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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of The Navy

Department Of The Navy'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 Department of the Navy in its first year of experience with this new act. The report focuses on the Navy's efforts to evaluate internal controls, review accounting systems, and improve the evaluation processes as a result of identified problems.



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

NATIONAL SECURITY AND  
INTERNATIONAL AFFAIRS DIVISION

B-202205

The Honorable John F. Lehman  
The Secretary of the Navy

Dear Mr. Secretary:

We reviewed the Navy's implementation of the Federal Managers' Financial Integrity Act which requires executive agencies to do ongoing evaluations and report annually on the adequacy of their systems of internal accounting and administrative control. It also requires the agencies to report annually on whether their accounting systems comply with the principles and standards prescribed by the Comptroller General.

The Navy is making progress in developing and implementing its internal control program, but has encountered problems and delays in achieving a satisfactory program throughout the Navy. Changes have been made or are planned which should alleviate many of these difficulties. However, managers at all levels need to give more attention and support to the program if it is to be satisfactorily implemented throughout the Navy.

This letter discusses the progress the Navy has made, problems observed, Navy's actions to address these problems, and a specific concern we have regarding the support some managers are giving the internal control program. Our review was part of a governmentwide assessment of the act's first-year implementation. Details of our observations, as well as our objective, scope, and methodology are discussed in appendix I. A glossary of terms is at the end of the appendices.

DEPARTMENT OF DEFENSE REPORTING  
UNDER THE FEDERAL MANAGERS'  
FINANCIAL INTEGRITY ACT

The Department of the Navy is one of the Department of Defense's (DOD's) 24 reporting centers. Each center is required to review the adequacy of its systems of internal accounting and administrative controls and report annually to the Secretary of

Defense. Each must also report on whether its accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General of the United States. These 24 reports provide the basis for the Secretary of Defense's annual report to the President and the Congress on the adequacy of DOD's internal controls as required by the Financial Integrity Act.

The Secretary of the Navy submitted his annual report on November 8, 1983. He cited areas of material weaknesses and planned corrective actions in both internal control and accounting systems. These weaknesses are summarized in appendix II.

THE NAVY'S INTERNAL CONTROL  
EVALUATION PROGRAM

A combination of tight time frames and limited staff resources at the Office of the Comptroller, the Navy's central implementing office, contributed to late, limited, and confusing guidance to headquarters components and field activities for implementing this new internal control program Navy-wide. These problems were compounded at the headquarters component and field activity levels by less than full acceptance by some managers of the program and implementation strategies which resulted in varying degrees of progress. (See appendix III for listings of headquarters components and field activities we visited.) Adding still further to the problems at all levels was an absence of practical training, particularly in how to do internal control reviews. The Secretary of the Navy's November 1983 report to the Secretary of Defense cited these and other problems in the first year evaluation process. Some of the more serious effects that we observed include the following:

- Many segments of the Navy were not included in the first-year implementation of the program. Some of the more prominent examples are the 63 field activities under the Naval Sea Systems Command, all operational forces, including ships and aircraft squadrons, and most parts of the headquarters of the Office of the Chief of Naval Operations.
- Internal review (audit) groups at some headquarters components and activities became heavily involved in organizing and directing the program as well as performing vulnerability assessments and internal control reviews. This limited the role of the linemenagers who should have primary responsibility for implementing the program.

- The process employed for identifying the Navy's programs most vulnerable to waste, loss, unauthorized use, or misappropriation did not provide consistent and complete assessments of Navy programs and functions. Therefore, all of the Navy's most vulnerable areas may not have been identified for purposes of initiating reviews of internal controls. For example, procurement was not rated highly vulnerable, despite widely recognized problems in this area.
- Programs and functions used for segmenting the Navy (for example, financial, supply, and maintenance, repair and overhaul) were found by Navy managers to be too broad to permit meaningful vulnerability assessments. One effect was that the assessments were of limited value to components and activities in identifying specific programs and functions to be reviewed for internal control weaknesses.
- At the components and field activities we visited, very few internal control reviews were performed in accordance with guidelines provided by the Office of Management and Budget (OMB). Many of these components and activities relied on audits and other studies for reporting on their status of internal controls in 1983. These often did not provide an adequate examination of internal controls.
- Automated data processing (ADP) internal controls were not adequately addressed. Over half of the Navy's headquarters components did not assess the vulnerability of ADP operations even though many had significant ADP activities. Also, internal control reviews of ADP that were performed were not conducted in accordance with OMB guidelines.

#### Changes being made

Important changes have been made or are planned which should address most of these problems. A Secretary of the Navy implementing instruction, issued July 29, 1983, provides improved guidance on implementing the program. A clarifying memorandum has been issued which better defines the role of internal review groups. Another memorandum has been drafted which provides improved methods and guidance for performing vulnerability assessments and emphasizes the need to address ADP internal controls. Training needs of managers involved in

performing vulnerability assessments and internal control reviews are being addressed. Steps also have been taken and are being taken to achieve Navy-wide implementation of the program. These changes should result in an improved internal control evaluation process which will provide the basis for more meaningful future statements by the Secretary of the Navy regarding the adequacy of the Navy's internal controls.

