



Department of Defense

INSTRUCTION

NUMBER 5010.40
January 4, 2006

USD(C)

SUBJECT: Managers' Internal Control (MIC) Program Procedures

- References:
- (a) DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996 (hereby canceled)
 - (b) DoD Directive 5118.3, "Under Secretary of Defense (Comptroller) (USD(C))/Chief Financial Officer (CFO), Department of Defense," January 6, 1997
 - (c) Section 3512 of title 31, United States Code
 - (d) Office of Management and Budget Circular No. A-123, "Management's Responsibility for Internal Control," August 5, 2005
 - (e) through (v), see Enclosure 1

1. REISSUANCE AND PURPOSE

This Instruction:

- 1.1. Reissues reference (a) to establish instructions for implementing and executing the Managers' Internal Control (MIC) Program authorized under paragraph 3.4.2. of reference (b).
- 1.2. Implements references (c) and (d).
- 1.3. Establishes the DoD Senior Assessment Team.

2. APPLICABILITY AND SCOPE

This Instruction applies to the Office of the Secretary of Defense, the Military Departments, the Office of the Chairman of the Joint Chiefs of Staff, the Combatant Commands, the Office of the Inspector General of the Department of Defense, the Defense Agencies, the DoD Field Activities, and all other organizational entities in the Department of Defense (hereafter referred to collectively as the "DoD Components").

3. DEFINITIONS

Terms used in this Instruction are defined in Enclosure 2.

4. POLICY

It is DoD policy under reference (b) that a MIC Program be established to review, assess, and report on the effectiveness of Internal Controls (ICs) in the Department of Defense. The MIC Program shall identify and promptly correct ineffective ICs, and establish ICs when warranted, for two distinct processes:

4.1. The Federal Managers' Financial Integrity Act (FMFIA) Overall Process as it pertains to the overall program, operational, and administrative controls relevant to the reporting categories explained in sections E3.1. through E3.15.

4.2. The FMFIA Over Financial Reporting Process relevant to the reporting category explained in section E3.16.

5. RESPONSIBILITIES

5.1. The Under Secretary of Defense (Comptroller) (USD(C)) shall monitor compliance with this Instruction and designate a DoD Senior Assessment Team to provide oversight and accountability regarding the Department's ICs over financial reporting. This team shall help ensure DoD operations are consistent with the Office of Management and Budget (OMB) Circular No. A-123 (reference (d)), and Standards for Internal Control for the Federal Government (reference (e)).

5.2. The Director of Administration and Management shall serve as the senior management official for the OSD and DoD Field Activities.

5.3. The Under Secretaries and Assistant Secretaries of Defense, in their capacity as DoD functional proponents, shall:

5.3.1. Identify and report any new systemic IC weaknesses in their functional areas, and report on the status of any existing systemic weakness until resolved.

5.3.2. Review the reported actions of the DoD Components that pertain to their area of functional responsibility and promptly assist the DoD Components to resolve weaknesses by taking necessary actions required by reference (b).

5.3.3. Report and explain the actions taken to resolve systemic weaknesses.

5.4. The Heads of DoD Components shall establish and maintain their MIC Program and ensure compliance with this Instruction. Only Components with Financial Statement Reporting Entities that produce stand-alone statements, or when specified in the annual guidance, shall establish a senior assessment team for each Financial Statement Reporting Entity consistent with reference (d).

6. PROCEDURES

6.1. Each DoD Component shall develop a MIC Program that concludes with the Component Head or principal deputy annually reporting reasonable assurance to the Secretary of Defense about the effectiveness of ICs. This program includes the following:

6.1.1. The Head of each DoD Component will assign IC responsibility to civilian and military leaders (hereafter referred to as “managers”), throughout the Department of Defense and provide trained personnel for planning, directing, and implementing the MIC program as defined in paragraphs 4.1. and 4.2.. DoD managers shall report assurance and track corrective actions taken to expedite prompt resolution of control deficiencies, reportable conditions, or material weaknesses found during the assessment. Documentation shall be maintained and fully disclosed in the annual assurance statement reporting any material weaknesses found during the assessment of ICs to include a schedule of actions to resolve those weaknesses.

