, or misappropriation of assets across a wide spectrum of government operations, which were largely attributable to serious weaknesses in agencies' internal controls. The act was designed to strengthen the existing requirement of the Accounting and Auditing Act of 1950 that executive agencies establish and maintain systems of accounting and internal control to provide effective control over and the accountability for all funds, property, and other assets for which the agency is responsible, 31 U.S.C. 3512(a)(3).

We believe that full implementation of the Financial Integrity Act will enable the heads of federal departments and agencies to identify their major internal control and accounting problems and improve controls essential to the development of an effective management control system and a sound financial management structure for their agency. To achieve this, the act requires:

- Each agency to establish and maintain its internal controls with the standards prescribed by the Comptroller General, so as to reasonably ensure that: (1) obligations and costs comply with applicable law, (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and (3) revenues and expenditures applicable to agency operations are recorded and properly accounted for.
- Each agency to evaluate and report annually on internal control systems. The report is to state whether agency systems of internal control comply with the objectives of internal controls set forth in the act and with the standards prescribed by the Comptroller General. The act also provides for the agency report to identify the material weaknesses involved and describe the plans for corrective action.

- Each agency to prepare a separate report on whether the agency's accounting systems conform to principles, standards and related requirements prescribed by the Comptroller General.
- The OMB to issue guidelines for federal departments and agencies to use in evaluating their internal control systems. These guidelines were issued in December 1982.
- The Comptroller General to prescribe standards for federal agencies' internal control systems. The Comptroller General issued these standards in June 1983.

The Comptroller General's presentation at the September 29, 1983, meeting of the assistant secretaries for management outlined expectations for agency efforts to report on conforming accounting systems to Comptroller General principles and standards (section 4 of the act). Recognizing that not all agencies had begun work to implement section 4, the Comptroller General emphasized the following constructive actions which could be taken to provide building blocks for future years' implementation:

- Organize for completing accounting systems evaluations and issue needed written policies and procedures.
- Inventory their accounting systems.
- Identify prior reported system deviations.
- Rank the systems according to the materiality of potential deviations from our accounting principles and standards.
- Initiate reviews of systems.
- Plan for the first-year report.

This DMA report is one of 22 GAO reports on federal agencies' efforts to implement the act.

#### OBJECTIVES, SCOPE AND METHODOLOGY

The objective of our review was to evaluate DMA's process in implementing the act. We reviewed pertinent directives, documents supporting DMA's evaluation, and DMA's consolidated annual report to the Secretary of Defense. We reviewed DMA's report in terms of its process qualifications, reported internal

control weaknesses, and reported nonconforming accounting systems. We also interviewed DMA officials responsible for establishing and monitoring the internal control and accounting system compliance evaluation processes at headquarters and the two DMA organizational units located in the Washington, D.C., area. Also, officials performing the evaluations were interviewed. Because our first-year review was limited to an evaluation of the implementation process, we did not attempt to independently determine the status of DMA's internal control system or the extent to which their accounting systems comply with the Comptroller General's principles and standards. Our work was conducted in accordance with generally accepted government auditing standards.

We conducted this review at DMA Headquarters, Washington, D.C.; the Hydrographic/Topographic Center, and Office of Distribution Services, Brookmont, Maryland, during the period of August 1983 through February 1984.



COMPTROLLER

## ASSISTANT SECRETARY OF DEFENSE

WASHINGTON DC 20301

27 MAR 1984

Mr. Frank C. Conahan  
Director, National Security  
and International Affairs  
Division  
General Accounting Office  
441 G Street, NW, Room 4804  
Washington, D.C. 20548


Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report, "The Defense Mapping Agency's First Year Implementation of the Federal Managers' Financial Integrity Act," dated March 12, 1984 (GAO Code No. 390003), OSD Case No. 6465B. No recommendations were included in the Draft Report.

The DoD concurs with the Draft Report's findings and is pleased with the favorable views of the GAO with respect to the Defense Mapping Agency's efforts to implement immediate corrective action on all findings.

DoD comments on each finding are provided in the Enclosure. The Department appreciates the opportunity to comment on the Draft Report.