#### Greater management commitment needed

One of the major difficulties in implementing this first-year program was obtaining adequate management support at a number of components and field activities. Some managers were very disenchanted, citing the need for more guidance, training, and staff resources before they could satisfactorily implement the program. Some questioned the value or payoff of the program. While the guidance has been improved, much training remains to be accomplished, and additional staff resources may not be forthcoming according to Navy Comptroller's Office officials. Because of these implementation problems, it is all the more critical that the Office of the Comptroller follow through on plans to establish procedures to ensure that each headquarters component is implementing a satisfactory internal control program.

#### ACCOUNTING SYSTEMS

Section 4 of the Federal Managers' Financial Integrity Act requires agencies to report annually on whether their accounting systems comply with principles and standards prescribed by the Comptroller General. In preparing its 1983 report, the Navy relied on information from headquarters component and field activity managers, past GAO and internal audits, and management studies. The report identified the Navy's 14 accounting systems, and summarized the areas of deficiency identified and planned corrective actions. The report also presented the Navy's initial judgments, based on readily available information, that nine of its systems did not comply with the Comptroller General's principles and standards and the remaining five substantially complied.

For future years' reporting, we believe it will be necessary for the Navy to test and evaluate the systems in operation, including internal controls, before attesting to their compliance.

The Navy is taking and planning several actions which, if carried out, should enable a more complete and accurate evaluation of its systems' compliance in future years. These include plans to establish followup procedures to track the status of corrective actions. We support completion of these efforts as described in appendix I.

CONCLUSIONS


The Navy has encountered a number of problems in implementing the Federal Managers' Financial Integrity Act. Changes are being made, however, which should lead to a more consistent, complete, and reliable assessment of internal controls in the future. The internal control program will, however, require substantial emphasis and oversight from top management to ensure that it is satisfactorily implemented throughout the Navy.

AGENCY COMMENTS

In its March 27, 1984, response to a draft of this report, DOD concurred with our findings. (See app. IV.) It also agreed with our only recommendation in the draft--that the Secretary of the Navy require components and activities to review their own high vulnerability programs, as well as those ranked high Navy-wide. Because of their agreement to do this, we have dropped that recommendation from the report. This is discussed on pp. 10 and 11 of appendix I.

. . . . .

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

Sincerely yours,  
  
Frank C. Conahan  
Director





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### ABBREVIATIONS

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



THE NAVY'S IMPLEMENTATION OF THE  
FEDERAL MANAGERS' 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 is 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 accounting and administrative controls in accordance 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 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 Comptroller General's principles and standards. The act also provides for agency reports 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 Office of Management and Budget (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 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 Comptroller General 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 report on the Department of the Navy is one of 22 GAO reports on federal agencies' efforts to implement the act.

DEPARTMENT OF THE NAVY'S  
IMPLEMENTATION PROCESS

The Navy's process for evaluating and reporting on internal control systems was based on major implementation phases outlined in the guidance provided by OMB--organizing and assigning responsibilities; segmenting the agency into organizational components and then into programs and functions within each component; performing vulnerability assessments to determine relative potential for loss; conducting internal control reviews to identify any weaknesses in controls; and reporting on the status of its controls.

The Navy's process for evaluating and reporting on whether its accounting systems comply with the Comptroller General's principles and standards consisted of (1) identifying its accounting systems, (2) identifying and reporting known weaknesses in each system with planned corrective actions, (3) beginning development of an inventory of subsystems which make up the major systems, and (4) initiating development of a process for evaluating its systems.

These two processes, in addition to the role of the Navy's Auditor General, are discussed below.

#### Internal control evaluation process

The Navy elected to use a decentralized organizational structure for implementing the act, identifying 26 headquarters components and assigning each the responsibility for establishing an internal control program within the component, including field activities. The Deputy Under Secretary of the Navy for Financial Management was assigned overall responsibility for the design, documentation, and operation of the internal control system, including overall policy guidance and direction. Overseeing development and implementation was the Department of Navy's Review and Oversight Council, a high-level group.

Internal control program implementation began in early 1982 in response to OMB Circular A-123, issued October 28, 1981, which prescribed internal control policies and standards for executive departments and agencies. The headquarters components were instructed in May 1982, to do vulnerability assessments on 20 broad program/functional areas. These assessments were reviewed by the Review and Oversight Council, who ranked the vulnerability of each of the 20 areas.

In January 1983 headquarters components and activities were instructed to begin internal control reviews. The reviews were to concentrate on the six areas ranked highly vulnerable by the Council--financial; supply; maintenance, repair and overhaul; medical; transportation; and morale, welfare and recreation.