6.1.2. Each DoD Component shall segment into organizational assessable units and maintain an inventory of its assessable units. The assessable unit managers must be the head of the assessable unit. The assessable unit managers will have a critical element in their performance appraisal plan addressing their MIC Program performance. A list of the assessable units must be a part of every DoD Component’s MIC Strategy (MICS) under paragraph I., subparagraph A, “Agency Implementation,” (reference (d)). All organizational parts in the chain of command of each DoD Component shall be contained in one or more of the DoD Component’s assessable units so that the list as a whole equals the entire DoD Component. For dual-hatted organizations, those organizations that belong to more than one DoD Component, only one of the DoD Components will become the parent Component for FMFIA reporting to reduce the administrative burden of the dual-hatted organization. All DoD Components will annually document and maintain an updated list of assessable units that includes the identification of the parent Component for dual-hatted organizations. In disputed cases, where no DoD Component accepts responsibility as the parent DoD Component for FMFIA reporting, the USD(C), acting on behalf of the Secretary of Defense in managing the MIC Program, shall assign by memorandum the parent DoD Component for FMFIA reporting as close to the beginning of the fiscal year as feasible.

6.1.3. The MIC Program will be segregated into two distinct processes:

6.1.3.1. All DoD Components shall establish the FMFIA Overall Process as defined in paragraph 4.1. of this Instruction.

6.1.3.2. Only Components with a Financial Statement Reporting Entity that produces stand-alone statements, or when specified in the annual guidance, shall establish the FMFIA Over Financial Reporting Process as defined in paragraph 4.2. of this Instruction.

6.1.4. For the FMFIA Overall Process as defined in section 4, DoD Components shall:

6.1.4.1. Assess the effectiveness of the ICs through a process determined by each DoD Component's senior management. These assessments shall be consistent with the guidance contained in references (b) and (d). This process should maximize the use of already existing management assessment or evaluation data and, when possible, minimize the creation of separate processes solely for the execution of the MIC Program.

6.1.4.2. Identify and report IC weaknesses. Each DoD Component shall establish and maintain a process that identifies and reports IC weaknesses, as follows:

6.1.4.2.1. Identification. The DoD Components may identify weaknesses in their ICs over program, operational or administrative areas through a variety of sources such as audits, inspections, investigations, management assessments, credible information of nongovernmental origin, staff meetings, and IC assessments. Additional sources are identified in section E2.7..

6.1.4.2.2. Reporting. Identified material weaknesses in the system of ICs shall be reported by the Head of the DoD Component in the FMFIA Overall Process Statement of Assurance to the Secretary of Defense. A material weakness is a reportable condition that the Head of the DoD Component determines to be significant enough to be reported to the next higher level. A reportable condition, which is not reported to the next higher level, is a control deficiency or combination of control deficiencies that in management's judgment represent significant deficiencies in the design or operation of internal control that could adversely affect the organization's ability to meet its internal control objectives. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned function, to prevent or detect fraud, waste, abuse, or mismanagement on a timely basis. Material weaknesses, reportable conditions, and control deficiencies are further defined in Enclosure 2. The determination of materiality is management's judgment. Materiality is defined in Enclosure 2.

6.1.5. For the ICs used in the FMFIA Over Financial Reporting Process as defined in section 4, DoD Components shall closely follow the procedures as established in Appendix A of references (d) and additional guidance provided in the MIC Program annual guidance.

6.1.6. Reference (d) requires DoD Component managers to take prompt and effective actions to correct weaknesses in their ICs for both the FMFIA Overall Process (see subparagraph 4.1.) and the FMFIA Over Financial Reporting Process (see subparagraph 4.2.). Promptly correcting IC weaknesses is management's responsibility. Components shall, for each unresolved material or systemic weakness reported to the Secretary of Defense:

6.1.6.1. Appoint a senior accountability official from senior management responsible for corrective action. This appointment should be based on the managers' ability to understand and correct the problem.

6.1.6.2. Require prompt resolution of corrective actions.

6.1.6.3. Require corrective action plans that show progress on a quarterly basis at a minimum.

6.1.5.4. Require corrective action plans that are consistent with laws, regulations, and administrative policy.

6.1.6.5. Require the addition of a critical element to the performance appraisal plan of the senior accountability official that indicates the effective and timely resolution of the material or systemic weakness.

