



# Department of Defense

## INSTRUCTION

NUMBER 5010.40  
May 30, 2013

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USD(C)/CFO

SUBJECT: Managers' Internal Control Program Procedures

References: See Enclosure 1

1. PURPOSE. This instruction:

a. Reissues DoD Instruction 5010.40 (Reference (a)) in accordance with the authority in DoD Directive (DoDD) 5118.03 (Reference (b)) to implement the policy in section 3512 of Title 31, United States Code (U.S.C.) (also known and referred to in this instruction as "The Federal Managers' Financial Integrity Act (FMFIA)") (Reference (c)) and Office of Management and Budget (OMB) Circular No. A-123 (Reference (d)).

b. Assigns responsibilities and prescribes procedures for the execution of the Managers' Internal Control Program.

2. APPLICABILITY. This instruction applies to the Office of the Secretary of Defense (OSD), the Military Departments, 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 within the DoD (referred to collectively in this instruction as the "DoD Components").

3. POLICY. This instruction implements DoD policy, pursuant to References (c) and (d), that a Managers' Internal Control Program be established to review, assess, and report on the effectiveness of internal control (IC).

4. RESPONSIBILITIES. See Enclosure 2.

5. PROCEDURES. See Enclosure 3.

6. INFORMATION COLLECTION REQUIREMENTS. The Annual Statement of Assurance to the Secretary of Defense, referenced in paragraph 3e of Enclosure 2; sections 1 and 8 and paragraphs 6a(2)(b) and 6b(2)(b) of Enclosure 3; section 2 of Enclosure 4; and paragraph c of Enclosure 6 of this instruction, has been assigned report control symbol DD-COMP(A)1618 in accordance with the procedures in Directive-type Memorandum 12-004 (Reference (e)) and DoD 8910.1-M (Reference (f)).

7. RELEASABILITY. **Unlimited**. This instruction is approved for public release and is available on the Internet from the DoD Issuances Website at <http://www.dtic.mil/whs/directives>.

8. EFFECTIVE DATE. This instruction:

a. Is effective May 30, 2013.

b. If this instruction is not otherwise reissued or cancelled in accordance with DoD Instruction 5025.01 (Reference (g)), it will expire effective May 30, 2023 and be removed from the DoD Issuance Website.



Robert F. Hale  
Under Secretary of Defense (Comptroller)  
Chief Financial Officer, Department of Defense

Enclosures

1. References
2. Responsibilities
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ENCLOSURE 1

REFERENCES

- (a) DoD Instruction 5010.40, "Managers' Internal Control Program (MICP) Procedures," July 29, 2010 (hereby cancelled)
- (b) DoD Directive 5118.03, "Under Secretary of Defense (Comptroller)/Chief Financial Officer, Department of Defense (USD(C)/CFO)," April 20, 2012
- (c) Title 31, Section 3512, United States Code
- (d) Office of Management and Budget Circular No. A-123, "Management's Responsibility for Internal Control," December 21, 2004
- (e) Directive-type Memorandum 12-004, "DoD Internal Information Collections", October 23, 2012
- (f) DoD 8910.1-M, "Department of Defense Procedures for Management of Information Requirements," June 30, 1998
- (g) DoD Instruction 5025.01, "DoD Directives Program," September 26, 2012
- (h) Office of Management and Budget Circular No. A-127, "Financial Management Systems," January 9, 2009
- (i) DoD 7000.14-R, Volume 1, "Department of Defense Financial Management Regulation (FMRs)," current edition
- (j) Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, Department of Defense, "Financial Improvement and Audit Readiness Guidance," current edition
- (k) Under Secretary of Defense (Comptroller)/Chief Financial Officer, Department of Defense Memorandum, "Changes to the Annual ICOFR SOA Reporting Requirements," April 22, 2011
- (l) Government Accountability Office, "Standards for Internal Control in the Federal Government," November 1, 1999
- (m) Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics Memorandum, "Guidance on the Assessment of Acquisition Functions under Office of Management and Budget, Circular No. A-123," April 6, 2009<sup>1</sup>
- (n) Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, Department of Defense, "Department of Defense Agency Financial Report," date varies by section, current edition<sup>2</sup>
- (o) Title 44, United States Code
- (p) Government Accounting Office/President's Council on Integrity and Efficiency Financial Audit Manual, July 2008
- (q) Public Law 104-208, "The Federal Financial Management Improvement Act of 1996," September 30, 1996
- (r) Office of Management and Budget Memorandum, "Conducting Acquisition Assessments Under Circular No. A-123," May 21, 2008
- (s) DoD Directive 5000.01, "The Defense Acquisition System," May 12, 2003, as amended

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<sup>1</sup> Available at <http://www.acq.osd.mil/pepolicy/index.html>

