

Extreme Makeover: Implementing OMB's Revised Circular A-123

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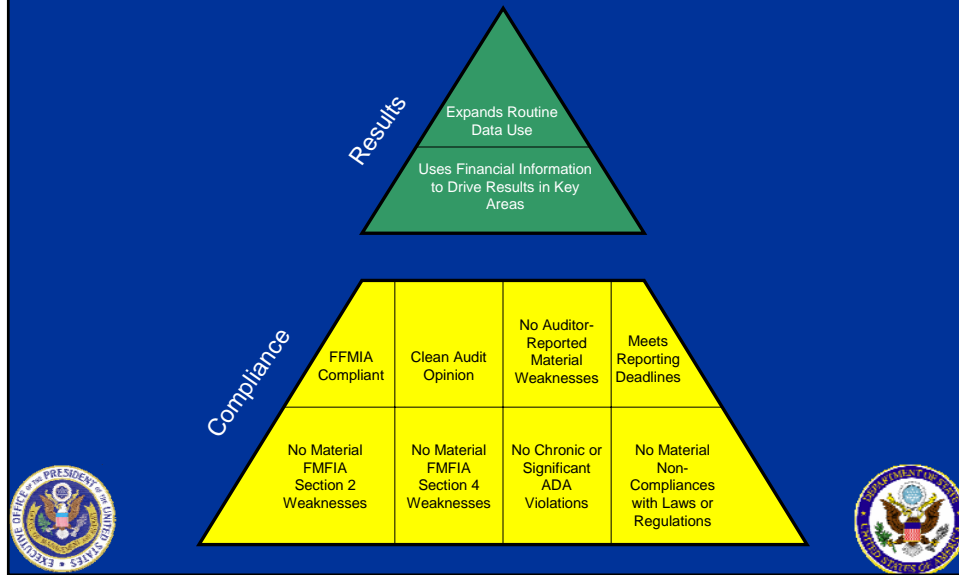


Today's Agenda

- Laying the groundwork for Improved Financial Performance
- New policy/requirements in Circular A-123, Appendix A
- Implementing Circular A-123, Appendix A
- An agency perspective: State Department
- Questions and answers



Getting to Green in Financial Management



Laying the Groundwork for Improved Financial Performance

- **More timely and accurate** reporting
- **More clean audit opinions**
- **Reduce** material weaknesses
- **Improve** financial processes
- **Strengthen** internal controls



More efficient and disciplined Financial Processes: What Happened in 2004?

- **Accelerated reporting** drove better processes
- Reconciliations and analyses performed *throughout* the year
- Annual “heroic efforts” unsustainable
- **New government-wide reporting process**



Moving Ahead: Effective Internal Control



New Requirements

- Revisions to Circular A-123 (December 2004)
- Strengthened/more rigorous management assessment processes for financial controls

Ongoing Activities

- Ongoing quarterly monitoring under PMA
- Ongoing audit testing / compliance reporting

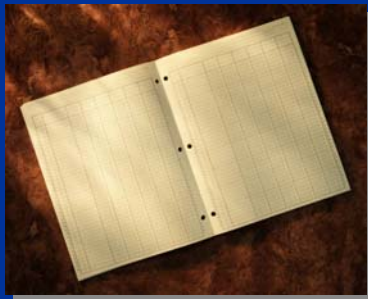


Why did OMB Revise Circular A-123?

- President's Management Agenda
- Existing internal control weakness
- Influence of Sarbanes-Oxley (SOX)
- Provide a comprehensive internal control framework/standards



Revised Circular A-123 Emphasizes



- Effective internal control is a management responsibility
- Financial reporting controls (Appendix A)
- Integrated Approach
 - Leverage existing activities
- Cost-effective Approach
 - Additional auditing under certain circumstance



Strengthened Assessment Process Management Requirements

- Requires a **strategic** look at **financial reporting risks**
- **Direct testing** of controls
- **Documentation** to support/validate results
- **New management assurance statements**



Important Management Judgments

- Scope = Breadth and Depth
 - Breadth
 - Financial reports included
 - Depth:
 - Processes supporting financial reports
 - Extent of work at major subsidiaries / locations
- Determining materiality
- Developing a testing approach
- Further implementation guidance



Seeking Efficiencies: Leveraging Baseline Activities

- FISMA
 - IT Security Review/Remediation
- IPIA
 - Assessment/Remediation
- Remediation activities
 - New controls/ corrective actions
- SAS 70 reviews
- Other program review activities



A-123 Reporting Requirements



- Assessment as of June 30th
- Assurance statement reported in PAR (November)
- Three types of assurance statements
- Report material weaknesses in statement
- Summary of corrective actions



Resources and Training

- A-123 Implementation Finalized
 - www.cfoc.gov/committees/fmpp/fmpp.cfm
- On-going informal training sessions sponsored by the CFO Council