Reports on the reviews--identifying accomplishments, material weaknesses, and plans for corrective action--were submitted to the Review and Oversight Council. These reports, together with input from internal audit groups and Navy assessments of its accounting systems' compliance with the Comptroller General's accounting principles and standards, provided the basis for the Secretary of the Navy's November 1983 report to the Secretary of Defense on the adequacy of the Navy's systems

of internal accounting and administrative controls and on the compliance of its accounting systems with the Comptroller General's principles and standards.

#### Navy reporting on its accounting systems

Not having much time to prepare its 1983 report, the Navy elected to use readily available information to report on accounting systems compliance. First, it identified 14 accounting systems (e.g., Navy Military Payroll System; Navy Industrial Fund Accounting System) into which it believed all of the accounting subsystems could be categorized. Secondly, a summary was prepared of major accounting system deficiencies identified by reviewing past audit reports and management studies and through special correspondence with responsible Navy managers. These deficiencies, along with planned corrective actions, were cited in the Navy's November 1983 report as general deficiencies affecting its overall accounting processes, and specific deficiencies affecting one or more of its 14 accounting systems.

The Navy also initiated, but did not complete, actions to

- inventory and categorize its accounting subsystems which make up the 14 systems,
- develop and implement procedures for evaluating its accounting subsystems for compliance with the Comptroller General's principles and standards,
- issue needed written policies and procedures, and
- identify system enhancement projects underway.

#### Role of Auditor General

In the Navy, the Auditor General is essentially equivalent to the Inspector General in other federal agencies. The internal control program's implementing instruction identifies three key roles for the Auditor General: (1) evaluate command and activity compliance with the instruction, (2) perform reviews of internal control documentation and systems as part of scheduled audits, and (3) provide technical assistance. The role of evaluating accounting systems is not specifically defined.

During the first year of implementation the Auditor General played a rather active role. For example, information and views on internal control vulnerabilities and weaknesses were provided

to top management; a broad review of implementation of the new program was performed; and comments on draft instructions, and some training and other technical advice were provided. In addition, audit guidelines were revised to incorporate additional steps for reviewing internal control systems. We believe that this demonstrated expertise could also prove useful in the Navy's planned work on its accounting systems. The Navy should consider exploring this potential as it plans evaluations of its accounting systems.

#### INTERNAL CONTROL PROGRAM PROGRESS

Beginning a new program in an organization as large and as decentralized as the Navy is a major task. The Department of the Navy has approximately 1,400 shore activities and 1,800 operational forces such as ships and aircraft squadrons. Its fiscal year 1984 budget of \$85.6 billion is the fourth highest of all federal agencies. Progress in implementing internal control programs varied throughout the Navy, with some headquarters components and activities making more progress than others. The Navy encountered problems with inadequate resources, guidance, training, quality control, and management support at some headquarters components and activities.

Difficulties encountered were related to both process and management, with some starting in the very early stages of the implementation effort and permeating the entire process. These problems should not, however, overshadow either the progress made thus far in implementing the legislation or the positive steps the Navy has taken and anticipates taking in the months ahead. Since these difficulties shed light on why the overall review led to a qualified statement on internal controls and provide a frame of reference for use in further implementing the program, they are discussed below as they affected each step of the internal control program process. We have also incorporated the actions the Navy has taken and plans to take to improve its internal control process.

#### Shortfalls in organizing

Navy-wide implementation of its internal control program was handled by only two staff members in the Comptroller's office who worked less than full-time on program implementation. These staff members were assigned in February 1982 in response to internal control requirements set forth in OMB Circular A-123. They were almost immediately faced with a request by the Office of the Secretary of Defense that vulnerability assessments be completed by July 31, 1982. These individuals, in addition to performing some of their normal duties, had to become familiar with internal control program requirements and

promulgate guidance to Navy's headquarters components needed to establish internal control programs. The guidance and training they provided was quite limited. This caused difficulties in establishing programs at headquarters components and in performing both vulnerability assessments and internal control reviews. A staff member was added to the implementation team in late 1983 to help ease the workload and provide improved guidance to components and activities.

One specific organizational-related problem that developed during the early phases of implementation was confusion over the role of internal review (audit) groups in implementing the program at the components and field activities. Part of the problem stemmed from some components and activities confusing this new Internal Control Program with the Internal Review Program. Contributing further to the confusion was early guidance which stated that the majority of internal control reviews were to be performed by the Naval Audit Service and internal review groups. The effect of all this was heavy involvement by the internal review groups at some components and activities in organizing and directing the program and performing vulnerability assessments and internal control reviews. While the guidance has been changed and clarified, this has resulted in an extremely limited involvement of line managers at some components and activities in the process.

#### Coverage of Navy limited

In reviewing first-year implementation of the program, we found that a large number of organizational elements did implement an internal control program. Some of the elements, such as ships and other operational forces, were excluded because of a conscious decision to proceed slowly in the first year. Other elements were excluded because of oversight or communication breakdowns, and still others were not included because they did not submit vulnerability assessments.