<sup>2</sup> Available at <http://comptroller.defense.gov/afr/fy2012.html>

- (t) Defense Acquisition University Glossary of Defense Acquisition Acronyms and Terms, 12th edition
- (u) Federal Accounting Standards Board, "Statement of Federal Financial Accounting Standards No. 5," current edition

ENCLOSURE 2

RESPONSIBILITIES

1. UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER, DEPARTMENT OF DEFENSE (USD(C)/CFO). The USD(C)/CFO:

- a. Monitors compliance with this instruction.
- b. Provides IC guidance, as needed, for:
  - (1) The operations assessment in accordance with Reference (d).
  - (2) The financial systems assessment in accordance with Reference (c), Appendix A of Reference (d), OMB Circular A-127, Chapter 3 of DoD 7000.14-R (References (h) and (i)), and the Financial Improvement Audit Readiness (FIAR) Guidance (Reference (j)).
  - (3) The financial reporting assessments in accordance with Appendix A of Reference (d), Reference (j), and the USD(C)/CFO Memorandum (Reference (k)).
- c. Establishes and supports a Senior Management Council to provide oversight and accountability for the DoD's Managers' Internal Control Program. This board will ensure DoD operations are consistent with References (c) through (i); the Government Accountability Office's Standards; and the Under Secretary of Defense for Acquisition, Technology, and Logistics (USD(AT&L)) Memorandum (References (l) and (m)).
- d. Co-chairs a FIAR Governance Board with the DoD Deputy Chief Management Officer (DCMO) to provide oversight and accountability for the DoD financial reporting and financial systems, as a part of the FIAR effort. This board will help ensure that DoD operations are consistent with References (c) through (m).
- e. Instructs the Director of Financial Improvement and Audit Readiness (DFIAR) to:
  - (1) Manage and oversee operations of the DoD's Managers' Internal Control Program.
  - (2) Provide guidance, as needed, for proper execution of the Managers' Internal Control Program and publish guidance for the preparation and submission of the annual statement of assurance to the Secretary of Defense.
  - (3) Develop the DoD's statement of assurance.
  - (4) Ensure the DoD adheres to annual reporting requirements.

(5) Provide quarterly status reports on all material weaknesses to the USD(C)/CFO and the DCMO and, as appropriate, Under Secretaries and Assistant Secretaries of Defense, and DoD and OSD Component heads.

2. OSD COMPONENT HEADS AND PRINCIPAL STAFF ASSISTANTS (PSAs). The OSD Component heads and PSAs:

a. Approve the statement of assurance of the Defense Agencies and DoD Field Activities under their authority, direction, and control prior to submission to the Secretary of Defense.

b. In their capacity as the DoD functional proponents, maintain ownership of any DoD-wide material weaknesses. This includes:

(1) Identifying and reporting systemic material weaknesses and reporting on the status of corrective actions, until resolved.

(2) Reviewing the reported actions of the DoD Components that pertain to their area of functional responsibility and promptly assisting to resolve any material weaknesses where leadership action is needed to correct the weakness.

3. DoD AND OSD COMPONENT HEADS. The DoD and OSD Component heads:

a. Establish a Managers' Internal Control Program to:

(1) Assess inherent risks in mission-essential processes.

(2) Document and design ICs.

(3) Test the design and operating effectiveness of existing ICs.

(4) Identify and classify control deficiencies and promptly prepare and execute corrective action plans. See Enclosure 6 of this instruction for guidance on the classification of control deficiencies.

(5) Monitor and report the status of corrective action plans until testing confirms resolution of identified deficiencies.

b. Designate in writing the Managers' Internal Control Program Coordinator of the DoD and OSD Component within 90 days of a vacated position, and oversee the Managers' Internal Control Program Coordinator's implementation of procedures noted in Enclosure 3 of this instruction.

c. Conduct a formal assessment of the acquisition functions requirements outlined in Reference (m), and provide a summary of the assessment in the statement of assurance.

d. Submit the annual statement of assurance to the Secretary of Defense as described in Enclosures 3 and 4 and provide an informational copy to the DFIAR. Provide separate explicit levels of assurance in a statement of assurance for each of the following three IC assessments required:

(1) Operational and administrative controls relevant to all mission-essential functions throughout their DoD and OSD Component, except financial reporting and financial systems, which are covered in paragraphs 3d(2) and 3d(3) of this enclosure.

(2) Financial reporting functions, as assessed under the oversight of the senior assessment team according to Appendix A of Reference (d) and References (j) and (k).

(3) Integrated financial management systems (IFMS) conformance with the federal requirements according to References (c), (d), (h), (i), and (j).



ENCLOSURE 3

PROCEDURES

1. DoD AND OSD COMPONENT MANAGERS' INTERNAL CONTROL PROGRAM. Each DoD and OSD Component establishes a Managers' Internal Control Program that provides an annual statement of assurance to the Secretary of Defense, which includes an explicit level of assurance about the effectiveness of ICs. A copy of the statement of assurance will be provided to the DFIAR. As described in Enclosure 2 of this instruction, the DoD and OSD Component head will designate a Managers' Internal Control Program Coordinator to assist in the execution of the Managers' Internal Control Program.