Sincerely,

  
John R. Quetsch  
Principal Deputy Assistant Secretary of Defense  
(001, 101)

Enclosure



DoD Comments  
on  
GAO Draft Report, "The Defense Mapping Agency's First Year  
Implementation of the Federal Managers' Financial Integrity Act,"  
dated March 12, 1984 (GAO Code No. 390003), OSD Case No. 6465B

GAO FINDING A

Identify and consider all agency elements or functions. For example, the first year process excluded Hydrographic and Topographic Center's field offices, motorpool, book library, silver recovery functions, and minicomputers. (p. 7, Draft Report) (See p. 5, of this report.)

DoD COMMENT

Concur. All functions and activities will be covered by the next round of vulnerability assessments in July 1984. Assessable units will be identified by program and organization. The number of assessable units will be finalized by the end of April 1984, and will be included in the revision of Defense Mapping Agency (DMA) Instruction 7040.6, subject, "Internal Control Systems." The revised Instruction will be issued within sixty (60) days after release of DoD Directive 7040.6.

GAO FINDING B

Adequately document vulnerability assessments. There was inconsistency in completing the forms. Some did not identify the preparer and/or describe the methodology used in conducting the assessment. (p. 7, Draft Report) (See p. 5, of this report)

DoD COMMENT

Concur. To ensure all vulnerability assessments are performed in a consistent manner, DMA will publish DMAG 7040.8, subject, "Guide for Conducting Vulnerability Assessments." The Guide will be published by the end of April 1984. The Guide will standardize the assessment process throughout DMA and will require a standard vulnerability assessment report.

GAO FINDING C

Establish a tracking system for identified internal control weaknesses and planned corrective actions. A tracking system had been established for weaknesses identified from internal control reviews, but a system for tracking vulnerability assessments had not been established and management had to assume corrective actions had been or were being taken. (p. 7, Draft Report) (See p. 5, of this report)

Note: Page numbers have been added to correspond to this report.

DoD COMMENT

Concur. The vulnerability assessment report includes a requirement to identify actions initiated to correct any material weaknesses. In addition, the report requires activities to identify any planned or proposed corrective actions for any material weaknesses identified during the assessment. Corrective action will be tracked by DMA's automated audit and internal review followup system.

GAO FINDING D

Provide vulnerability assessment and internal control review training. During the first year no internal training was provided and participation in external training was limited. (p. 8, Draft Report) (See p. 5, of this report)

DoD COMMENT

Concur. During April 1984, DMA Headquarters personnel will use DMAG 7040.7, subject, "Guide for Conducting Management Control Reviews," and DMAG 7040.8, subject, "Guide for Conducting Vulnerability Assessments," to conduct training for all Agency internal control officials. During May 1984, all supervisors and managers will be trained in conducting vulnerability assessments.

GAO FINDING E

Provide guidance on the methodology for assessing and reviewing automatic data processing (ADP) controls, particularly, for general and application controls. The original guidance did not address these areas. (p. 8, Draft Report) (See p. 5, of this report)

DoD COMMENT

Concur. DMAG 7040.8, subject, "Guide for Conducting Vulnerability Assessments," will require, for ADP operations, that all aspects be reviewed, including manual input, software, security and output. DMA Interim ADP Security Program Manual will be used to supplement the Office of Management and Budget Guidelines in evaluating ADP systems.

GAO FINDING F

Identification and evaluation will be made of the manual processing functions that support automated systems. (p. 9, Draft Report) (See p. 6, of this report)

DoD COMMENT

Concur. DMAG 7040.8, subject, "Guide for Conducting Vulnerability Assessments," will require, for ADP operations, that all aspects be reviewed, including manual input, software, security and output.

GAO FINDING G

Responsible managers will submit annual certifications that the accounting software has not been altered, or if the software has been altered, a statement of the results from testing the accounting system changes in conformance with the Comptroller General's principles and standards. (p. 9, Draft Report)  
(See p. 6, of this report)

DoD COMMENT

Concur. If any system has been altered, the activity must certify that the changes meet all required standards (ADP, security, accounting, etc.). Plans were issued in March 1984 for accomplishing the Fiscal Year 1984 evaluation and certification of accounting systems used by DMA. This will be accomplished by the end of September 1984.

## GLOSSARY

The following definitions were developed by GAO for our review of the implementation of the Federal Managers' Financial Integrity Act.