OMB Expectations

- Organizational approach decided
 - Form a senior assessment team
- Specific planning decisions underway
 - Scope
 - Materiality
 - ID baseline activities
 - Risk-based testing plan
- OMB requested agency implementation plans by August 31st



Implementation Guide: *The Process*

- Purpose of the guide
- How the guide was developed
- Scope/applicability of the guide



Implementation Guide Contents

- Introduction
- Step 1: Planning
- Step 2: Evaluating Control at the Entity Level
- Step 3: Evaluating Control at the Process Level
- Step 4: Testing
- Step 5: Concluding, Reporting, Correcting
- Exhibits
- Frequently Asked Questions





Step 1: Planning

- The critical step
- Senior management support—
establishment of Senior Assessment
Team (SAT)
 - SAT Responsibilities
 - SAT Membership
- Determining overall approach – top-down



Step 1: Planning

- Special considerations
 - Multiple locations
 - Cross-servicing entities
- Integrate and coordinate
 - Within your agency
 - With OIG and independent auditors
 - Outside your agency





Step 1: Planning

- Significant financial reports
 - *Breadth* and *Depth* of financial reporting
 - Minimum: annual and quarterly statements
 - Other significant reports



Step 1: Planning

- Setting and using *materiality*
 - What is materiality?
 - Quantitative considerations
 - Qualitative considerations
 - Methodology for applying materiality:
 - Reporting materiality
 - Planning materiality
 - Testing materiality





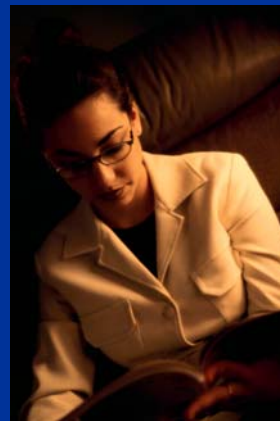
Step 1: Planning

- Other materiality considerations
 - Individually significant components
 - Common systems
 - Changing conditions during the assessment

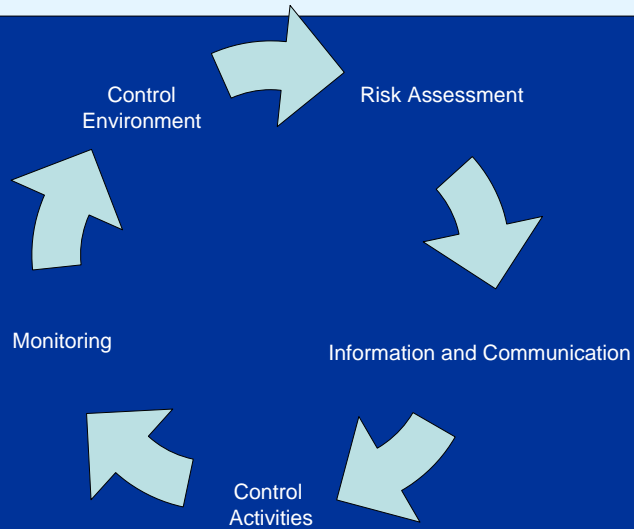


Step 2: Evaluating Control at the Entity Level

- Evaluate control elements that operate at the *entity* or *organizational* level
- Evaluate control elements at the *entity* level that could impact *process* level controls



The 5 Control Elements



Step 3: Evaluating Control at the Process Level

- Understand key financial reporting processes
- Identify key controls
- Understand control design
- Understanding IT controls
- Exhibit 4 – Account Risk Analysis

Step 3: Evaluating Control at the Process Level

- Documenting Controls
 - Form of documentation
 - Current documentation
 - Sufficient detail to support assessment
 - Exhibit 5 – Specific Control Evaluation



Step 3: Evaluating Control at the Process Level

- Cross-Servicing Providers and Service Organizations
 - Management's responsibility
 - Reliance on SAS 70 reports
 - Timing of SAS 70 reports



Step 4: Testing

- What to test – key controls
- When to test – June 30 cut-off
- How much to test – past experience of effectiveness



Step 5: Concluding, Reporting, Correcting

- Concluding on effectiveness of controls
 - Internal Control Deficiency
 - Reportable Condition
 - Material Weakness
- Exhibit 5 – Specific Control Evaluation



Step 5: Concluding, Reporting, Correcting

- Internal Reporting
 - Internal control deficiencies that are not deemed material weaknesses to the agency as a whole should be tracked internally.
- External Reporting
 - As of June 30
 - Reported in the annual Performance and Accountability Report (PAR)



Step 5: Concluding, Reporting, Correcting

- What is the agency's responsibility for changes in internal controls that could occur between June 30 and September 30?
 - Newly identified material weaknesses
 - Correction of previously identified material weaknesses



Assessment of Effectiveness

- **Unqualified** – No material weaknesses noted
- **Qualified** – Material weaknesses were noted, but not pervasive
- **Statement of No Assurance** – No assessment process in place or noted pervasive material weaknesses



Corrective Action Plans

- Establish targeted milestones and completion dates
- Senior Management Council review and monitor corrective action plan
- Corrective Action Plan Framework



