

Office of INSPECTOR GENERAL

Audit Report

*Review of USITC's Compliance with the
Federal Managers' Financial Integrity Act
of 1982 for Fiscal Year 1990*

Report No. IG-03-91



February 1991

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UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

February 11, 1991

**Review of USITC's Compliance with the Federal
Managers' Financial Integrity Act of 1982**

The Federal Managers' Financial Integrity Act of 1982, Public Law 97-255, requires executive agencies to establish internal accounting and administrative controls in accordance with the Comptroller General standards and related requirements. The Act further requires that agency heads submit an annual statement to the President and the Congress on the adequacy of internal controls and actions taken to correct weaknesses identified. The Commission has elected to comply with the Act since its inception.

This review was scheduled to fulfill the function of the Office of Inspector General to report annually to the Chairman on the adequacy of the Commission's review of internal controls. The objectives of this review were to: (1) determine the status of the Commission's compliance with the Act and applicable guidelines for the year ended September 30, 1990; (2) evaluate the procedures developed to perform the internal control reviews, the results of the reviews and proposed corrective actions; and (3) review and evaluate corrective action taken on prior deficiencies.

I found that the evaluation of the system of internal accounting and administrative control, as described in Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government, issued by the Director of the Office of Management and Budget in consultation with the Comptroller General, has been carried out in a reasonable and prudent manner in the Commission for the fiscal year ended September 30, 1990. During this review, nothing came to our attention that would indicate that the Commission did not substantially comply with the above-mentioned guidelines.

In a memorandum to the Chairman dated December 20, 1990, the Internal Control Officer reported that there was one material internal control weakness to report for the Commission. Based on the applicable criteria and reviews and observations of Commission operations, we concurred with this conclusion.

During the review, we found that the internal control reviews were generally conducted in accordance with the guidance provided in Directive 1601.2 with the exception of the testing of internal controls for which additional training needs to be provided. We observed that two of the assessable units should be reevaluated in the annual update of the management evaluation plan. We found that corrective action was taken on prior year recommendations and that the Commission has implemented two and given adequate consideration to another four policy suggestions made by the Office of Management and Budget to improve management control.

The Internal Control Officer is aware of these issues and, we believe, is either taking appropriate action or giving proper consideration to the issues; therefore, we have made no recommendations in this report. We particularly support his efforts to have responsible officials attend training on how to conduct internal control reviews.

The Director, Office of Administration agreed with our findings and to implement the suggestions. His comments are presented in their entirety as an Appendix to this report.

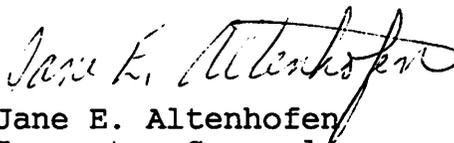

Jane E. Altenhofen
Inspector General

TABLE OF CONTENTS

	Page
INTRODUCTION AND SCOPE	1
BACKGROUND	2
FINDINGS	3
MATERIAL INTERNAL CONTROL WEAKNESS	3
INTERNAL CONTROL REVIEWS	4
Testing	4
ASSESSABLE UNITS	5
PRIOR YEAR RECOMMENDATIONS	6
Revised Directive	6
Identified Weaknesses	6
MANAGEMENT CONTROL PROGRAM OPERATIONS	7

Attachments

1. Memorandum to Acting Chairman dated December 20, 1990
2. Guidance on Determining Material Weaknesses
3. Guidance on Determining Material Nonconformances

Appendix - Memorandum from Director, Office of Administration, dated February 7, 1991, on Draft Report

INTRODUCTION AND SCOPE

This review was scheduled to fulfill the function of the Office of Inspector General to report annually to the Chairman on the adequacy of the Commission's review of internal controls. The objectives of this review were to: (1) determine the status of the Commission's compliance with the Federal Managers' Financial Integrity Act (FMFIA) and applicable guidelines for the year ended September 30, 1990; (2) evaluate the procedures developed to perform the internal control reviews (ICRs), the results of the reviews and proposed corrective actions; and (3) review and evaluate corrective action taken on prior deficiencies.