### Accounting System

The total structure of the methods and procedures used to record, classify, and report information on the financial position and operations of a governmental unit or any of its funds, or organizational components. An accounting system should assist in the financial management functions of budget formulation and execution, proprietary accounting and financial reporting.

### Administrative Function

An activity in an agency which is carried out to support the accomplishment of an agency's programs, missions, or objectives. These activities may include ADP, travel, or consulting services. However, there is no uniform definition of administrative functions; each agency's may be unique.

### ADP Application Controls

Controls that are unique to each software application system. Application controls are intended to assure the quality of data origination, input, processing, and output.

### ADP General Controls

Controls that apply to the overall management of the ADP function in an agency. General ADP controls have a direct effect on the quality of service rendered to ADP users and cover the processing of all ADP application systems. These controls affect most ADP hardware and application software systems, and include

- organizational controls for the ADP unit;
- system design, development, and modification controls;
- data center management controls;
- data center security controls;
- system software controls; and
- hardware controls.

These controls should be evaluated by ADP managers as part of an analysis of the general control environment.

### Assessable Unit

A program or administrative function or subdivision thereof, which is to be the subject of a vulnerability assessment. An agency should identify its assessable units in such a way as to (1) include the entire agency and (2) facilitate meaningful vulnerability assessments. All agency programs or administrative functions must be assessed, with the exception of those involved in the performance of policymaking or statutory formulation.

### Audit Resolution

Begins when auditors report their findings to management and completed only after management takes action. Management must either correct identified deficiencies, produce improvements, or demonstrate that findings are invalid. "Audit Resolution" is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

### Control Objective

A desired goal or condition for a specific event cycle, system, or subsystem. An agency's control objectives should be developed for each agency activity and should address the three objectives in the Federal Managers' Financial Integrity Act. An example of a control objective may be "Paychecks should be issued to all, and only, entitled persons." "Control Objectives" are one of the Comptroller General's Standards for Internal Controls in the Federal Government.

### Control Technique

Any mechanism relied on to efficiently and effectively accomplish a control objective. These mechanisms, if operating as intended, help prevent fraud, waste, abuse, or mismanagement. An example of a control technique might be the comparison of automated personnel and payroll master files prior to computing and issuing paychecks. "Control Techniques" are one of the Comptroller General's Standards for Internal Controls in the Federal Government.

### Documentation

That information which would allow an independent reviewer to reach the same conclusions as the original reviewer regarding an agency's internal controls; and the methods used, personnel involved, and conclusions reached in conducting its internal control evaluation, improvement, and reporting process. This information should be current

and be available for review. "Documentation" of internal controls is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

### Event Cycle

A grouping of similar activities. An entity's activities can be grouped into a discrete number of cycles. These groupings are based on what is accomplished, and therefore facilitate the identification of cycle objectives. For example, most agencies will have a disbursement cycle which will include all events contributing to the objective of providing reasonable assurance that all payments are legal, proper, accurate, and timely.

### General Control Environment

Those environmental factors that can influence the effectiveness of internal controls over program and administrative functions. An evaluation of the general control environment is the first step in the vulnerability assessment process required by OMB's Guidelines.

This evaluation may be performed for the component as a whole, or individually for each program and administrative function within the component. The determining factors would be the size, nature, and degree of centralization of the programs and functions conducted within the agency component.

### Inherent Risk

The inherent potential for waste, loss, unauthorized use, or misappropriation due to the nature of an activity itself. An analysis of each assessable unit's inherent risk is the second step in the vulnerability assessment process required by OMB's Guidelines. OMB's Guidelines suggest that the matters to be considered in the analysis should include, but need not be limited to, the following: purpose and characteristics, budget level, impact outside the agency, age and life expectancy, degree of centralization, special concerns, prior reviews, and management responsiveness.

### Internal Controls

The plan of organization and all coordinate methods and measures adopted by an agency to provide reasonable assurance that the three objectives of the Federal Managers' Financial Integrity Act of 1982 are achieved. Internal controls should be established in accordance with the Comptroller General's Internal Control Standards. Typically, an internal control represents the combination

of a control objective, along with a control technique (or set of techniques) which are being relied on to achieve that control objective.

