

BY THE U.S. GENERAL ACCOUNTING OFFICE

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

**Defense Logistics 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 Logistics 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.



124030



028711

GAO/NSIAD-84-99

MAY 1, 1984

**Request for copies of GAO reports should be sent to:**

**U.S. General Accounting Office  
Document Handling and Information  
Services Facility  
P.O. Box 6015  
Gaithersburg, Md. 20760**

**Telephone (202) 275-6241**

**The first five copies of individual reports are free of charge. Additional copies of bound audit reports are \$3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are \$1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".**



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND  
INTERNATIONAL AFFAIRS DIVISION

B-202205

Vice Admiral Eugene A. Grinstead  
Director, Defense Logistics Agency

Dear Admiral Grinstead:

This report presents the results of our review of the Defense Logistics Agency's (DLA's) efforts to implement and comply with the Federal Managers' Financial Integrity Act of 1982. Our review was part of a governmentwide assessment of the act's first-year implementation.

We found that DLA has made progress in evaluating internal accounting and administrative controls (referred to as internal controls) and accounting systems compliance as required under the act. DLA recognizes that further improvements can be made and is drafting new guidance and planning other actions that we believe should improve its evaluation processes. Details of the act's requirements 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's head to evaluate and report annually to the President and the Congress on the adequacy of their systems of internal 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 agencies.

The Secretary of Defense's December 28, 1983, statement was compiled from separate reports from the Department of Defense's (DOD's) 24 reporting centers, including DLA. As required by DOD's implementing guidance, reports to the Secretary of Defense are to be provided each year and will be the basis for the Secretary of Defense's annual statement to the President and the Congress on DOD's compliance with the act.

In accordance with the act, the Director of the Office of Management and Budget (OMB) established guidelines to provide a basic approach to evaluating, improving, and reporting on agencies' internal controls. OMB recommends the following steps as an efficient, effective way to perform the evaluations:

- Organize the internal control evaluation process.
- Segment the agency into organizational and/or functional components to create an inventory of assessable units.
- Conduct vulnerability assessments to determine the susceptibility of a program or function to waste, loss, unauthorized use, or misappropriation.
- Review internal controls (a detailed examination of an accounting or administrative system to determine if adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost-effective manner).
- Take corrective actions.
- Report on the adequacy of internal controls and plans for corrective actions.

#### DLA'S INTERNAL CONTROL EVALUATION PROCESS

The results of DLA's internal controls evaluation process were the basis for the agency Director's report to the Secretary of Defense. DLA is drafting or planning changes that should improve its evaluation process.

#### Process supporting the first-year report

DLA began its internal control review process by issuing DLA Regulation 7000.12, dated May 21, 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, DLA had segmented its organization and field activities<sup>1</sup> had completed vulnerability assessments before the Financial Integrity Act was approved in September 1982, and OMB issued its Internal Control Guidelines in December 1982. DLA headquarters elements<sup>2</sup> and field activities completed several additional actions before reporting to the Secretary of Defense. DLA issued Regulation 7000.13 on internal control reviews in February 1983; headquarters elements performed vulnerability assessments; and field activities performed internal control reviews.

DLA Regulations 7000.12 and 7000.13 assigned overall internal control evaluation responsibility to the DLA Comptroller. Initially, a small group in the Comptroller's office provided guidance, technical assistance, coordination, and training for the internal control evaluation process. This group became the Internal Review Division in October 1983.

DLA Regulation 7000.12 requires field activities to perform vulnerability assessments and internal control reviews. This was supplemented by DLA Regulation 7000.13 which provided further instruction to field activities on internal control review responsibilities and procedures. Because DLA initially believed that its vulnerability primarily existed in its field activities, the process was not applied to the headquarters elements until mid-1983. Guidance on the internal control evaluation process for the headquarters elements was distributed through various memorandums issued in June 1983 and thereafter.