6.1.6.6. Ensure that an adequate determination has been made prior to reporting a material weakness as resolved. The last milestone in each corrective action plan shall include a correction validation unless a metric is used, in which case, the final corrective action shall describe how the metric goal was met.

6.1.7. The Head of the DoD Component shall annually submit a FMFIA Overall Process Annual Statement of Assurance based on a general assessment of the effectiveness of their ICs over the functions described in Enclosure 3. This statement of assurance shall also include material weaknesses found in ICs and the plans to correct them as well as be consistent with the MIC Program annual guidance about the content and structure of the statement. The statement must be signed by the Head of the DoD Component or the Principal Deputy and submitted annually to the Secretary of Defense by September 1 or an alternative date, as required by the MIC Program annual guidance. The signature authority may not be delegated below the Principal Deputy level.

6.1.8. Only DoD Components with Financial Statement Reporting Entities that produce stand alone financial statements or are defined as an entity in the MIC Program annual guidance, shall annually submit a separate FMFIA Over Financial Reporting Process Statement of Assurance based on a general assessment of the effectiveness of their ICs over financial reporting specifically relevant to the function described in section E3.16.. This statement shall be consistent with MIC Program annual guidance on the content and structure of the statement and also include material weaknesses found on the ICs over financial reporting, and the plan to correct them. The FMFIA Over Financial Reporting Process Statement of Assurance must be signed by the Head of the DoD Component or the Principal Deputy and submitted as a subset to the FMFIA Overall Process Annual Statement of Assurance statement to the Secretary of Defense by September 1 of each year or an alternative date if required by the MIC Program annual guidance. The signature authority may not be delegated below the Principal Deputy level.

6.1.9. Reference (d) encourages use of senior management councils as a forum for assessing and monitoring MIC Program efforts. The DoD Components are encouraged to establish their own senior management council.

6.1.10. The DoD Components with Financial Statement Reporting Entities that produce stand alone financial statements shall establish an Entity Senior Assessment Team to oversee the implementation of Appendix A of reference (d) and the MIC Program annual guidance. A highly recommended source for designating the Entity Senior Assessment Team is the audit committee that is overseeing the financial statement reporting activities for the Component's Financial Statement Reporting Entity or entities.

7. INFORMATION REQUIREMENTS

7.1. For the FMFIA Overall Process, as defined in section 4, references (c) and (d), the Secretary of Defense is required to submit a statement of assurance in a single FMFIA report section as part of the Performance and Accountability Report (PAR) labeled, "Management Assurances," annually by November 15.

7.1.1. This report should include the identification of Sections 2 and 4 of FMFIA material weaknesses in ICs over all program areas except the functional area of financial reporting.

7.1.2. A determination should be made on whether noncompliance with reference (c) should be reported as nonconformance with Section 4 of FMFIA, and if so, included in this section of the report.

7.1.3. A material weakness must be included in this report with a schedule of corrective actions for any "significant deficiency" found under the Federal Information Security Management Act (FISMA) of 2002 (reference (f)).

7.2. For financial reporting as required by references (c) and (d), the Secretary of Defense is required to also submit by November 15 of each year, a separate assurance over the effectiveness of the internal controls over financial reporting. This assurance must be a subset of the FMFIA Overall Process Statement of Assurance of the section labeled, "Management Assurances," in the PAR and is based on the results of management's assessment conducted according to the requirements in Appendix A of reference (d). Management is precluded from concluding that the Department of Defense's IC over financial reporting is effective (unqualified) if there are one or more material weaknesses. This statement shall include:

7.2.1. A statement of management's responsibility for establishing and maintaining adequate IC over financial reporting for the Department of Defense.

7.2.2. A statement identifying Appendix A of reference (d) as the framework used by management to conduct the assessment of the effectiveness of the Department of Defense's internal control over financial reporting.

7.2.3. An assessment of the effectiveness of the Department of Defense's IC over financial reporting as of June 30, including an explicit conclusion as to whether the internal controls over financial reporting are effective.