The FMFIA is applicable to executive agencies. As set forth in a memorandum from the General Counsel (GC-J-138, dated August 19, 1986), the Commission is not an executive agency and therefore not subject to the Act. The Commission has chosen to voluntarily follow the provisions of the Act and implementing circulars issued by the Office of Management and Budget (OMB). Accordingly, references to "compliance" in this report are based on the adoption of directives consistent with the Act and regulations.

The review was conducted in November and December 1990. I evaluated the Commission's efforts to comply with the requirements of the Act, and guidance issued by the OMB in Circulars A-123 and A-127 for the reporting period ended September 1990. I also evaluated the Commission's compliance with additional guidance provided by OMB in 1990 on improving management control reporting program operations (June 4 memoranda) and the 1990 FMFIA reporting requirements (July 5 memoranda).

The review focused on ICRs conducted in fiscal year (FY) 1990 for four assessable units: Ethics in Government, Technical Assistance (except Trade Agreements), Mail Services, and Trade Remedy Assistance. We determined whether the ICRs were conducted in accordance with Commission policy and procedures and reviewed supporting documentation.

We also determined whether Alternative ICRs identified for five assessable units - ADP Systems, Information Security, Personnel Services, Payroll/Timekeeping, and Budgeting - properly met the requirements of conducting an ICR. A triennial Federal Information Resources Management Review, which included an OMB Circular A-130 review, was conducted for ADP Systems. Inspector General audits were conducted of Information Security, Personnel Services, Payroll/Timekeeping, and Budgeting.

This review was performed in accordance with generally accepted government auditing standards. Accordingly, the review included an examination of internal controls and other auditing procedures that were considered necessary under the circumstances.

BACKGROUND

The FMFIA requires executive agencies to establish internal accounting and administrative controls in accordance with the Comptroller General standards and related requirements. It further requires that agency heads submit an annual statement to the President and the Congress on the adequacy of internal controls and actions taken to correct weaknesses identified. The Commission, which is not defined as an executive agency, has elected to comply with the Act since its inception.

OMB has issued two circulars providing guidance to agencies on implementing the requirements of the FMFIA. OMB Circular A-123, Internal Control Systems, revised as of August 16, 1983, prescribes policies and procedures executive agencies are to follow in establishing, maintaining, evaluating, improving and reporting on internal controls in their program and administrative activities. OMB Circular A-127, Financial Management Systems, issued on December 19, 1984, defines policies and procedures agencies must adhere to in developing, operating, evaluating, and reporting on financial management systems.

USITC Directive 1601.2, dated July 23, 1990, establishes the Commission's Guidelines for Conduct of Risk Assessments and Internal Control Reviews. The Directive voluntarily incorporates the OMB Circulars that provide guidance. Related guidance is set forth in USITC Directive 2102, dated June 22, 1989, on Financial Management System Policies.

The Commission's programs and operations have been divided into 30 assessable units for which an individual, usually an office director, has been designated as the responsible official. These officials are responsible for conducting ICRs as periodically scheduled and responding to the annual call for assurances issued by the Commission's Internal Control Officer (ICO), who is the Director, Office of Administration.

In accordance with his responsibility to provide training, the ICO scheduled two sessions on evaluating internal controls in 1990. In June, all responsible officials were requested to attend a one-day seminar on "How to Conduct Internal Control Reviews". In August, all senior staff were invited to attend a Small Agency Council Management Seminar on the responsibilities and concepts in establishing, maintaining and testing internal control systems.

FINDINGS

We found that the evaluation of the system of internal accounting and administrative control, has been carried out in a reasonable and prudent manner in the Commission for the FY ended September 30, 1990, and concurred in the identification of one material internal control weakness. We found that the ICRs were generally conducted in accordance with the guidance provided in Directive 1601.2 with the exception of the testing of internal controls for which additional training needs to be provided. We observed that two of the assessable units should be reevaluated in the ICO's annual update of the management evaluation plan. We found that corrective action has been taken on prior year recommendations and that the Commission has implemented two and given adequate consideration to another four policy suggestions made by OMB to improve management control.

MATERIAL INTERNAL CONTROL WEAKNESS

In a memorandum to the Acting Chairman dated December 20, 1990, the ICO reported that there was one material internal control weakness concerning the payroll and time and attendance procedures to report for the Commission. Based on the applicable criteria and my reviews and observations of Commission operations, we concurred with this conclusion in a memorandum to the Acting Chairman dated December 20, 1990, (Attachment 1).