Two key headquarters components essentially missed were the Office of the Chief of Naval Operations, and the Navy Recruiting Command. These were oversights resulting from organizational misunderstandings. Three other headquarters components--Office of the General Counsel, Office of Naval Legal Services, and the Chief of Information--submitted no vulnerability assessments and were excluded from the evaluation of internal controls which followed.

At the activity and project office level of the nine components reviewed, we found a considerable amount of nonparticipation. For example, the Naval Sea Systems Command decided to exclude its 63 field activities from the program in



the first year. Only about half of the 98 activities under the Commander-in-Chief, Pacific Fleet, reviewed their internal controls. Also, of the approximately 50 project offices responsible for procuring ships, aircraft, and other similar weapon systems and support systems under the Headquarters of the Naval Material Command, Naval Sea Systems Command, and Naval Air Systems Command, only one did a review of internal controls.

Navy officials stated that most, if not all, of the organizational elements excluded in the first year-implementation effort will be covered in the future.

Some of this limited coverage is also due to inadequate support of some managers. We found skepticism and disenchantment among personnel as they faced the challenge of implementing an internal control program throughout their organization with limited guidance, inadequate training and shortages of support personnel. A key implementing official at one component told us he hoped the program would "die out" before he had to implement it at field activities.

The Deputy Under Secretary of the Navy for Financial Management, the key Navy official responsible for its internal control program, recognizes the need for greater manager support. The official has sent letters to those components which did not give adequate attention to the program with the intent of obtaining their full support in the future.

Adding to our concern, however, are recent decisions not to (1) mandate comments, where appropriate, in the fitness reports of military officers regarding performance in the area of internal controls and (2) require commanding officers of ships to report on the status of internal controls on their ships. We believe these decisions could affect the attention military officers will give to the internal control evaluation and improvement process.

The Comptroller's Office, as the central implementing office, must establish procedures to ensure that each headquarters component is properly implementing an internal control program. This would include a centralized followup system to track internal control weaknesses and corrective actions. Personnel working on the program recognize these needs and are planning to take steps to ensure that headquarters components administer appropriate programs. They also plan to establish a centralized automated tracking system.

Vulnerability assessments  
of limited value

The Navy's 1982 vulnerability assessment process was for the primary purpose of providing its Review and Oversight Council information upon which to rank the vulnerability of its 20 broad programs and functions. This information was provided; however, it was inconsistent and incomplete for the following reasons:

- We believe the broad program and functional areas used by the Navy were too large to facilitate the conduct of meaningful vulnerability assessments and internal control reviews. Several components cited problems with this. The 20 programs and functions included such broad areas as financial; supply; procurement; and maintenance, repair, and overhaul.
- The headquarters components charged with doing the vulnerability assessments were given no guidance on how programs and subfunctions should be defined. Each headquarters component used its own judgment which resulted in inconsistent application. For example, one of the functional areas was research. This area was intended to include testing and evaluation of weapon systems being developed, a key function at several headquarters components. However, only one component addressed testing and evaluation in its vulnerability assessments.
- The headquarters components were to perform vulnerability assessments on only those programs and functions where there was a significant level of effort. However, because a significant level of effort was not quantified, some components did not submit assessments on areas where we believe there was a significant level of effort. For example, neither the Naval Air Systems Command nor the Naval Military Personnel Command assessed ADP vulnerability. Their combined FY 1982 expenditures on ADP was about \$141 million.
- The headquarters components were instructed by the Office of the Comptroller to not put much time into the assessments, but to base them principally on management's judgment and experience. The result was that many components made no analysis of the general control environment or inherent risks. An analysis of the general control environment evaluates factors such as management's commitment to internal controls, the competence and integrity of personnel and organizational checks and balances.

--Little documentation was required from the components, and even some that was required was not submitted. The result was inconsistent documentation among components, with very vague descriptions of the rationale behind the assessment assigned.

All of this has had at least two major negative effects. First, the Review and Oversight Council vulnerability rankings were based on inconsistent and incomplete information. The other key effect was on the internal control review process. The vulnerability assessments performed at headquarters of such broad areas as finance and supply proved to be of very limited value to managers planning and scheduling internal control reviews. Some activities thus found it necessary to do their own round of vulnerability assessments. For example, when the Navy Finance Center, Cleveland, Ohio, an activity under the Office of the Comptroller, started to plan and schedule internal control reviews in the financial area, the financial vulnerability assessment prepared by the Office of the Comptroller was of little value because it was so broad. The center had to expend time and resources dividing its financial activities into smaller functions and performing vulnerability assessments on them before initiating internal control reviews. If the vulnerability assessments originally performed had been targeted to more specific subfunctions, such as retired pay or reserve pay, the internal control review process would have been more focused and probably more beneficial.

Navy's guidance for the next round of vulnerability assessments has been changed and is being further modified to address these problems. The headquarters components have been instructed to use the same 20 programs and functions, subdivide them at the component level, and do vulnerability assessments on the assessable subfunctions. We were told that the guidance will require assessments in all 20 areas, not just those involving a significant level of effort. The assessments are also to include a more meaningful analysis and be more thoroughly documented. Implementing this improved strategy and guidance, together with other changes, including better training, should result in an improved vulnerability assessment process in 1984.