2. SENIOR MANAGEMENT COUNCILS AND SENIOR ASSESSMENT TEAMS

a. All DoD and OSD Components should establish Senior Management Councils to oversee operational, financial, and financial systems reporting. In addition, DoD and OSD Components that are required to provide a statement of assurance over financial reporting and financial systems reporting should establish an entity level senior assessment team.

b. The Senior Management Council and senior assessment team meetings can provide a forum for discussing, assessing, and monitoring the Managers' Internal Control Program efforts.

c. The senior assessment teams will oversee the implementation of the ICs over financial reporting in accordance with References (j) and (k) and the ICs over financial system reporting in accordance with References (c), (h), and (i). Senior assessment team charters should be updated to reflect the requirements of References (l) and (m), the DoD Agency Financial Report (Reference (n)), and sections 3534 and 3544 of Title 44, U.S.C, also known and referred to in this instruction as "The Federal Information Security Management Act of 2002" (FISMA) (Reference (o)). It is recommended that the senior assessment team include cross-functional business partners, including an advisory audit representative.

3. MANAGERS' INTERNAL CONTROL PROGRAM COORDINATOR. The Managers' Internal Control Program Coordinator:

a. Coordinates with assessable unit managers to ensure proper documenting of end-to-end processes that support operational, administrative, system, and financial events to assess controls and improve efficiency in the DoD.

b. Identifies best business practices and recommends to assessable unit managers ways to improve the control documentation, enhance controls, eliminate inefficient controls, or implement new controls.

c. Ensures subject matter experts assess risks that may adversely affect the DoD and OSD Component's mission or operations.

- d. Ensures that the commander, director, or the assessable unit managers identify IC objectives based on risk assessments in order to support the DoD and OSD Component.
- e. Assists in testing, as necessary, and validates conclusions provided by subject matter experts on the effectiveness of the ICs.
- f. Assists in identifying and classifying IC deficiencies based on evaluations conducted. See Enclosure 6 for guidance on the classification of control deficiencies.
- g. Ensures corrective action plans are developed by the assessable unit managers or the subject matter expert to address control deficiencies.
- h. Ensures that identified efficiencies, “best practices”, or deficiencies are shared across the assessable units within each respective DoD and OSD component, to ensure relevant information is available for use by the assessable units.
- i. Tracks progress of corrective action plans.
- j. Actively communicates with the DoD Component Senior Management Council or senior assessment team on corrective action plans and the resolution status for all control deficiencies in the reporting categories identified in Enclosure 5 of this instruction.
- k. Maintains Managers’ Internal Control Program documentation (e.g., process flows and narratives, associated risk matrices, control objectives, control activities, and statement of assurances from the assessable unit managers to support the statement of assurance).

4. ASSESSABLE UNITS. Each DoD and OSD Component will be segmented into organizational, functional, or other assessable units, by the MICP Coordinator so that all subcomponents, task forces, or organizations under the direct authority, supervision, and responsibility of the Component are identified as a separate and distinct assessable unit. Assessable unit identification must ensure that the entire organization is covered. An assessable unit must be large enough to allow managers to evaluate a significant portion of the activity being examined, but not so large that a manager cannot document processes and controls.

5. ASSESSABLE UNIT MANAGERS. The assessable unit manager:

- a. MICP Coordinator shall appoint a trained AUM for every AU, who is a Government employee due to the inherently governmental nature of the work, who shall manage a successful MICP.
- b. Assesses risks that may adversely affect the assessable unit’s mission or operations.
- c. Identifies IC objectives that support the assessable unit.
- d. Documents operational, administrative, system, and financial ICs.

- e. Reviews processes and procedures to provide recommendations for the enhancement, elimination, or implementation of assessable unit ICs.
- f. Recommends the retention, enhancement, elimination, or implementation of ICs for the assessable unit.
- g. Tests the effectiveness of the ICs.
- h. Identifies and classifies IC deficiencies according to the reporting categories described in Enclosure 5 and the classifications in Enclosure 6 of this instruction.
- i. Develops corrective action plans.
- j. Tracks progress of corrective action plans.
- k. Actively communicates with the Managers' Internal Control Program Coordinator on corrective action plans as required for reporting and resolution of all control deficiencies.
- l. Maintains Managers' Internal Control Program documentation (e.g., process flows and narratives, including associated risk matrices, control objectives, control activities, and statement of assurances to support the DoD and OSD Component) in a central location to efficiently provide documents to the Managers' Internal Control Program Coordinator as requested. Some documentation may exist for other purposes, including operating instructions, standard operating procedures, or other policy directives.