#### Internal Control Review

A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner. OMB's Guidelines recommend six steps for an internal control review: (1) identification of the event cycle, (2) analysis of the general control environment, (3) documentation of the event cycle, (4) evaluation of internal controls within the cycle, (5) testing of the internal controls, and (6) reporting the results. Internal control reviews should normally be conducted for those areas rated as highly vulnerable in the vulnerability assessment process, where corrective action is not readily apparent. An agency should allocate resources for these detailed reviews of internal control based on vulnerability; those most vulnerable should be reviewed first.

#### Internal Control Standards

In 1983, the Comptroller General issued a set of Standards For Internal Controls In The Federal Government. The Federal Managers' Financial Integrity Act of 1982 requires each executive agency to establish internal accounting and administrative controls in accordance with these standards. There are five general standards, six specific standards, and one audit resolution standard. The five general standards are: (1) reasonable assurance, (2) supportive attitude, (3) competent personnel, (4) control objectives, and (5) control techniques. The six specific standards are: (1) documentation, (2) recording of transactions and events, (3) execution of transactions and events, (4) separation of duties, (5) supervision, and (6) access to and accountability for resources.

#### OMB Guidelines

The document issued by the Office of Management and Budget in December 1982, Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government. An evaluation conducted in accordance with these guidelines is to provide a basis for an agency's annual statement required by the act.

## Preliminary Evaluation of Safeguards

A judgment regarding the existence and adequacy of internal control over an assessable unit. This evaluation is the third step in the vulnerability assessment process required by the OMB Guidelines. The evaluation is preliminary in that a more in-depth review of internal controls is the focus of the internal control review phase. The preliminary evaluation of controls required here should be based largely on the evaluator's working knowledge of the existence and functioning of internal controls in the subject assessable unit.

## Program

Generally, an organized set of activities directed toward a common purpose or goal, and undertaken or proposed by an agency in order to carry out its responsibilities. In practice, however, the term "program" has many meanings. It is used to describe the agency's mission, functions, activities, services, projects, and processes.

## Reasonable Assurance

Internal control systems should provide reasonable, but not absolute, assurance that the objectives of the system will be accomplished. This concept recognizes that the cost of internal control should not exceed the benefit expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of internal controls. Errors or irregularities may occur and not be detected because of inherent limitations in any internal control, including those resulting from resource constraints, or congressional restrictions. "Reasonable Assurance" is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

## Segmentation

The process by which an agency identifies its assessable units; i.e., its programs and administrative functions. The inventory of assessable units developed as a result of this process must be appropriately detailed so as to provide a basis for the conduct of meaningful vulnerability assessments. The OMB Guidelines provide that all the agency activities, except those concerned with policymaking, should be included in the inventory.

There is no single best method to segment an agency, particularly in light of variations in agency organization structure and responsibilities.



### Specific Risk

A judgment regarding the likelihood and magnitude of error or irregularity in the event cycle being evaluated. These judgments represent an essential element of the fourth step recommended by OMB in its Guidelines for an internal control review: "Evaluation of the internal controls within the event cycle." The judgment regarding specific risk is based on a comparison of control objectives with related control techniques. Based on this evaluation, the amount and type of control testing, OMB's fifth step in an internal control review, will be determined.

### Testing

The examination of available evidence to determine whether internal controls are functioning as intended. Testing is the fifth step recommended in OMB's Guidelines for the performance of an internal control review.

The nature of the controls, the significance of the cycle, importance of control objective, the nature of the specific risks, possible compensating controls, testing resources, and timing must all be considered in developing appropriate tests. Generally, testing can be categorized as either "compliance" or "substantive." Compliance testing is generally used when the judgment regarding specific risk has given reason to rely on a control technique. It is designed to verify if one or more internal control techniques are operating. The other category of testing, "substantive" testing, is used when the specific risk is sufficiently great that the control cannot be relied on. A substantive test is designed not to verify the operation of a control technique but rather to verify the results of the process to which the control was applied.

### Vulnerability Assessment

A biennial review of the susceptibility of an assessable unit to the occurrence of waste, loss, unauthorized use, or misappropriation. OMB's Guidelines prescribe three basic steps for the conduct of vulnerability assessment: (1) analyze the general control environment, (2) analyze the inherent risk, and (3) perform a preliminary evaluation of existing safeguards.

The primary purpose of vulnerability assessments is to determine if and in what sequence resources should be allocated for the performance of internal control reviews.

(390003)





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