Reviews of internal controls  
quite limited

The Navy first instructed its headquarters components and activities to begin internal control reviews on January 5, 1983. They were informed that internal reviews and other types of audits and studies would be considered internal control

reviews.<sup>1</sup> Being provided no guidance or training on how to do an internal control review, the managers at the components and activities we visited opted, for the most part, not to attempt to do internal control reviews. Finally, some guidance for performing internal control reviews, including the OMB guidelines, was sent in April 1983, but this was not accompanied by practical training.

The result was that, at the components and field activities we reviewed, very few internal control reviews were performed in accordance with the OMB Internal Control Guidelines of December 1982. The documentation available for determining how the reviews were performed was, in some instances, inadequate. Statements by these activities and headquarters components on the status of their internal controls were based in most instances on internal reviews, audits, and other studies. The scope of these reviews was often quite limited and did not include such critical OMB guideline review steps as identification and documentation of the event cycles being reviewed and testing of the internal controls.

The internal control review process gave only minimal consideration to ADP functions. Internal control reviews of ADP functions were not conducted in accordance with OMB guidelines. For example, the key step of testing the internal controls was not performed. Moreover, reviews that we examined of other functional areas, such as financial and supply, were, for the most part, restricted to nonautomated aspects of these program areas and, therefore, did not include testing of ADP-based controls.

Regarding scheduling of internal control reviews, the Navy's current policy requires each component and activity to first perform internal control reviews in the program areas ranked highly vulnerable, Navy-wide. Once these areas have been reviewed, the components and activities are encouraged, but not required, to review those programs considered highly vulnerable by the component or activity. We believe not requiring reviews of local high vulnerability areas could result in local internal control weaknesses going undetected. The vulnerability of an area is very much dependent on local conditions. The management attitude, organizational structure, personnel, organizational

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<sup>1</sup> Internal reviews are independent evaluations of operations performed at components or activities for the commanding officer by auditors within the organization. Internal control reviews are detailed examinations by line managers of the internal controls within their area of responsibility.

checks and balances, and safeguards are all local factors which heavily influence the vulnerability of a program area. An example of this policy's effect can be seen at the Headquarters of the Commander-in-Chief of the Pacific Fleet. This component ranked administrative support as its most highly vulnerable area in June 1982. As of October 15, 1983, it still had not performed internal control reviews in this area. The three areas it had reviewed were financial, supply and transportation, each ranked low by the component but high Navy-wide.

The Navy agrees that the policy should be revised to require reviews of local high vulnerability areas. It will be revising its guidance by May 15, 1984, to require reviews of all high vulnerability areas in the internal control review process.

This and many changes the Navy is making to its approach in performing vulnerability assessments should help provide for improved planning and scheduling of internal control reviews in 1985, after the 1984 round of assessments is completed. A self-study training course being developed for DOD managers should also help, but it will not be available until about June 1984. Thus, the benefits to be derived will probably not be realized before 1985.

While progress was quite limited at some field activities, others we visited have made a considerable effort to establish an effective internal control program. For example, management at the Pacific Missile Test Center, Point Mugu, California, and the Navy Finance Center, Cleveland, Ohio, has given the program substantial emphasis. Efforts have included involving line managers in the program, providing some training in performing internal control reviews, and conducting analyses of internal controls.

#### ACCOUNTING SYSTEMS COMPLIANCE

Under section 4 of the Federal Managers' Financial Integrity Act, each agency must report annually on whether its accounting systems conform to the principles and standards prescribed by the Comptroller General. Although the Navy neither identified all of its accounting subsystems nor evaluated them for compliance with the standards, its 1983 report contained a summary of available information on the systems in a meaningful, organized fashion. The report (1) identified 14 systems into which the Navy believes it can categorize all of its estimated 180 accounting subsystems, (2) summarized the known areas of

deficiency identified in its 14 systems, and (3) presented the Navy's initial judgments of the compliance of each system with the Comptroller General's accounting principles and standards.

To compile its November 1983 report, the Navy summarized material weaknesses that had been identified in its 14 systems through prior audits and management studies and through special correspondence with responsible managers. Using this information, the Navy reported that 9 of its 14 systems do not comply with the Comptroller General's accounting principles and standards. It also reported that, based on judgment, the remaining five systems substantially comply with the principles and standards, but are not in full compliance. The report included a brief description of identified material deficiencies in its 14 systems and planned corrective actions. Appendix II contains a synopsis of the deficiencies cited.

Such efforts, in our view, represent a reasonable first-year effort to comply with the act's section 4 requirements. However, such approaches are far too limited to provide a sound basis for concluding whether the accounting systems are operating properly and in accordance with the Comptroller General's principles and standards. More comprehensive and detailed evaluations are necessary for this purpose.

For future years' work under the act's section 4 requirement, we believe it will be necessary, at a minimum, to test and evaluate the systems in operation, including internal controls, prior to attesting to their compliance.