6. MANAGERS' INTERNAL CONTROL PROGRAM PROCESS. The Managers' Internal Control Program will be organized into three distinct IC assessments.

a. Operations Assessment. DoD and OSD Components:

(1) Assess the effectiveness of IC through a process consistent with the guidance contained in References (c) and (d) and the Managers' Internal Control Program guidance in accordance with Reference (l). This process must include risk assessments, the identification of IC, and IC testing. Leverage any and all existing management assessments, evaluations, continuous process improvement project results, established "best practices," and recent audit findings, if applicable. Recent audit findings must not be the primary support of an assessable unit's evaluation of IC and must only be used to further substantiate management's conclusions.

(2) Identify and report IC deficiencies. Each DoD and OSD Component will establish and maintain a process that identifies and reports IC deficiencies by the reporting categories in Enclosure 5 of this instruction, as follows:

(a) Identification. Identify IC deficiencies primarily through testing conducted by the assessable unit manager at the assessable unit level. Other sources of information such as audits, inspections, investigations, management assessments, and credible information of nongovernmental origin may also identify an IC deficiency.

(b) Reporting. Identified material weaknesses in ICs based on testing the design and operation will be reported by the DoD and OSD Component head in the statement of assurance to the Secretary of Defense. The classification of control deficiencies is management's judgment using the guidance included in Enclosure 6 of this instruction. The concept of materiality is not primarily financial. Qualitative factors such as impact on mission success or failure, health and safety, and threat to image must be considered.

(3) Assess the acquisition functions for major defense acquisition programs through a process consistent with the guidance contained in Reference (m). This process includes completing the DoD Assessment of Internal Control over Acquisition Functions Template, determining if there are new control deficiencies, and developing a corrective action plan, then summarizing the results of the completed assessment in the statement of assurance. DoD and OSD Components are not required to submit the completed DoD template unless requested by the USD(AT&L) for review.

b. Financial Reporting Assessment. For identifying and assessing the financial reporting ICs, DoD and OSD Components will follow the procedures as established in Appendix A of Reference (d) and References (j) and (k).

(1) Assess the effectiveness of financial reporting ICs. This process should include risk assessments, identification of control objectives, and the identification and testing of ICs consistent with References (j) and (k). Leverage any and all existing management assessments and evaluations as well as recent audit findings, if applicable. Recent audit findings should not be the primary support and should only be used to further substantiate management's conclusions.

(2) Identify and report IC material weaknesses. Each DoD and OSD Component will use the methodology in the FIAR guidance to identify IC deficiencies and report IC material weaknesses within end-to-end business processes. Each DoD and OSD Component will develop financial improvement plans that incorporate corrective action plans for material weaknesses identified, as required by References (j) and (k). Summaries of the corrective action plans will be reported in accordance with Reference (k).

(a) Identification. Identify IC deficiencies primarily through IC testing conducted by the assessable unit manager at the assessable unit level. Other sources of information such as audits, inspections, investigations, management assessments, credible information of nongovernmental origin, and meetings with the senior accountable official may also identify an IC deficiency.

(b) Reporting. The DoD and OSD Component head will report financial reporting IC material weaknesses in the statement of assurance to the Secretary of Defense in accordance with Reference (k). The classification of IC deficiencies is management's judgment based on the guidance in Enclosure 6 of this instruction. Section 230.01 of Government Accounting Office/President's Council on Integrity and Efficiency Financial Audit Manual (Reference (p)) describes materiality as "the magnitude of an omission or misstatement of an item in a financial report that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the

inclusion or correction of the item". All material weaknesses will be reported annually in accordance with References (j) and (k).

c. Financial System Assessment. DoD and OSD Components must follow the procedures established in References (c), (h), and (i), and the Managers' Internal Control Program and FIAR guidance, to assess, evaluate, and report the conformance of their IFMS compliance with federal requirements prescribed in References (c), (h), and (i). Nonconformance with federal financial management system requirements constitutes a material weakness, which must be reported in the statement of assurance and accompanied by corrective action plan summaries with the milestones for resolution. DoD and OSD Components with portions of their IFMS provided by service providers must require testing of material controls within the IFMS by the service provider auditor as part of the service provider agreement to enable the DoD and OSD Component to assess the reliability of the overall IFMS in accordance with Reference (j).