7.2.3.1. If a material weakness is discovered by June 30, but corrected by September 30, a statement should be included that identifies the material weakness, the corrective action taken, and that it has been resolved by September 30 for the Department of Defense.

7.2.3.2. If a material weakness is discovered after June 30, but prior to September 30, the statement identifying the material weaknesses should be updated to include the subsequently identified material weakness.

7.3. All DoD Components shall provide annually a FMFIA Overall Process Statement of Assurance that provides the DoD Component Head's or Principal Deputy's reasonable assurance of the effectiveness of ICs. The DoD Components shall consider IC weaknesses disclosed by all sources, including management studies; DoD Component audits, inspections, investigations, or internal review reports; and Inspector General (IG), DoD, and GAO reports. This statement of assurance is based on management's assessment of the effectiveness of the agency's ICs as of the date signed for that fiscal year.

7.4. Only DoD Components, which have Financial Statement Reporting Entities that are required by OMB or the Department of Defense to produce stand alone financial statements, shall also annually provide a FMFIA Over Financial Reporting Process Annual Statement of Assurance on the effectiveness of ICs over financial reporting for each Financial Statement Reporting Entity. This assurance shall be a subset to the FMFIA Overall Statement of Assurance. The assurance shall be based on the results of management's assessment conducted according to the requirements Appendix A of reference (d) and the MIC Program annual guidance. This statement of assurance is management's assessment of the effectiveness of the agency's ICs as of June 30 of each fiscal year or as prescribed in the MIC Program annual guidance.

7.5. The Head of the DoD Component or Principal Deputy shall sign the annual FMFIA Overall and FMFIA Over Financial Reporting Statements of Assurance in the format provided in the MIC Program annual guidance to the Secretary of Defense by September 1 of each year, or as required. Additional copies of the statement and accompanying reports shall be furnished to the USD(C); the quantity of this submission will be contained in the MIC Program annual guidance provided by USD(C).

7.5.1. The FMFIA Overall Process Statement of Assurance will have a cover memorandum, signed by the DoD Component Head or the Principal Deputy, providing the organization's senior management assessment as to whether there is reasonable assurance that the organization's ICs are in place and operating effectively. Those DoD Components required to produce the FMFIA Over Financial Reporting Process Statement of Assurance for each Financial Statement Reporting Entity shall report assurance in subparagraphs to the FMFIA Overall Statement of Assurance cover memorandum. Appendix A of reference (d) must be

identified as the framework used by management to assess the effectiveness of the agency's IC over financial reporting as of June 30. Under reference (d), each statement of assurance must take one of three forms:

7.5.1.1. An unqualified statement of assurance ("I have reasonable assurance that..."). Each unqualified statement must have a firm basis for that position, which will be summarized in the cover memorandum. A more extensive explanation of that position must be clearly articulated in the body of the statement.

7.5.1.2. A qualified statement of assurance ("I have reasonable assurance that... except for..."). The material weaknesses in ICs that preclude an unqualified statement should be cited in the cover memorandum.

7.5.1.3. A statement of no assurance ("I do not have reasonable assurance that..."). The basis for this position should be summarized in the cover memorandum.

7.5.2. Statements of assurance will be in the format provided in the MIC Program annual guidance and include a description of how the DoD Component assessment was conducted and state the reasonable assurance achieved,

7.5.3. If the level of assurance is "qualified" for either the FMFIA Overall or any FMFIA Over Financial Reporting Statement(s) of Assurance, the following must be included:

7.5.3.1. Uncorrected material weaknesses (current year and prior year disclosures) and the specific plans and schedules for correction. The specific plans and schedules shall include the actions that will correct a weakness. Although the actions that should correct the weakness may be in development, the weaknesses should be reported and the tentative actions should be disclosed in a manner consistent with management's current perceptions.

7.5.3.2. Material weaknesses corrected in the current year (current year disclosures and prior year disclosures corrected in the current year) and a description of the actions taken. Each corrected material weakness shall include, as the last milestone, a validation milestone which evaluates and certifies the effectiveness of the corrective action.

7.6. Reports on the MIC Program have been assigned Report Control Symbol DD-COMP (AR) 1618 according to DoD 8910.1-M (reference (g)).