To facilitate the vulnerability assessment process, DLA's 15 headquarters elements and 25 field activities were segmented by functional areas (i.e., supply, property disposal, and civilian personnel). By this method, DLA established a total of 187 segments in 18 functional areas. DLA field activities and headquarters elements further subdivided the 187 segments to perform vulnerability assessments. For example, the Defense Contract Administration Services Region in Cleveland, Ohio, performed 61 vulnerability assessments in its 8 functional areas.

---

<sup>1</sup>For example, the Defense Contract Administration Services Region in Cleveland, Ohio, and the Defense Depot in Mechanicsburg, Pennsylvania.

<sup>2</sup>For example, the Directorate of Supply Operations and the Directorate of Contract Management.

DLA, in May 1982, assigned its field activities the responsibility to perform vulnerability assessments and submit internal control review schedules. The DLA Comptroller does not have an inventory of the assessments performed by field activities; however, rankings of assessable units from the assessments performed by field activities in 1984 will be provided to DLA headquarters. In July 1983, vulnerability assessments were performed by DLA's headquarters elements, but internal control reviews will not be performed until 1984.

In January 1983, DLA's Office of the Comptroller assigned internal control review areas, covering all 18 functions, to the field activities. The methodology used in making these assignments was not documented. As of October 14, 1983, (the cut-off date set by DLA), 22 field activities had provided the Office of the Comptroller a total of 44 internal control review reports, covering 14 of the 18 functional areas. The Office of the Comptroller obtained, orally, the internal control review results for the remaining functional areas.

DLA has assigned primary responsibility for follow up and corrective action on vulnerability assessment and internal control review weaknesses to the field activities.

Planned improvements  
for the process

DLA has drafted new guidance to assist field activities and headquarters elements in the internal controls evaluation process and is planning to (1) improve its training program, (2) issue appropriate guidance for assessing automated data processing (ADP) areas, and (3) track corrective actions. We believe these actions should improve DLA's internal control evaluation process. The changes in DLA's process address such circumstances as the need to:

- Provide specific guidance to field activities for completing the assessment process. The existing guidance resulted in vulnerability assessments not being consistently performed at the two field activities we reviewed. For example, the Defense Depot in Mechanicsburg, Pennsylvania, did not perform vulnerability assessments, while the Defense Contract Administration Services, in Cleveland, Ohio, performed and documented their vulnerability assessments before scheduling internal control reviews.
- Provide additional internal control evaluation training, including consideration of training to be adopted by the DOD. For the first-year's process, DLA's Office of the

Comptroller provided limited internal training and field activities had only limited participation in external training.

- Assign managers responsibility for and provide them guidance in evaluating automated data processing general and application controls. This type of guidance was not included in existing or newly drafted DLA regulations.
- Incorporate a tracking system to identify corrective actions needed in DLA's audit follow-up system. DLA headquarters did not have a follow-up system to track weaknesses found during internal control reviews.

#### DLA'S ACCOUNTING SYSTEM COMPLIANCE EVALUATION PROCESS

Under section 4 of the act, each agency must report annually on whether its accounting systems conform to the accounting principles and standards prescribed by the Comptroller General. DLA's Comptroller had responsibility for assuring that its accounting systems comply with the Comptroller General's accounting principles and standards prior to the act. Responsibility for section 4, however, has not been formally assigned. DOD advised us that DLA plans to assign this responsibility to the Chief, Accounting and Finance Division, Office of the Comptroller, by December 1984.

DLA's process for evaluating and reporting on whether its accounting systems complied with the Comptroller General's principles and standards included: (1) identifying accounting systems, (2) requiring initial judgments on compliance, and (3) reporting efforts underway to replace existing systems. However, it did not include testing operating accounting systems. DLA began testing operating accounting systems for such compliance in December 1983 and plans to formally document its testing procedures. We believe this testing will make future compliance certifications more meaningful.