7. PROMPT RESOLUTION OF MATERIAL WEAKNESSES IN ICs. Reference (d) requires the DoD and OSD Component heads, Managers' Internal Control Program Coordinators, assessable unit managers, senior assessment teams, and senior accountable officials to monitor the effectiveness of ICs throughout the year to ensure that prompt and effective actions are taken to correct any material weaknesses that were identified and reported. DoD and OSD Components will, for each unresolved material weakness reported to the Secretary of Defense:

a. Appoint a senior accountable official, who will be held accountable by the DoD and OSD Component Senior Management Council or senior assessment teams for monitoring and ensuring timely resolution of the material weakness. This appointment must be based on the manager's ability to resolve the DoD and OSD Component's reported material weakness within the timelines reported.

b. Require timely resolution of identified material weaknesses by completing corrective action plan milestones by the reported completion date.

c. Require the senior accountable official to update the DoD and OSD Component Senior Management Council or senior assessment team quarterly to address timeliness or failure to achieve milestone dates contained in the corrective action plans.

d. Ensure that an adequate remediation has been executed and retested prior to reporting a material weakness as resolved. The last milestone in each corrective action plan must include a validation of the material weakness resolution.

## 8. STATEMENT OF ASSURANCE

a. The DoD and OSD Component will submit an annual statement of assurance based on the general assessment of the effectiveness of their ICs over all functions described in Enclosure 4 of this instruction. This statement of assurance will include a letter signed by the DoD or OSD Component head or alternatively by the Principal Deputy, that asserts to one of the three levels of assurance, as described in Enclosure 4 of this instruction. The statement of assurance will include a description of each reported material weakness identified and a summary of the

corrective action plans to correct the material weaknesses according to the Managers' Internal Control Program guidance, provided by the USD(C)/CFO. The statement of assurance must be signed and submitted to the Secretary of Defense no later than the first Wednesday following Labor Day.

b. DoD and OSD Components designated in the Managers' Internal Control Program and FIAR guidance will annually submit:

(1) A separate financial reporting statement of assurance memorandum based on a general assessment of the effectiveness of their ICs over financial reporting, as of June 30. The financial reporting statement of assurance memorandum will be consistent with the guidance described in Reference (k). The financial reporting statement of assurance memorandum must be included with the DoD Component's overall statement of assurance submitted to the Secretary of Defense.

(2) A separate financial system statement of assurance based on the results of their assessment and evaluation of their financial management systems' compliance with the federal requirements prescribed in References (c), (h), and (i). Additional information is provided in Enclosure 4 of this instruction. The statement of assurance must be signed by the DoD or OSD Component head or alternatively by the Principal Deputy, and submitted to the Secretary of Defense.

ENCLOSURE 4

INFORMATION REQUIREMENTS

1. DoD STATEMENT OF ASSURANCE. As required by References (c) and (d), the Secretary of Defense must submit a statement of assurance in a single FMFIA report section as part of Reference (n) labeled “Management Assurances,” annually by November 15, or a date specified by OMB. This will provide explicit assurance for:

a. Operations, except for financial reporting and financial systems.

b. Financial reporting as specified by Appendix A of Reference (d) and Reference (j). This represents a formal assessment on the effectiveness of the DoD IC over financial reporting as of June 30, including an explicit conclusion as to whether the ICs over financial reporting are effective.

c. IFMS according to References (c), (h), and (i). A material weakness must be included in the FMFIA financial systems section of the DoD statement of assurance with a schedule of corrective actions for any “significant information security deficiency” found and reported pursuant to sections 3534 and 3544 of Reference (o). FISMA requires the DoD and OSD Components to report as a material weakness any instances of a lack of substantial compliance in accordance with Public Law 104-208 (Reference (q)) if related to financial management systems. See Reference (d) for further information on reporting significant deficiencies.

2. DoD and OSD COMPONENT STATEMENT OF ASSURANCE

a. All DoD and OSD Components will annually provide:

(1) An operations statement of assurance that provides reasonable assurance of the effectiveness of ICs over operations. The DoD and OSD Components will consider IC deficiencies disclosed by all sources including management studies; DoD Component audits, inspections, investigations, or internal review reports; and Inspector General, DoD and Government Accountability Office reports. However, IC deficiencies should be primarily identified by the DoD and OSD Component’s individual testing of their ICs. This statement of assurance is based on management’s assessment of the effectiveness of their ICs as of the date signed for that fiscal year.

(2) An explicit level of assurance on the effectiveness of ICs over financial reporting as of June 30, for those DoD and OSD Components specified in the Managers’ Internal Control Program and FIAR guidance. The assurance will be based on management’s assessment conducted according to the requirements of References (j) and (k). This statement of assurance is management’s assessment of the effectiveness of the DoD and OSD Component’s ICs as prescribed by the Managers’ Internal Control Program and FIAR guidance and is submitted no later than the date noted in Reference (j).