The Navy is taking and planning actions that, if carried through, should enable it to (1) report more accurately on its systems in future years and (2) assure that actions are taken to correct material accounting system deficiencies. Specifically, the Navy has initiated actions to develop (1) inventories of operational and developmental accounting subsystems and (2) procedures for evaluating its accounting systems' compliance with the Comptroller General's principles and standards. Navy officials informed us that they plan to complete their inventories of accounting subsystems and perform prototype evaluations of two during 1984. In addition, they plan to

- identify resources needed to perform the evaluations;
- develop procedures that will provide quality assurance over the evaluation process, including adequate followup of recommended actions; and

--clearly define the Auditor General's role in the evaluation process.

Navy officials have further informed us that they still have some concerns and problems to work out, including:

- further consolidation and standardization of Navy accounting subsystems within each of the 14 systems. This is needed to actually have 14 cohesive systems that work together as part of a single Department accounting system and
- further evaluation of the Navy's accounting system network. Several years may be required to both evaluate the network and to take actions to correct the material system deficiencies.

We recognize that the Navy faces a difficult undertaking in the years ahead to bring its accounting systems into compliance with the Comptroller General's principles and standards. The Navy reported that actions are underway or planned to correct deficiencies in its systems to bring them into compliance. While we did not evaluate these actions we did note that some of them will not be completed for several years. The Navy has initiated interim actions to help alleviate some of its system deficiencies.

We support the Navy's efforts to (1) identify and evaluate all of its subsystems and (2) correct the deficiencies in these subsystems so as to achieve its goal of complying with the Comptroller General's principles and standards. The efforts taken by Navy thus far have been positive toward achieving this goal. We urge completion of its ongoing and planned efforts, as described in this report, in an expeditious manner.

#### OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our review was to evaluate the Department of the Navy's progress in its first-year implementation of the act and its report on the status of internal controls and accounting systems. To achieve this objective we

- assessed the Navy's process for evaluating and improving its system of internal accounting and administrative controls for reporting under the act and

--evaluated the Navy's report of November 8, 1983, to the Secretary of Defense, on the status of the Navy's internal control and accounting systems and its plans for correcting material weaknesses in these systems.

To accomplish these tasks we concentrated our efforts at the Office of the Comptroller of the Navy, which was responsible for coordinating the establishment of the Navy-wide internal control program, and at 9 of the Navy's 26 headquarters components, including some field activities, where the internal control program was being implemented. (See appendix III for a list of the places visited.) At these locations, we reviewed internal control program policies and procedures and other key documents such as vulnerability assessments, internal control reviews, and internal control status reports. We also interviewed officials and other key personnel responsible for implementation of the program and/or performing vulnerability assessments and internal control reviews.

Our review was limited to an evaluation of the Navy's implementation process. We did not attempt to independently determine the status of the Navy's internal control systems or the extent to which its accounting systems comply with the Comptroller General's principles and standards. Because of the heavy dependence of many of the Navy's programs and functions (e.g., financial, supply, and procurement) on automated systems, we did examine the consideration given to ADP during the Navy's implementation of the act.

Our approach to assessing the Navy's process was to first look at how the Navy organized and segmented itself for purposes of implementing its internal control program. This work enabled us to assess whether complete coverage of all programs and functions was being achieved and adequate overall direction was being provided. We then reviewed the vulnerability assessments performed by the Navy to determine whether they provided an adequate assessment of the susceptibility of Navy programs to waste, loss, unauthorized use or misappropriation of assets. This was followed by an evaluation of the Navy's process and plans for performing detailed reviews of internal controls to identify actions needed to correct weaknesses in systems of internal accounting and administrative control. Finally, we examined the Secretary of the Navy's report to the Secretary of Defense on the status of Navy's internal controls to evaluate whether the report identified all known internal control weaknesses and provided for adequate plans for implementing corrective actions.



In addition to the above work, we evaluated the Navy's assessment of and reporting on whether its accounting systems were in compliance with the Comptroller General's prescribed accounting principles and standards. We reviewed the methods used by the Navy during 1983 to identify and report on its accounting systems and the material deficiencies in those systems. We also interviewed responsible personnel to determine the Navy's plans for developing specific policies and procedures for inventorying, testing, evaluating, and reporting on its accounting systems in the future.

Our review was made in accordance with generally accepted government auditing standards. It was complemented by a similar examination by the Naval Audit Service which disclosed many of the same problems we found. The Audit Service's review was quite broad, covering 80 Navy activities.