As reported to the Commission in audit report #IG-06-90 issued on September 21, 1990, we found a material internal control weakness in the payroll and time and attendance procedures. The weakness, which was the composite of multiple areas where internal controls needed to be improved, met the criteria for materiality established by OMB. The OMB guidance on defining material weaknesses is presented in its entirety in Attachment 2.

The internal control weakness includes some areas of non-conformance, and could have been classified as a material non-conformance in accordance with the OMB criteria. The OMB guidance on defining material nonconformances is presented in its entirety in Attachment 3.

I concurred with the ICO that it was not necessary to report the same finding as both a material internal control weakness and a material nonconformance. To ensure full disclosure, the section for reporting material nonconformances was footnoted.

INTERNAL CONTROL REVIEWS

We found that the ICRs were generally conducted in accordance with the guidance provided in Directive 1601.2 with the exception of the testing of internal controls. Only one of the four ICRs conducted in FY 1990 included testing.

Testing

OMB Circular A-123 and the implementing guidelines emphasize that all internal control techniques must be tested and documentation on the testing must be maintained by the responsible official. Testing is important in order to ensure that controls are actually being followed and to counteract the tendency of officials to rely on controls they "know" to be in effect.

USITC Directive 1601.2 states that documentation showing testing method, items tested and results will be maintained by the responsible official. A form to record the results of testing and an optional form to record the actual tests done are provided as attachments to the Directive. Testing procedures are defined as including:

- observation of operating procedures;
- physical examination of quantity and/or condition of tangible assets;
- confirmation of information accuracy by means of communication with independent third parties;
- interviews with employees facilitated by questionnaires or interview checklists; or
- analysis of transaction documents, if the performance of the control leaves documentary evidence.

We found that testing was done on only one of the ICRs - Technical Assistance, in the form of sending questionnaires to selected offices. Two other ICRs (Mail Services and Trade Remedy Assistance) included the form reporting test results, but the results were not based on actual tests.

Individuals involved in conducting the three ICRs for which testing was not done said, in general, that they did not conduct tests because they did not see how that step applied to their assessable unit. The ICO has recognized the need for better understanding of the testing step. He included a statement in the Acting Chairman's FY 1990 FMFIA Report that during FY 1991 the Commission planned to provide training that addresses the testing of internal controls. We concur with this approach and suggest that all of the responsible officials scheduled to conduct ICRs in FY 1991 participate in this training.

ASSESSABLE UNITS

The Commission is currently segmented into 30 assessable units. As stated in the Directive 1601.2, the assessable units change with the passage of new laws, changing administrative emphasis, identified program areas, and so forth. Managers are to notify the ICO of any additions, deletions or corrections to the assessable units, and have done so on occasion.

We suggest that the ICO consider the following observations on assessable units when updating the management evaluation plan.

1. ADP Systems was scheduled for an ICR in FY 1990 to be accomplished by an Alternative ICR. When an Alternative ICR is done instead of the ICR, the event cycles are not identified and the processes are not described. In the absence of this description, the assessable unit is not defined. In talking with various officials, it was obvious that ADP systems needs to be reevaluated in terms of changes in technology, the Commission reorganization and the broader context of Information Resources Management.
2. Mail Services was an assessable unit for which an ICR was conducted in FY 1990. The responsible official suggested to the ICO that this assessable unit might be a good candidate for removal since the function is performed by a contractor. We do not believe that functions performed by a contractor should necessarily be exempt from the FMFIA process. If weaknesses were identified, a change order may be needed or possibly changes in the next contract. Furthermore, a cycle for monitoring the contract should be identified when the function is primarily performed by a contractor.

As for mail services specifically, we believe a cycle for calculating postage costs is also warranted. Mail services has a very specific process for determining the amount to be paid for postage. We noted that a review of official mail utilization and equivalent postage conducted in April 1989 found that the Commission had not accurately calculated the actual amount of postage, understating the amount of postage and resulting reimbursement to the Commission by nearly \$5000. The internal control weaknesses that contributed to the undercalculation were not identified in FY 1989 or 1990.