(3) An explicit level of assurance on the effectiveness of ICs over financial systems, for those Components specified in the Managers' Internal Control Program guidance and FIAR guidance. The assurance will be based on management's assessment conducted according to the requirements of References (c), (h), and (i) and Managers' Internal Control Program guidance. This statement of assurance is management's assessment of the effectiveness of the DoD and OSD Component's IFMS conformance to federal requirements as prescribed by the Managers' Internal Control Program and FIAR guidance.

b. The DoD and OSD Component statement of assurance will have one cover memorandum. Those DoD and OSD Components providing levels of assurance for financial reporting and financial systems will report assurance in subsections to the statement of assurance cover memorandum, and provide the senior assessment team with the memorandum signed by the DoD or OSD Component head or alternatively by the Principal Deputy. In accordance with Reference (d), each assurance level explicitly stated in the statement of assurance must meet one of three levels of assurance:

(1) Unqualified Statement of Assurance. An unqualified statement of assurance provides reasonable assurance that ICs are effective with no material weaknesses reported or that the IFMS is in conformance with federal requirements. Each unqualified statement should describe how the level of assurance is supported and how assessments were conducted.

(2) Qualified Statement of Assurance. A qualified statement of assurance provides reasonable assurance that ICs are effective with the exception of one or more material weakness or the IFMS is not in conformance with federal requirements. The statement of assurance must cite the material weaknesses in internal management controls that preclude an unqualified statement.

(3) Statement of No Assurance. A statement of no assurance provides that no assurance can be provided that ICs are effective because few or no assessments were conducted, the noted material weaknesses are pervasive across many key operations, or the IFMS is substantially noncompliant with federal requirements.

c. The DoD and OSD Component statement of assurance will be in the format prescribed by the Managers' Internal Control Program and FIAR guidance, which will describe how the level of assurance is supported and how assessments were conducted.

(1) When the level of assurance is "qualified" for operations, the format provided by the Managers' Internal Control Program guidance must include:

(a) Uncorrected material weaknesses (current year disclosures and prior year disclosures) and the summary of the corrective action plans for resolution. The summary will provide milestone timelines that will correct a material weakness. Although the actions that should correct the material weakness may still be in development, the material weaknesses must be reported with a current status as of the date the statement of assurance is signed.



(b) Material weaknesses corrected in the current year (current year disclosures and prior year disclosures corrected in the current year) and the summary of the corrective actions taken. Each corrected material weakness will include, as the last milestone, a validation step that evaluates and certifies the effectiveness of the corrective actions.

(2) When there is no level of assurance (i.e., “no assurance”) for operations ICs, the statement of assurance must include all uncorrected material weaknesses.

(3) DoD and OSD Components will report the level of assurance for financial reporting and financial system ICs in accordance with References (j) and (k).

ENCLOSURE 5

IC REPORTING CATEGORIES

1. The DoD and OSD Component will designate each operational IC deficiency into one of the following reporting categories:

a. Communications. Communication requires a sender, a message, and an intended recipient, although the receiver need not be present or aware of the sender's intent to communicate at the time of communication; thus communication can occur across vast distances in time and space.

b. Intelligence. The plans, operations, systems, and management activities for accomplishing the collection, analysis, processing and dissemination of intelligence in order to provide guidance and direction to commanders in support of their decisions.

c. Security. The plans, operations, systems, and management activities for safeguarding classified resources (not peripheral assets and support functions covered by other reporting categories). Also covers the DoD programs for protection of classified information.

d. Comptroller and 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 Reference (d).

e. 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, in accordance with to Reference (m) and the OMB Memorandum (Reference (r)).

f. Force Readiness. The operational readiness capability of combat and combat support (both Active and Reserve) forces which provide the necessary flexibility to deter potential foes and rapidly respond to a broad spectrum of global threats.

g. Information Technology. Any equipment or interconnected system or subsystem of equipment that is used in the automatic acquisition, storage, manipulation, management, movement, control, display, switching, interchange, transmission, or reception of data or information. It includes computers, ancillary equipment, software, firmware and similar services and related resources whether performed by in-house, contractor, other intra-agency or intergovernmental agency resources or personnel.

h. Acquisition

(1) The guidance in Reference (m) applies to all acquisitions, including major acquisitions and items designated as major systems, subject to the procedures of the Defense Acquisition Board, the Military Services Acquisition Review Councils, or the Selected Acquisition Reporting System. Reference (m) requires the use of an acquisition assessment template when conducting IC reviews and reporting of IC material weaknesses. The purpose of the acquisition template is to assist in the:

- (a) Determination of risks related to proper implementation.
- (b) Evaluation of existing controls and monitoring activities.
- (c) Consideration of corresponding standards and success factors.
- (d) Determination of new material weaknesses.