7.7. The Commanders of the Combatant Commands shall submit annual reports as described in paragraph 7.3. and, where applicable, paragraph 7.4., to the Secretary of Defense. Information copies shall be provided to the Chairman of the Joint Chiefs of Staff and USD(C).

8. EFFECTIVE DATE

This Instruction is effective immediately.



Tina W. Jonas
Under Secretary of Defense (Comptroller)

Enclosures – 3

- E1. References, continued
- E2. Definitions
- E3. IC Reporting Categories

E1. ENCLOSURE 1

REFERENCES, continued

- (e) Government Accountability Office, "Standards for Internal Control in the Federal Government," November 1999
- (f) Section 101 of title 6, United States Code
- (g) DoD 8910.1-M, "DoD Procedures for Management of Information Requirements," June 1998
- (h) Section 501 of title 31, United States Code
- (i) Office of Management and Budget Circular A-130 (Revised), "Management of Federal Information Resources," November 28, 2000
- (j) OMB Circular A-11, Preparation, Submission and Execution of the Budget, July 16, 2004
- (k) Section 1101 of title 31, United States Code
- (l) Section 7501 of title 31, United States Code
- (m) DoD 5000.1, "The Defense Acquisition System," May 12, 2003
- (n) DoD 8000.1, "Management of DoD Information Resources and Information Technology," February 27, 2002
- (o) Government Accountability Office (GAO) Internal Control Management and Evaluation Tool, August 2001
- (p) OMB Circular A-76, Performance of Commercial Activities, May 29, 2003
- (q) FASAB Generally Accepted Accounting Principles, multiple dates¹
- (r) Treasury Financial Manual, Volume 1: Federal Agencies, latest version²
- (s) United States Standard General Ledger (USSGL), latest version³
- (t) OMB Bulletin No. 01-09, "Form and Content of Agency Financial Statements," September, 25, 2001⁴
- (u) OMB Circular No. A-136, "Financial Reporting Requirements," December 21, 2004
- (v) DoD 7000.14-R, "DoD Financial Management Regulation," current edition

¹ Can be found at <http://www.fasab.gov/accepted.html>

² Can be found at <http://www.fms.treas.gov/tfm/vol1/>

³ Can be found at <http://www.fms.treas.gov/ussgl/current.html>

⁴ Can be found at <http://www.whitehouse.gov/omb/bulletins/b01-09.html>

E2. ENCLOSURE 2

DEFINITIONS

E2.1. Assessable Unit. An organizational subdivision and part of the total IC organization that requires compliance with the MIC Program for a DoD Component.

E2.2. Comptroller General Standards. The five standards issued by the Comptroller General to be applied by all managers in the Federal Government in establishing, assessing, documenting, monitoring, and reporting ICs under GAO Standards for Internal Control in the Federal Government (reference (e)), which are listed below.

E2.2.1. Control Activities. Control activities include policies, procedures, and mechanisms in place to help ensure that agency objectives are met. Several examples include proper segregation of duties; physical control over assets; proper authorization; and appropriate documentation and access to that documentation.

E2.2.2. Control Environment. The organizational structure and culture created by management and employees to sustain organizational support for effective ICs. Within the organizational structure, management must clearly: define areas of authority and responsibility; appropriately delegate the authority and responsibility throughout the agency; establish a suitable hierarchy for reporting; support appropriate human capital policies for hiring, training, evaluating, counseling, advancing, compensating, and disciplining personnel; and uphold the need for personnel to possess and maintain the proper knowledge and skills to perform their assigned duties as well as understand and be responsible for maintaining effective IC within the organization.

E2.2.3. Information and Communication. Information should be communicated to relevant personnel at all levels within an organization. The information should be relevant, reliable, and timely. It is also crucial that an agency communicate with outside organizations as well, whether providing information or receiving it. Examples include receiving updated guidance from central oversight agencies; management communicating requirements to the operational staff; operational staff communicating with the information systems staff to modify application software to extract data requested in the guidance.