#### INSPECTOR GENERAL'S ROLE

DLA does not have an Office of the Inspector General. Consequently, DOD's Office of the Inspector General reviewed DLA's internal controls and accounting systems compliance evaluation processes. Results of their review were informally provided to DLA. At the time of our review, the Office of the

Inspector General had not issued its final report on DLA's internal control evaluation process. Its report, dated October 24, 1983, stated that DLA's accounting systems compliance evaluation process was reasonable.

#### DLA'S DIRECTOR'S REPORT

DLA identified its areas of weakness through its internal control review, General Accounting Office, and Office of the Secretary of Defense Inspector General reports. The Director's 1983 report to the Secretary of Defense identified the following areas of weakness:

- Agency-wide "Policies and procedures do not ensure the receipt of materials requisitioned by the Military Services from DLA and those shipped to DLA activities or delivered directly to DLA customers from vendors and contractors."
- Program Specific "a. Receipt inspections of Defense Electronics Supply Center assets were not performed at Naval Supply Center, Norfolk. b. Review of unliquidated obligations at Defense Personnel Support Center has not significantly reduced the dollar value still outstanding. c. Due to systems voids<sup>3</sup> at contract administration activities, manual processing of expenditure data is required at the Defense Personnel Support Center."

The Director's report also listed the 25 accounting systems in DLA's inventory. Five of these were identified as being in conformance with the Comptroller General's accounting principles and standards. Of the nonconforming accounting systems, 19 lacked depreciation accounting and 1 lacked integration of its subsystems. Replacements for these noncomplying systems and their expected implementation dates are cited in the Director's report.

#### CONCLUSION

We believe that DLA's planned changes to its internal control and accounting systems compliance evaluations should improve compliance with the Federal Managers' Financial Integrity Act. Further, we believe that the reasonable

---

<sup>3</sup>Data or information forwarded in a format that cannot be processed directly by the recipient's automated data processing equipment and software.



assurance statement in your annual reports will become more meaningful as these changes are implemented. 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

DOD concurs with the observations in this report and has provided milestones for each action to improve the process. The dates range from December 1983, when testing of operating accounting systems was started; to June 1985, when its automated follow-up system is expected to be operational. DLA's revised guidance on its internal control evaluation process will be issued in June 1984. DOD's comments are 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.

Sincerely yours,



Frank C. Conahan  
Director



## C o n t e n t s

	<u>Page</u>
APPENDIX	
I DLA'S IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT-- BACKGROUND	1
The Financial Integrity Act	1
Objectives, scope, and methodology	2
II Letter, dated March 27, 1984, from the Principal Deputy Assistant Secretary of Defense (Comptroller)	4
GLOSSARY	7

### ABBREVIATIONS

ADP	Automated Data Processing
DLA	Defense Logistics Agency
GAO	General Accounting Office
OMB	Office of Management and Budget



DLA'S IMPLEMENTATION OF THE FEDERAL  
MANAGERS' FINANCIAL INTEGRITY ACT--BACKGROUND

THE 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 an executive agency establish and maintain systems of accounting and internal control to provide effective control over and 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 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 accounting and administrative 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 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 accounting and administrative control systems. These guidelines were issued in December 1982.

The Comptroller General to prescribe principles and standards for federal agencies' internal accounting and administrative 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 the Comptroller General's 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 accounting systems.
- Identify prior reported system deviations.
- Rank the systems according to the materiality of potential deviations from the Comptroller General's accounting principles and standards.
- Initiate reviews of systems.
- Plan for the first year report.

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

#### OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to evaluate DLA's process in implementing the act. Because our first-year review was limited to an evaluation of the implementation process, we did not attempt to

independently determine the status of DLA's internal control system or the extent to which DLA's accounting systems comply with the Comptroller General's principles and standards.

We initiated our review in July 1983 at three headquarters elements--the Office of the Comptroller and the Directorates of Contract Management and Supply Operations--and at two field activities--the Defense Contract Administrative Services Region, Cleveland, Ohio, and the Defense Depot, Mechanicsburg, Pennsylvania. Our review was completed in February 1984.