(2) Reference (r) and DoDD 5000.01 (Reference (s)) may be helpful when evaluating a material weakness for inclusion in this category, by providing a template that is organized by four interrelated cornerstones as a foundation for evaluating the acquisition function, and by providing acquisition policies that govern the Defense Acquisition System, respectively.

i. Manufacturing, Maintenance, and Repair. The management and operation of in-house and contractor-operated facilities performing maintenance and repair 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.

j. Other. All functional responsibilities not represented by any other functional category, including management and use of land, sea, and air transportation for movement of personnel, materiel, supplies, and equipment using military and civilian sources.

k. Personnel and Organizational Management. Authorizations, recruitment, training, assignment, use, development, and management of military and civilian DoD personnel. Also includes the operations of headquarters' organizations. Contract personnel are not covered by this category.

l. 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).

m. Property Management. Construction, rehabilitation, modernization, expansion, improvement, management, and control over real property (both military and civil works construction), to include installed equipment and personal property. Also covers disposal actions for all materiel, equipment, and supplies including the Defense Reutilization and Marketing System.

n. 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.

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

p. 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).

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

2. When reporting financial reporting or financial system IC material weakness according to evaluations conducted, the DoD and OSD Component will classify the end-to-end business processes affected by the control weakness. The following IC categories will be used to classify the material weakness:

a. Budget-to-Report. Budget-to-Report encompasses the business functions necessary to plan, formulate, create, execute, and report on the budget and business activities of the entity. It includes updates to the general ledger. It also includes all activities associated with generating and managing the internal and external financial reporting requirements of the entity, including pre- and post-closing entries related to adjustments, reconciliations, consolidations, eliminations, etc.

b. Hire-to-Retire. Hire-to-Retire encompasses the business functions necessary to plan for, hire, develop, assign, sustain, and separate personnel in the DoD and OSD Component.

c. Order-to-Cash. Order-to-Cash encompasses the business functions necessary to accept and process customer orders for services or inventory. This includes managing customers, accepting orders, prioritizing and fulfilling orders, distribution, managing receivables, and managing cash collections.

d. Procure-to-Pay. Procure-to-Pay encompasses the business functions necessary to obtain goods and services. This includes requirements identification, sourcing, contract management, purchasing, payment management, and receipt and debt management.

e. Acquire-to-Retire. Acquire-to-Retire encompasses the business functions necessary to obtain, manage, and dispose of accountable and reportable property (capitalized and non-capitalized assets) through their entire life cycle. It includes functions such as requirements identification, sourcing, contract management, purchasing, payment management, general property, plant and equipment management, and retirement.

f. Plan-to-Stock. Plan-to-Stock encompasses the business functions necessary to plan, procure, produce, inventory, and stock materials used both in operations and maintenance as well as for sale.

ENCLOSURE 6

CLASSIFICATION OF CONTROL DEFICIENCIES

The DoD and OSD Component will classify each IC deficiency.

a. Control Deficiency. 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 functions, to satisfactorily accomplish their assigned functions or inhibits the prevention or detection of misstatements on a timely basis.

b. Reportable Condition. Reportable conditions, as defined in the Glossary, are internal to a DoD and OSD Component and not reported in the statement of assurance to the Secretary of Defense. An overall reportable condition is a control deficiency, or combination of control deficiencies, that in management's judgment, represents significant deficiencies in the design or operation of ICs that could adversely affect the DoD and OSD Component's ability to meet its IC objectives. A reportable condition specifically related to financial reporting is a control deficiency, or combination of control deficiencies, that adversely affects the DoD and OSD Component's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles. The criteria for a reportable condition means that there is a more than remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected.

c. Material Weakness. Material weaknesses, as defined in the Glossary, must be reported in the DoD and OSD Component's statement of assurance to the Secretary of Defense. A financial reporting material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. For an IC deficiency to be considered a material weakness:

(1) It must involve a weakness in ICs (such as ICs that are not in place, are not being used, or are inadequate), which:

- (a) Impairs or potentially impairs essential operations or missions;
- (b) Significantly weakens established safeguards against waste, fraud, abuse, and mismanagement of resources;
- (c) Demonstrates substantial noncompliance;
- (d) Threatens the image, reputation, or credibility of the organization;
- (e) Compromises or weakens information security; or

- (f) Is determined during an external inspection and upheld as a significant finding.
- (2) It must warrant the attention of the next higher level either for awareness or action.

## GLOSSARY

### PART I. ACRONYMS AND ABBREVIATIONS

CFO	Chief Financial Officer
DFIAR	Director of Financial Improvement and Audit Readiness
DoD CIO	DoD Chief Information Officer
DoDD	DoD Directive
FIAR	Financial Improvement and Audit Readiness
FISMA	Federal Information Security Management Act
FMFIA	Federal Managers' Financial Integrity Act
IC	internal control
IFMS	integrated financial management systems
OMB	Office of Management and Budget
PSA	Principal Staff Assistant
USD(AT&L)	Under Secretary of Defense for Acquisition, Technology, and Logistics
USD(C)/CFO	Under Secretary of Defense (Comptroller)/Chief Financial Officer, Department of Defense
U.S.C.	United States Code

### PART II. DEFINITIONS

Unless otherwise noted, these terms and their definitions are for the purpose of this instruction.