PRIOR YEAR RECOMMENDATIONS

The OIG audit report on the FY 1989 FMFIA process stated that the Commission had substantially complied with the requirements of OMB Circular A-123. These requirements were to: maintain a current internal control directive, develop a management control plan, make risk assessments and internal control evaluations, and implement corrective actions. The audit report included two recommendations, to revise Directive 1601.1 and review identified weaknesses for appropriateness. Corrective action has been taken on both recommendations.

Revised Directive

We recommended that the Directive be revised to include provisions for coordination, clarify requirements for performance plans, and establish training as an ICO responsibility. The Directive was revised as recommended and issued on July 23, 1990.

We also recommended that supervising officials be reminded of their responsibility to ensure that performance plans for responsible officials under their supervision result in recognition for internal control accomplishments, such as timely correction of internal control weaknesses and appropriate actions for violations of internal controls. This was done in a memorandum to all Office Directors on November 20, 1990.

The new guidance in the Directive and memorandum was issued too late to be included in the performance periods for SES members that ended on June 15, 1990, or for GM level staff that ended on August 15, 1990. Next year, we will ascertain whether the performance plans for responsible officials, as defined in Directive 1601.2, have the required element on internal control.

Identified Weaknesses

We also recommended that items in the followup system be reviewed for appropriateness and be deleted or rephrased as necessary. In March 1990, the ICO notified the responsible officials of the audit findings, provided guidance on listing weaknesses and corrective actions, and requested that the lists of weaknesses be revised and updated as necessary. In reviewing the lists, we found that the identification of weaknesses and corrective actions were improved.

MANAGEMENT CONTROL PROGRAM OPERATIONS

We found that the Commission has implemented two of six policy suggestions made by OMB. In their memorandum of June 4, 1990, OMB expressed a concern that each agency have a comprehensive management control program that identifies material weaknesses promptly, develops effective corrective actions, targets the necessary resources for resolution, and validates elimination or reduction of the severity of the weaknesses. OMB suggested that agencies give priority to implementing six policies, if not already part of the program, to effect such a program. These policies were to:

1. Integrate the FMFIA Management Control Review and Reporting Process with the Budget
2. Establish an Early Warning Reporting Capability for Emerging Problems
3. Establish an Agency Management Control Review Committee
4. Establish FMFIA Training Programs for Managers
5. Identify Relative Significance of Weaknesses
6. Validate Corrective Actions

Two of these policies have been implemented. As discussed earlier in this report, Directive 1601.2 was revised to assign responsibility to the ICO to provide training as needed. In accordance with this responsibility, the ICO arranged for two training sessions on evaluating internal controls in 1990. To address the need for an early warning system, paragraph 4c(3) of Directive 1601.2 sets forth that Office Directors are responsible for notifying their supervisor, Chairman, ICO, and the Inspector General of a mission-critical problem or a deterioration of an existing material weakness without regard to the normal annual reporting cycle.

The other policies have not been implemented for various reasons according to the ICO and his Special Assistant. They said these suggestions were for agencies that have high risk areas (the Commission has none), and budget restrictions that impact on implementation of corrective action (which is not the case at the Commission). The communication system within the Commission is sufficient so that a Management Control Review Committee is not needed. As for validating corrective actions, this is done for the findings in audit reports and is not appropriate in the Commission's ICR system which is management oriented.

We concur that the training and early warning system were the most important of the policy suggestions for the Commission at this time. The other suggestions can be reevaluated in the future if the ICO becomes aware of such a need, possibly due to increased emphasis by OMB of a specific policy or budget restrictions in future Commission appropriations.

INSPECTOR GENERAL



IG-N-146

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, D.C. 20436

December 20, 1990

MEMORANDUM

TO: Acting Chairman

THRU: Internal Control Officer

FROM: Inspector General *Gene B. Allenhofer*

SUBJECT: Review of USITC's Compliance with the Federal Managers' Financial Integrity Act of 1982

The Federal Managers' Financial Integrity Act of 1982 requires executive agencies to establish internal accounting and administrative controls in accordance with the Comptroller General standards and related requirements. The Act further requires that agency heads submit an annual statement to the President and the Congress on the adequacy of internal controls and actions taken to correct weaknesses identified. The Commission, which is not defined as an executive agency according to the Office of General Counsel, has elected to comply with the Act since its inception.