E2.2.4. Monitoring. Monitoring the effectiveness of internal control should occur in the normal course of business. In addition, periodic reviews, reconciliations or comparisons of data should be included as part of the regular assigned duties of personnel. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations. If an effective continuous monitoring program is in place, it can provide the resources needed to maintain effective ICs throughout the year. Deficiencies found in internal control should be reported to the appropriate personnel and management responsible for that area. Deficiencies identified whether through internal review or by

an external audit should be evaluated and corrected. A systemic process should be in place for addressing deficiencies.

E2.2.5. Risk Assessment. Management should identify internal and external risks that may prevent the organization from meeting its objectives. When identifying risks, management should take into account relevant interactions within the organization as well as with outside organizations. Management should also consider previous findings; e.g., auditor identified, internal management reviews, or noncompliance with laws and regulations when identifying risks. Identified risks should then be analyzed for their potential effect or impact on the agency.

E2.3. Control Deficiency. The design or operation of a control that does not allow management or employees to prevent or detect misstatements on a timely basis or accomplish the mission objectives is a control deficiency.

E2.3.1. Design Deficiency. A control necessary to meet the control objective is missing or an existing control is not properly designed, so that even if the control operates as designed the control objective is not consistently met.

E2.3.2. Operation Deficiency. A properly designed control that does not operate as designed or the person performing the control is not qualified or properly skilled to perform the control effectively.

E2.4. DoD Functional Proponent. The DoD staff principal responsible for policy and oversight of a particular functional area.

E2.5. Financial Statement Reporting Entity. An entity assigned by either the Office of Management and Budget or the Department of Defense to produce and provide to OUSD(C) stand alone financial statements, both quarterly and annual.

E2.6. Internal Control (IC). ICs are the organization, policies, and procedures that help program and financial managers to achieve results and safeguard the integrity of their programs.

E2.7. Internal Control (IC) Assessment. A documented evaluation on the effectiveness and adequacy of the system to meet the mission objectives, implemented in a cost-effective way to comply with reference (c).

E2.7.1. Internal Control Assessments for the FMFIA Over Financial Reporting Process. The conduct of assessing the effectiveness of ICs over financial reporting which should closely follow the guidance in Appendix A of reference (d) and MIC Program Annual Guidance provided by OUSD(C).

E2.7.2. Internal Control Assessment for the FMFIA Overall Process. The conduct of assessing the effectiveness of ICs for the functions under the FMFIA Overall Process, which includes all program, activities, and operational areas as defined in Enclosure 3.

The assessment shall be designed by management following the references (b), (d), (e), and the MIC Program Annual Guidance provided by OUSD(C). DoD Components are encouraged to prevent this process from becoming an isolated exercise outside the daily operating and management activities and should consolidate these assessments with other evaluative activities such as:

E2.7.2.1. Annual evaluations and reports pursuant to Federal Information Security Management Act (FISMA) (reference (f)) and OMB Circular No. A-130, Management of Federal Information Resources (reference (i)).

E2.7.2.2. Annual reviews and reports pursuant to Government Performance and Results Act (reference (k)).

E2.7.2.3. Audits of financial statements conducted pursuant to the Chief Financial Officers (CFO) Act of 1990 (reference (h)), including information revealed in preparing the financial statements; the auditor's reports on the financial statements, IC, and compliance with laws and regulations; and any other materials prepared relating to the statements.

E2.7.2.4. IG and GAO reports, including audits, inspections, reviews, investigations, outcome of hotline complaints, or other products.

E2.7.2.5. Management knowledge gained from the daily operation of agency programs and systems.

E2.7.2.6. Management reviews conducted to assess ICs or for other purposes with an assessment of IC as a by-product of the review.

E2.7.2.7. Other reviews or reports relating to agency operations; e.g., for the Department of Health and Human Services, quality control reviews of the Medicaid and Temporary Assistance for Needy Families programs.

E2.7.2.8. Program Assessment Rating Tool assessments (reference (j)).

E2.7.2.9. Program evaluations.

E2.7.2.10. Reports and other information provided by the Congressional committees of jurisdiction.

E2.7.2.11. Single Audit reports for grant-making agencies (reference (l)).

E2.8. Internal Control (IC) Standards. See paragraph E2.2. above in this Instruction and reference (e).

E2.9. Managers' Internal Control (MIC) Program. Management responsibility as defined by this Instruction, reference (b), and the MIC Program Annual Guidance provided by OUSD(C)).