acquisition. The conceptualization, initiation, design, development, test, contracting, production, deployment, logistics support, modification, and disposal of weapons and other systems, supplies, or services (including construction) to satisfy DoD needs, intended for use in or in support of military missions as defined in Defense Acquisition University Glossary of Defense Acquisition Acronyms and Terms (Reference (t)).

assessable unit. Any organizational, functional, programmatic or other applicable subdivision of an organization that allows for adequate IC analysis. An assessable unit's functions include the documentation, identification, and insertion of controls associated with a specific sub-function in order to mitigate identified risk. The assessable unit is required to have an appointed and adequately trained assessable unit manager.

assessable unit manager. The government employee selected by appropriate functional leadership that is responsible for the Managers' Internal Control Program requirements of the assessable unit. The assessable unit manager must be a government employee, to prevent



inherently governmental functions from being performed by contracted employees, and possess an in-depth understanding of the processes and procedures of the assessable unit.

corrective action plan. A written document that spells out the specific steps necessary to resolve a material weakness, including targeted milestones and completion dates. Corrective action plans for operational assessment material weaknesses are maintained with the Managers' Internal Control Program documentation. Corrective action plans for financial reporting and financial systems material weaknesses are maintained in the FIAR Planning Tool.

DoD functional proponent. Staff principal responsible for policy and oversight of a particular functional area.

IC. The organization, policies, and procedures that help program and financial managers to achieve results and safeguard the integrity of their programs by reducing the risk of adverse activities.

IC assessment. A documented evaluation on the effectiveness and adequacy of the IC framework to meet the mission objectives.

IFMS. A unified set of financial systems and the financial portions of mixed systems encompassing the software, hardware, personnel, processes (manual and automated), procedures, controls, and data necessary to perform financial management functions, manage financial operations of the DoD and OSD Component, and report on the DoD and OSD Component's financial status to central agencies, Congress, and the public.

#### levels of assurance

unqualified. Provides reasonable assurance that ICs are effective with no material weaknesses reported or that the IFMS is in conformance with federal requirements.

qualified. Provides assurance that ICs are effective with the exception of one or more material weaknesses or the IFMS is not fully compliant with federal requirements.

no assurance. No assurance can be provided that ICs are effective because few or no assessments were conducted, the noted material weaknesses are pervasive across many key operations, or the IFMS is substantially noncompliant with federal requirements.

#### materiality

operations. The risk of error or inability to accomplish mission objectives. The level of materiality is based upon management's judgment.

financial reporting and financial systems. The risk of error or misstatement on the financial statements that could occur and would impact management's or user's decisions or conclusions based on such statements. Materiality for financial reporting is further defined in Appendix A, paragraph C of Reference (d).

material weakness. A specific instance of a failure in a system of control or lack of control that would significantly impair fulfillment of agency's mission, violate statutory or regulatory requirements, or significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property or other assets. The material weakness may present a major impact to the environment, safety, security, or readiness of the command. For financial reporting, this would include a reportable condition or combination of reportable conditions that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

Managers' Internal Control Program Coordinator. The action officer for each DoD and OSD Component who leads the assessable unit managers in the design and implementation of the Managers' Internal Control Program.

OSD Component. One of the offices that compose OSD whose principal reports directly to the Secretary or Deputy Secretary of Defense.

PSAs. The Under Secretaries of Defense; the DoD DCMO; the GC DoD; the IG DoD; and those ASDs, ATSDs, and OSD Directors, and equivalents, who report directly to the Secretary or Deputy Secretary of Defense

reportable condition. A control deficiency or combination of control deficiencies, that in management's judgment, represents significant deficiencies in the design or operation of ICs that could adversely affect the DoD and OSD Component's ability to meet its IC objectives. Also known as a significant deficiency.

reasonable assurance. An informed judgment by management regarding the overall adequacy and effectiveness of ICs based upon available information that the systems of ICs are operating as intended according to Reference (c).

remote. Defined in Statement of Federal Financial Accounting Standards No. 5 (Reference (u)).

senior assessment team. A team of senior level executives that provide oversight of assessing and documenting the effectiveness of ICs for financial reporting and financial systems.

senior accountable official. A member of the highest level of management or leadership of the DoD and OSD Component.

Senior Management Council. A committee or board of senior level executives that convene to advise the DoD and OSD Component head or Principal Deputy on IC matters related to operations, financial reporting, and financial systems, to include the identification of IC material weaknesses that merit reporting as material weaknesses.

statement of assurance. An annual statement, in memorandum format, that provides a leader's explicit level of assurance on whether ICs are effective. The statement of assurance is based on

self-assessments and testing of ICs developed for mission-essential functions relative to risk and identifies any material weaknesses found during the analysis.

systemic material weakness. A specific instance of a failure in a system of control or lack of control that is pervasive within the DoD and materially affects ICs across organizational and program lines, usually affecting more than one DoD and OSD Component.