The Inspector General is to report annually to the Chairman on the adequacy of the Commission's review of internal controls. I reviewed and evaluated the Commission's compliance with the Act and applicable guidelines for the fiscal year ended September 30, 1990; the procedures developed to perform the internal control reviews; the results of the reviews and proposed corrective actions; and corrective actions taken on prior deficiencies.

I found that the evaluation of the system of internal accounting and administrative control, as described in USITC Guidelines for Conduct of Risk Assessments and Internal Control Reviews, issued by the Director of the Office of Management and Budget in consultation with the Comptroller General, has been carried out in a reasonable and prudent manner in the Commission for the fiscal year ended September 30, 1990. During the review, nothing came to my attention that would indicate that the Commission did not substantially comply with the above-mentioned guidelines. I will report on several areas in which the evaluation process could be improved in a draft audit report to be issued in January 1991.

The Commission's Internal Control Officer Report identifies one material internal control weakness in the Commission concerning the payroll and time and attendance procedures. Based on the applicable criteria and my reviews and observations of Commission operations, I concur with this conclusion.

If you have any questions, please contact me on 252-2210.

cc: Commission

GUIDANCE ON DETERMINING MATERIAL WEAKNESSES

For determining whether weaknesses in internal control systems (Section 2) are material, the weakness should meet one or more of the following criteria:

- significantly impair the fulfillment of an agency or component's mission;
- deprive the public of needed services;
- violate statutory or regulatory requirements;
- significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; or
- result in a conflict of interest.

Each material weakness should meet one or more of the following additional criteria:

- merit the attention of the agency head/senior management, the Executive Office of the President, or the relevant Congressional oversight committee;
- exist in a majority of agency components or in a major program or activity;
- risk or result in the actual loss of either \$10 million or 5 percent of the resources of a budget line item; or
- reflect adversely on the credibility of the agency report when subsequently made public.

GUIDANCE ON DETERMINING MATERIAL NONCONFORMANCES

For determining whether nonconformances (Section 4) are material, the nonconformance should meet one or more of the following criteria:

- merit the attention of the agency head/senior management, the Executive Office of the President, or the relevant Congressional oversight committee;
- prevent the agency primary accounting system from achieving central control over agency financial transactions and resource balances;
- reflect nonconformances in a subsidiary or program system that causes nonconformances in the primary system or prevent compliance of the subsidiary or program system with GAO Title II as implemented in OMB Circular A-127, the Standard General Ledger, and the Core Financial Systems Requirements; or
- result in an actual material misstatement (either 5 percent of a budget line item or \$10 million) in reports required by the OMB, the Treasury Department, or the Congress.



AD-O-091

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, DC 20436

February 7, 1991

MEMORANDUM

TO: The Inspector General

FROM: Director, Office of Administration *Laura S. Goodrich*

SUBJECT: Draft Report, "Review of USITC's Compliance with the FMFIA of 1982 for FY 1990"

As requested by Memorandum dated January 10, 1991 (IG-O-005), submitted as an attachment to this memorandum is the Office of Administration's response to the subject draft audit report issued in January 1991. In accordance with Section 11 of the USITC Directive 1701, the Commissioners have had an opportunity to comment on the response and the Acting Chairman has approved it.

Please call me at 252-1131 or Bill Stuchbery at 252-1135 if you have any questions.

Attachment

cc: General Counsel
Director, Office of Industries
Director, Trade Remedy Assistance Office
Director, Office of Management Services
Director, Office of Information Resources Management

Review of USITC's Compliance with the FMEIA
of 1982 for FY 1990

(Office of Administration Comments)

The Office of Administration agrees with the Inspector General's "Findings" on page 3 of the draft report and will proceed to implement the following corrective actions:

1. Provide internal control training for the managers who are responsible for assessable units. Training will include a segment on testing of internal controls.

Due Date: June 28, 1991.

2. The two assessable units, Mail Services and ADP Systems will be reevaluated in the update of the annual management evaluation plan.

Due Date: February 28, 1991.