E2.10. Managers' Internal Control Strategy (MICS). A brief, written strategy that indicates the number of scheduled and accomplished IC assessments and the identity of DoD Component assessable units and progress for accomplishing annual program requirements consistent with information reported in the DoD Component's FMFIA Overall Process Annual Statement of Assurance.

E2.11. Material Weakness in ICs for the FMFIA Overall Process is a reportable condition which is significant enough to report to the next higher level. It is management's judgment as to whether or not a weakness is deemed material.

E2.12. Material Weakness in the ICs over Financial Reporting is a reportable condition, or combination of reportable conditions, that results in more than a remote likelihood that a material misstatement of the financial statements, or other significant financial reports, will not be prevented or detected. The determination is a management judgment as to whether a weakness is material.

E2.13. Materiality for FMFIA Over Financial Reporting. Materiality for FMFIA Over Financial Reporting is defined as the risk of error or misstatement on the financial statements that could occur and would impact management's or users' decisions or conclusions based on such statements. Materiality for FMFIA Over Financial Reporting is further defined in Appendix A, paragraph C, Planning Materiality of reference (d). The level of materiality each Financial Statement Reporting Entity is to use for FMFIA Over Financial Reporting will be defined in the annual guidance provided by the USD(C).

E2.14. Materiality for FMFIA Overall. Materiality for FMFIA Overall is defined as the risk of error or inability to accomplish mission objectives. The level of materiality each Component is to use for FMFIA Overall is based upon that particular Component management's judgment.

E2.15. Reasonable Assurance. An informed judgment by management as to the overall adequacy and effectiveness of ICs based upon available information that the systems of ICs are operating as intended by reference (c).

E2.16. Reportable Conditions for the FMFIA Overall Process. A control deficiency, or combination of control deficiencies, that in management's judgment, should be communicated because they represent significant weaknesses in the design or operation of IC that could adversely affect the organization's ability to meet its IC objectives.

E2.17. Reportable Conditions for the FMFIA Financial Reporting Process. A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report external financial data reliably

according to generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements, or other significant financial reports, is more than inconsequential will not be prevented or detected.

E2.18. Risk. The possibility an event will occur and adversely effect the achievement of the IC objectives and may result in the loss of Government resources or cause an agency to fail to accomplish significant mission objectives through fraud, error, or mismanagement. Risk is measured by the likelihood and the impact of the event having a negative effect.

E2.19. Senior Assessment Team for Assessing ICs over Financial Reporting for Both the Department of Defense and Entity. A team of senior level executives that provide oversight of assessing and documenting the effectiveness of ICs over financial reporting. The team provides oversight for:

E2.19.1. Determining the assessment design and methodology.

E2.19.2. Determining the scope of the assessment, i.e., those financial reports covered by the assessment.

E2.19.3. Ensuring that assessment objectives are clearly communicated throughout the organization.

E2.19.4. Ensuring that the assessment is carried out in a thorough, effective, and timely manner.

E2.20. Senior Management Council. A committee or board of senior level executives that convene to advise the head of an organization on IC matters, to include the identification of IC weaknesses that merit reporting as material weaknesses.

E2.21. Senior Official. A senior official is a member of the highest level of management or leadership of the agency or Component.

E2.22. System Non-conformance. Instances in which financial management systems do not substantially conform to financial system requirements constitute system non-conformance as defined in reference (d). Financial management systems include both financial and financially related (or mixed) systems.

E2.23. Systemic Weakness. A systemic weakness is one that materially affects internal control across organizational and program lines and usually affects more than one DoD Component.

E2.24. Tool for Evaluating Internal Controls. The Government Accountability Office has published a tool for use in evaluating internal controls (see GAO Internal Control Management and Evaluation Tool (reference (o))).

E3. ENCLOSURE 3

INTERNAL CONTROL (IC) REPORTING CATEGORIES

When reporting a material weakness in internal controls, the DoD Component will identify which function the material weakness concerns. The following will be used as the reporting categories used to classify the material weaknesses:

E3.1. Research, Development, Test, and Evaluation. The basic project definition, approval, and transition from basic research through development, test, and evaluation and all DoD and contractor operations involved in accomplishing the project work, excluding the support functions covered in separate reporting categories such as Procurement and Contract Administration.