Auditor Perspective

- Coordination with management
- Distinctions between Audit and A-123
- Auditor reporting considerations



Coordination: Management and Auditor

- Short term: what to expect in the first year(s)
 - Identification of controls
 - Documentation of controls
- Long term
 - Audit efficiencies



Perspectives: Management and Auditor

- Objectives
 - Auditor
 - Consideration of internal control for audit planning and control risk assessment
 - Opinion on financial statements
 - Management
 - Identify
 - Document
 - Assess and test
 - Assurance statement



Perspectives: Management and Auditor

- Materiality
 - Auditor can set higher levels than management based on objectives
 - Lower threshold for management to ensure all levels of management responsibility in relation of mission can be covered (e.g. program, cycle, transactions)

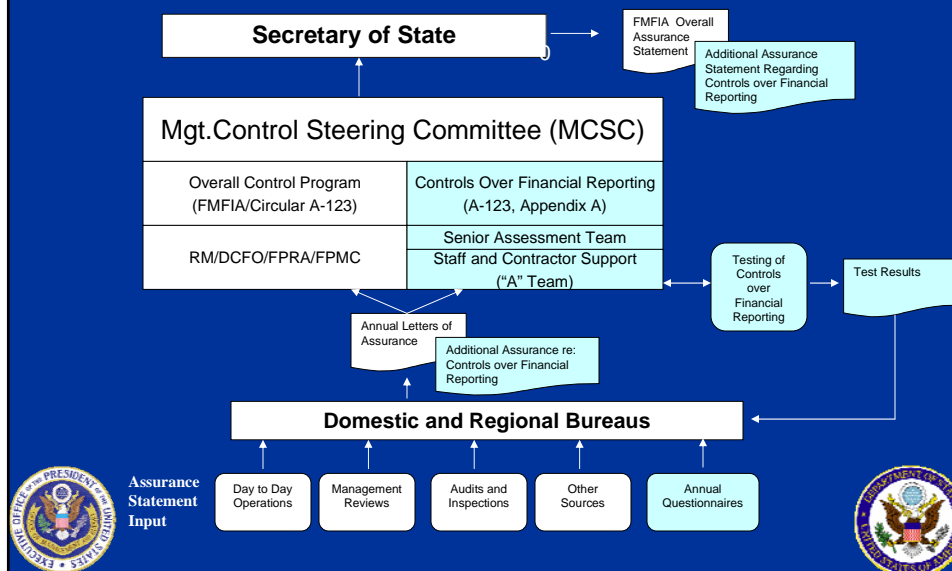


An Agency Perspective: Department of State

- Builds off of a solid management control program with a record of success
 - Recognized as a best practice
 - Reduced material weaknesses under FMFIA from 10 to zero between 1999 and 2002
- Commitment from senior management
 - Seeking excellence, not just compliance
 - Diagnostic and training opportunities



Department of State: Management Control Program



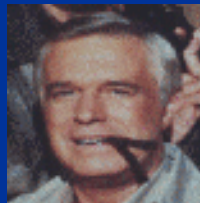
Department of State: Proposed SAT Composition and Support

- Deputy Chief Financial Officer, Chair
- Selected representation from the MCSC
- SAT Support
 - The Appendix A Assessment Team (or “A” Team)
 - Staff members
 - Contractor resources
 - “A” Team will:
 - Annually assess, document (using Federal audit documentation protocols), test and report on controls over financial reporting
 - Provide staff support for SAT activities



The “A” Team

DCFO Staff



Contractor Support



TBD



TBD



Department of State: Planning/Scope of A-123 Assessment

- Significant Financial Reports
 - Consolidated Financial Statements and Notes
 - Combining Statement of Budgetary Resources
- Materiality
- Reliance/Coordination with Other Work
 - F/S Auditors: Budgetary Cycle, FSN Payroll
 - FISMA, IPIA, Recovery Audits, ISO 9000, SAS 70s



Department of State: Key Financial Processes

- Fund Balance with Treasury
- Cash Receipts and Revenue
- Cash Disbursements and Expenses
- Budgetary Resources
- Procurement
- Payroll & Benefits
- Foreign Service Retirement & Disability Fund
- Business Type Funds
- Property & Equipment
- Contributions to International Organizations
- Financial Reporting
- Grants



Implementation Timetable


- Planning (January 2005 – March 2006)
- Documentation
 - Seven cycles (April 2005 – August 2005)
 - Remaining cycles (Nov 2005 – March 2006)
 - Control Environment (Nov 2005–March 2006)
- Testing (Feb 2006 – August 2006)
- Evaluating Results and Reporting (July – Nov 2006)



Implementation Risks

- Resource/Funding Availability
- Excessive sampling (financial statement auditors, IPIA, recovery auditors, management reviews, A-123 testing)
- Focus on financial reporting at the expense of managerial/operating controls
- Viewed as a CFO responsibility as opposed to a managerial responsibility





Questions?