To accomplish our objective, we reviewed DLA internal control regulations, directives, correspondence, workpapers, vulnerability assessments, and internal control reviews. We also interviewed DLA officials.

This review was conducted in accordance with generally accepted government auditing standards.



COMPTROLLER

## ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 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 Logistics Agency's First Year Implementation of the Federal Managers' Financial Integrity Act," dated March 12, 1984 (GAO Code No. 390003), OSD Case No. 6465A. The Department generally concurs with the Draft Report. DoD comments on each finding are in the Enclosure. Thank you for providing an opportunity to comment.

Sincerely,

  
John R. Quetsch  
Principal Deputy Assistant Secretary of Defense  
(Comptroller)

Enclosure



## DoD Comments

on

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

GAO FINDING A

Defense Logistics Agency's (DLA's) Office of the Comptroller has drafted revised guidance and has plans for improving the internal controls and accounting systems compliance evaluation processes. (p. 1, Draft Report) (See p. 1, this report.)

DoD COMMENT

Concur. DLA guidance on internal controls has been revised and will be issued by June 1984, pending issuance of the DoD Directive.

GAO FINDING B

DLA's Office of the Comptroller, however, does not have an inventory of the assessments performed below the major functional areas. (p. 5, Draft Report) (See p. 3, this report.)

DoD COMMENT

Concur. DLA has requested its field activities to perform vulnerability assessments during the third quarter of Fiscal Year 1984 in accordance with the Office of Management and Budget Guidelines. The field activities will provide DLA Headquarters (HQ) their rankings of each assessable unit in July 1984.

GAO FINDING C

DLA plans to improve its training program. (p. 7, Draft Report) (See p. 4, this report.)

DoD COMMENT

Concur. DLA has advised its field activities of courses available on internal control for managers. In addition, videotapes have been provided to each field activity for showing periodically to operating personnel. The tapes are the result of briefings provided to all field activities in 1983. By July 1984, DLA anticipates that DoD training materials under development will be available for distribution to field activities.

GAO FINDING D

DLA's newly drafted guidance does not address automated data processing (ADP) general and application controls. (p. 7, Draft Report) (See p. 5, this report.)

Note: Page numbers were added to correspond with the final report.

DoD COMMENT

Concur. DLA will include a provision in its guidance to have field activities review ADP general and application controls. Anticipated completion date is June 1984.

GAO FINDING E

DLA HQ plans to track reported internal control review weaknesses and monitor corrective actions through its audit followup system. (p. 8, Draft Report) (See p. 6, this report.)

DoD COMMENT

Concur. DLA has a manual system for tracking internal control weaknesses in operation. An automated system is expected to be operational by June 1985.

GAO FINDING F

DLA's Office of the Comptroller has not been assigned specific responsibilities for accounting system compliance under the Act. (p. 8, Draft Report) (See p. 5, this report)

DoD COMMENT

Concur. DLA has assigned the responsibility for accounting system compliance to the Chief of the Accounting and Finance Division. This assignment will be formalized by December 1984.

GAO FINDING G

To have more meaningful certifications of compliance with the Comptroller General's principles and standards, it will be necessary to test the systems in operation. (p. 9, Draft Report) (See p. 5, this report.)

DoD COMMENT

Concur. All accounting systems which were approved by the Comptroller General have been tested at one or more field activities as of March 1984. DLA plans to test the operating accounting systems at all field activities, one per month, continuously. These tests began in December 1983.

## 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.

### Agency Component

A major organization, program, or functional subdivision of an agency having one or more separate systems of internal control, and a specific, responsible manager.

### 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)





28119

**AN EQUAL OPPORTUNITY EMPLOYER**

**UNITED STATES  
GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548**

**OFFICIAL BUSINESS  
PENALTY FOR PRIVATE USE, \$300**

**POSTAGE AND FEES PAID  
U S GENERAL ACCOUNTING OFFICE**



**THIRD CLASS**