E3.2. Major Systems Acquisition. Items designated as major systems and are subject to the procedures of the Defense Acquisition Board, the Military Services Acquisition Review Councils, or the Selected Acquisition Reporting System. DoD Directive 5000.1 (reference (m)) may be helpful when evaluating a weakness for inclusion in this category.

E3.3. Procurement. The decisions to purchase items and services with certain actions to award and amend contracts (e.g., contractual provisions, type of contract, invitation to bid, independent Government cost estimate, technical specifications, evaluation and selection process, pricing, and reporting).

E3.4. Contract Administration. The fulfillment of contractual requirements including performance and delivery, quality control and testing to meet specifications, performance acceptance, billing and payment controls, justification for contractual amendments, and actions to protect the best interests of the Government.

E3.5. Force Readiness. The operational readiness capability of combat and combat support (both Active and Reserve) forces based on analyses of the use of resources to attain required combat capability or readiness levels.

E3.6. Manufacturing, Maintenance, and Repair. The management and operation of in-house and contractor-operated facilities performing maintenance and repair and/or installation of modifications to materiel, equipment, and supplies. Includes depot and arsenal-type facilities as well as intermediate and unit levels of military organizations.

E3.7. Supply Operations. The supply operations at the wholesale (depot and inventory control point) level from the initial determination of material requirements through receipt, storage, issue reporting, and inventory control (excluding the procurement of materials and supplies). Covers all supply operations at retail (customer) level, including the accountability and control for supplies and equipment of all commodities in the supply accounts of all units and organizations (excluding the procurement of material, equipment, and supplies).

E3.8. Property Management. Construction, rehabilitation, modernization, expansion, improvement, management, and control over real and installed property, and facilities (both military and civil works construction) and includes all phases of property life-cycle management. Also covers disposal actions for all materiel, equipment, and supplies including the Defense Reutilization and Marketing System.

E3.9. Communications and/or Intelligence and/or Security. The plans, operations, systems, and management activities for accomplishing the communications and intelligence missions and safeguarding classified resources (not peripheral assets and support functions covered by other reporting categories). Also covers the DoD programs for protection of classified information.

E3.10. Information Technology. The design, development, testing, approval, deployment, use, and security of automated information systems (using a combination of computer hardware, software, data or telecommunications that performs functions such as collecting, processing, storing, transmitting or displaying information) and other technologies for processing management information. This includes requirements for justification of equipment and software. DoD Directive 8000.1 (reference (n)) may be helpful when evaluating a weakness for inclusion in this category.

E3.11. Personnel and/or Organization Management. Authorizations, recruitment, training, assignment, use, development, and management of military and civilian personnel of the Department of Defense. Also includes the operations of headquarters organizations. Contract personnel are not covered by this category.

E3.12. Comptroller and/or Resource Management. The budget process, finance and accounting, cost analysis, productivity and management improvement, and the general allocation and continuing evaluation of available resources to accomplish mission objectives. Includes pay and allowances for all DoD personnel and all financial management areas not covered by other reporting categories, including those in connection with OMB Circular A-76 (reference (p)).

E3.13. Support Services. All support service functions financed from appropriated funds not covered by the other reporting categories such as healthcare, veterinary care, and legal and public affairs services. All nonappropriated fund activities are also covered by this category.

E3.14. Security Assistance. Management of DoD Foreign Military Sales, Grant Aid, and International Military Education and Training Programs.

E3.15. Other (Primarily Transportation). All functional responsibilities not contained in sections E3.1. through E3.15., including management and use of land, sea, and air transportation for movement of personnel, materiel, supplies, and equipment using both military and civilian sources.

E3.16. Financial Reporting. Processes, procedures, and systems used to prepare, compile, and generate the DoD financial statements according to reference (c); reference (h); the Federal Accounting Standards Advisory Board (FASAB) guidance (reference (q)); the Department of the Treasury Manual (references (r) and (s)) and financial reporting guidance established by OMB Bulletin No. 01-09 and Circular No. A-136 (references (t) and (u)); and DoD 7000.14-R (reference (v)).