SYNOPSIS OF MATERIAL WEAKNESSES  
REPORTED BY THE NAVY

INTERNAL CONTROL WEAKNESSES

1. Reviews disclosed that invoices were paid either late, which resulted in large interest penalty expenditures, or early, which forced the Treasury to borrow large sums.
2. Reviews and audits identified deficiencies in administration and control over travel advances.
3. Reviews and audits disclosed weaknesses in timekeeping and payroll including inadequate separation of duties and inadequate control over approval and use of overtime.
4. An audit identified control deficiencies which allowed the processing of duplicate payments of invoices.
5. Several audits disclosed significant weaknesses in material management practices at shipyards and other facilities. One example was excess inventories of shop stores.
6. Reviews and audits disclosed the need to adhere to and improve control and accountability over plant property, small tools, and ground support equipment.
7. Audit reports identified several instances where Foreign Military Sales customers were not charged for significant costs and surcharges.
8. The responsibility for policy and implementation of security is fragmented in the Department of the Navy. This causes confusion, is costly, and builds delays into the system.
9. One shipyard had not established an adequate control system to ensure credit for material turned in to the supply system.
10. One component's field activities had no written directives to document procedures for tracking equipment and material.
11. Major deficiencies were identified in some of one component's allotment and procurement accounting systems.

12. A review at one component disclosed that outstanding charges for materials, contractual services, and services were overstated due to improper document processing and inadequate reviews by fund administrators.
13. Inadequate internal control procedures resulted in duplicate ordering of materials procured commercially by one component.
14. Decentralized cash collection procedures at certain activities weakened internal controls and complicated verification procedures.
15. Inadequate cash control procedures at one Public Works Center lead to the undesirable practice of estimating collection and expenditure transactions.
16. Outdated financial accounting systems at one component contained weaknesses related to documentation, recording of transactions, and execution of transactions.
17. Permanent change of station rates used by one component were inaccurate and out of date leading to significant understatement and overstatement of obligations.
18. Accounting records used by one component contained significant errors which distorted its financial reports.
19. At one field activity some customers receiving Navy training were being billed without adequate documentation to support the charges. A number of significant excessive charges were discovered in an audit.
20. Internal control procedures at one finance center need to be improved to prevent payments on fraudulent retired pay accounts.
21. Law prevents the Navy from performing audits of bills for transportation of Navy property. The Navy believes it needs prepayment audit authority.
22. A review at one component identified a number of false travel claims.
23. One component's procurement procedures were not identifying the most economical method for acquiring spare parts.

24. One component was not reporting a significant number of major procurement transactions in the Procurement Management Reporting System which provides procurement data to the Congress, the Executive Branch, and the private sector.
25. Inadequate and conflicting guidance exists to govern the Naval Disability Evaluation System.
26. Navy pharmacies are governed by procedures which are vague, general, and ambiguous in several areas. Pharmacies have thus adopted their own operational guidelines.
27. Problems exist in the use of procedures for changing computer terminal passwords.

#### ACCOUNTING SYSTEM WEAKNESSES

1. Planning for accounting systems does not adequately address managers' information needs.
2. Accounting systems' review and evaluation procedures need to be changed so that Navy can adequately determine whether its systems meet the Comptroller General's principles and standards.
3. Accounting systems need to be integrated and coordinated with functional systems. For example, supply transactions and accounting transactions which are related would be processed simultaneously with integrated or coordinated systems.
4. Design and development of accounting systems must be coordinated throughout Navy.
5. Cash management objectives must be addressed (e.g., paying bills only when due--not early or late).
6. Navy systems need to take better advantage of new ADP technology to improve accuracy and timeliness.
7. Navy operations are not all under general ledger control.
8. Some Navy accounting systems do not use accrual accounting.
9. Total costs are not always developed by accounting systems. Better accounting for costs is needed in some areas.

10. Some systems do not meet GAO's requirements for property and inventory accounting.
11. Late input of transaction data contributes to inaccurate accounting records.
12. More standardization of systems is needed to eliminate duplicative systems.
13. Some systems do not adequately meet user's information needs without manual memorandum records.
14. Some payroll processing and accounting is inadequate. As a result, duplicate manual memorandum records must be kept to maintain accurate records.
15. Accounting for receivables is inadequate in some systems.
16. Administrative control over funds is inadequate in some systems.
17. Some systems do not provide for adequate identification of separate funds which is necessary to identify funds available for investment.
18. Some systems do not provide adequate control over disbursements which is necessary for accurate, timely payments.

HEADQUARTERS COMPONENTS  
AND SUBORDINATE FIELD ACTIVITIES  
VISITED

1. Office of the Chief of Naval Operations, Washington, D.C.
  - Field Support Activity, Washington, D.C.
2. Office of the Comptroller of the Navy, Washington, D.C.
  - Navy Accounting and Finance Center, Washington, D.C.
  - Navy Finance Center, Cleveland, Ohio
3. Naval Material Command, Washington, D.C.
4. Naval Air Systems Command, Washington, D.C.
  - Naval Air Rework Facility, Cherry Point, North Carolina
  - Pacific Missile Test Center, Point Mugu, California
5. Naval Sea Systems Command, Washington, D.C.
6. Headquarters, U.S. Marine Corps, Washington, D.C.
  - Marine Corps Finance Center, Kansas City, Missouri
  - Marine Corps Central Design and Programming Activity, Kansas City, Missouri
  - Marine Corps Base, Camp Pendleton, California
  - Marine Corps Air Station, El Toro, California
7. Commander-in-Chief, U.S. Atlantic Fleet, Norfolk, Virginia
  - Norfolk Naval Base, Norfolk, Virginia
  - Norfolk Naval Station, Norfolk, Virginia
8. Commander-in-Chief, U.S. Pacific Fleet, Pearl Harbor, Hawaii
  - Naval Air Station, Barbers Point, Hawaii
  - Naval Station, Pearl Harbor, Hawaii
  - Naval Magazine, Lualualei, Hawaii
  - Naval Air Station, Miramar, San Diego, California
  - Naval Station, San Diego, California
9. Commander-in-Chief, U.S. Naval Forces, Europe, London, England
10. Naval Supply Systems Command, Washington, D.C.<sup>1</sup>
11. Naval Military Personnel Command, Washington, D.C.<sup>1</sup>
12. Chief of Naval Education and Training, Washington, D.C.<sup>1</sup>
13. Naval Security Group Command, Washington, D.C.<sup>1</sup>

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<sup>1</sup>These headquarters components were visited only for ADP-related purposes.



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 Department of the Navy's First Year Implementation of the Federal Managers' Financial Integrity Act," dated March 12, 1984 (GAO Code No. 390001), OSD Case No. 6467.

GAO identified several problems and delays encountered in the first year implementation efforts. Changes have been made or are planned which should alleviate many of these difficulties. The Draft Report contains one recommendation.

The DoD concurs with the GAO recommendation. Comments on each of GAO's findings and recommendation 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  
(Comptroller)

Enclosure

DoD Comments  
on

GAO Draft Report, "The Department of the Navy's First Year Implementation of the Federal Managers' Financial Integrity Act," dated March 12, 1984 (GAO Code No. 390001), OSD Case No. 6467

GAO FINDING A

In its review of the Department of the Navy (DON), the General Accounting Office (GAO) identified several factors which contributed to problems in achieving satisfactory implementation of the DON Internal Control Program. These factors included:

- Exclusion of certain activities in first year implementation efforts. (p. 2)
- Confusion in the role of internal review. (p. 2)
- Programs/functions too broadly defined to permit meaningful vulnerability assessments. (p.3)
- A lack of guidance and practical training to assist managers in performing vulnerability assessments and internal control reviews. (p. 2)
- Inadequate coverage of automated data processing. (p.3)
- Limited reviews in high vulnerability areas peculiar to individual commands/activities. (p.5)

DoD COMMENT

Concur. GAO found that important changes have been made or are planned which address most of these problems. Issuance of Secretary of the Navy (SECNAV) guidance and policy memoranda provide methods to correct the problem areas. Steps have been taken to provide much broader DON-wide implementation of the program and to meet the training needs of managers. GAO concluded that these actions should result in an improved internal control evaluation process and more meaningful future statements by SECNAV regarding adequacy of DON's internal controls.

With respect to the accounting systems report required pursuant to Section 4 of the Federal Managers' Financial Integrity Act, GAO acknowledged a lack of specific guidance from the Office of Management and Budget to assist agencies in evaluating systems.

The Navy, in preparing the first year report on accounting systems' compliance, obtained information from major headquarters' components and field activities to complement known financial management requirements and past audit evaluations. This



information was used for the Navy's initial judgments of its systems' compliance with Comptroller General's principles and standards. GAO found these actions to represent a reasonable first-year effort to comply with the Act's Section 4 requirement, but pointed out a need for more comprehensive and detailed evaluations in future years. The auditors felt DON's planned actions, as defined in the SECNAV's report of November 8, 1983, should ensure a more complete and accurate evaluation of its accounting systems' compliance in future years.

#### GAO RECOMMENDATION

Given actions and changes initiated by the DON during the course of the audit, GAO offered one recommendation: that SECNAV require components and activities to review their own high vulnerability programs, as well as those rated high Navy-wide.. (p. 5)

#### DoD COMMENT

Concur. SECNAV guidance will be revised by May 15, 1984, to require all high vulnerability areas to be reviewed in the internal control review process. SECNAVINST 5200.35 will also be revised to require (vice encourage) coverage of both local and Navy-wide high vulnerability areas. This change will be incorporated in a revision which will be promulgated after issuance of the Department of Defense Internal Control Directive currently undergoing revision.

## 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.

### 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 policy-making 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 of the program, 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.

### 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.

### Quality Assurance

The process(es) or system(s) of an agency which provide reasonable assurance that the internal control evaluation, improvement, and reporting process established in accordance with the OMB Guidelines is carried out in a consistent, accurate, and reliable manner. These processes or systems will form part of the basis for the annual assurance letters, and statement to the President and the Congress. An agency's quality assurance has several essential elements, including appropriate documentation for the internal control evaluation process, appropriate IG role in the process, adequacy of resources and overall organization of the process, appropriate training for managers with internal control responsibilities, and assuring that actions taken will correct weaknesses permitting fraud, waste, or mismanagement.

### 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.

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