Audit Report

OFFICE OF THE INSPECTOR GENERAL

COMPLIANCE WITH THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT AT THE DEFENSE COMMERCIAL COMMUNICATIONS OFFICE

Report No. 93-151

July 26, 1993

Department of Defense

Acronyms

DECCO	Defense Commercial Communications Office
DISA	Defense Information Systems Agency
FMFIA	Federal Managers' Financial Integrity Act of 1982
GAO	General Accounting Office
IMC	Internal Management Control
MCP	Management Control Plan
OMB	Office of Management and Budget

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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Report No. 93-151

July 26, 1993

MEMORANDUM FOR DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY

SUBJECT: Report on Compliance with the Federal Managers' Financial Integrity Act at the Defense Commercial Communications Office (Project No. 2RE-2015.01)

Introduction

We are providing this final report for your information and use. It discusses compliance with the Federal Managers' Financial Integrity Act of 1982 (FMFIA) at the Defense Commercial Communications Office (DECCO).

The FMFIA requires each executive agency to periodically evaluate its system of internal controls and to report annually to the President and the Congress. An agency's report should state whether its system complies with the requirements of the FMFIA and should identify material internal control weaknesses, if any, and plans for correcting the weaknesses.

Audit Results

DECCO's internal control program was not in full compliance with the requirements of the FMFIA. Those requirements are implemented in Office of Management and Budget (OMB) Circular A-123, "Internal Control Systems," August 4, 1986; DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987; and Defense Information Systems Agency (DISA) Instruction 630-125-6, "DCA [Defense Communications Agency][1] Internal Management Control Program," July 23, 1987. DECCO's program needed improvements in the areas of FMFIA performance standards, risk assessments, internal control evaluations, and FMFIA training. DISA has issued supplementary guidance and directed that specific improvement actions be taken in those areas. If actions are implemented by DECCO, the conditions disclosed by the audit will be corrected.

Objectives

The overall audit objective was to determine whether FY 1992 financial statements for the Defense Business Operations Fund-Communications Information Services Activity were presented fairly in accordance with generally accepted accounting

[1] Now the Defense Information Systems Agency

principles. We also evaluated applicable internal controls and assessed compliance with laws and regulations for transactions and events having a direct and material effect on the financial statements. This report discusses only the FMFIA aspects of our objective to assess compliance with laws and regulations. A separate report will be issued on assessments of compliance with other applicable laws and regulations, the financial statements, and internal controls.

Scope

The Five Year Management Control Plan (MCP), September 17, 1991, which was included as part of DECCO's FY 1991 Annual Statement of Assurance to DISA, showed that DECCO assessed 12[2] of its 36 assessable units during FY 1991. The MCP indicated that each unit is assessed at least once every 5 years. The 12 units assessed in FY 1991 were scheduled to be reassessed in FY 1996. Our audit focused on the FMFIA work performed for the 12 units assessed in FY 1991.

We discussed the system of internal controls with managers at DISA and DECCO to determine whether controls had been established and to ensure compliance with the regulatory provisions of OMB Circular A-123 and DoD Directive 5010.38. We examined and evaluated FMFIA policies and procedures for each of the 12 assessable units. We interviewed the assessable unit manager; reviewed the 1991 risk assessment documents; and determined whether internal control reviews were performed and, if so, the extent of those reviews.

This financial related audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. The audit was made at DISA, Washington, D.C., and DECCO, Scott Air Force Base, Illinois.

Internal Controls

We evaluated the effectiveness of DECCO's internal controls applicable to FMFIA performance standards, the risk assessment process, completed internal control reviews, and FMFIA training. Although internal control deficiencies, as defined by the FMFIA, OMB Circular A-123, and DoD Directive 5010.38, were disclosed by the audit, the DISA had taken actions during the audit to correct the deficiencies.

Prior Audits and Other Reviews

IG, DoD, Report No. 89-015, "Report on the Fiscal Year 1988 Evaluation of the Implementation of the Federal Managers' Financial Integrity Act of 1982 at the Defense Communications Agency," October 21, 1988, concluded that the Defense

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[2] Ten managers made the twelve assessments; two managers assessed two units each.

Communications Agency's Accounting System Evaluation and Reporting process at the Communications Services Industrial Fund was in compliance with the Federal Managers' Financial Integrity Act and with OMB Circular No. A-127, "Financial Management Systems," for FY 1988. The FY 1988 evaluation did not include an analysis of the internal management program results or the efficiency and effectiveness of the procedures used in the implementation of the FMFIA.

Background

The DECCO is headquartered at Scott Air Force Base, Illinois. The DECCO, a field organization of the Defense Information Systems Agency, is responsible for the acquisition of telecommunication services and equipment on behalf of its DoD and 65 other Federal agency customers. The DECCO is responsible for administering about 89,000 contracts valued at $1.2 billion annually. Some of the communications services and equipment DECCO acquires for its customers are basic telephone circuits and networks, fiber optics, video teleconferencing, satellites, and packet switching (transfer of communication bundles).

DoD Directive 5010.38 requires managers of assessable units to conduct risk assessments and internal control evaluations of assigned units, as necessary, at least every 5 years to ensure that the system of internal controls is working in accordance with General Accounting Office (GAO) standards. DISA Instruction 630-125-6 implements DoD Directive 5010.38 and provides guidance on risk assessments, internal control evaluations, and internal management control responsibilities for the DISA and its field organizations. The Instruction mandates specific documentation requirements for internal control evaluations and requires that supervisors evaluate assessable unit managers annually on FMFIA responsibilities. Supplement 1 of the Instruction, "Risk Assessments and Internal Management Control Reviews," issued in March 1988, includes additional guidance on performing risk assessments and internal management control reviews. The Supplement also details the methodology to be followed in conducting reviews, to include identifying work flow, assessing controls, testing controls, and reporting and following up on internal control weaknesses.

Enclosure 1 describes specific requirements for risk assessments, internal control evaluations, documentation, and evaluation of assessable unit managers' FMFIA responsibilities.

Discussion

DECCO's FY 1991 internal control program did not comply with DISA Instruction 630-125-6 in the areas of FMFIA performance standards, risk assessments, internal control evaluations, and FMFIA training. However, DISA issued guidance and direction during the audit that, if implemented, will result in DECCO's compliance in those areas. The conditions and corrective actions are discussed below.

Performance Standards. Generally, internal control responsibilities were not included in the managers' performance plans, and, when they were included, they were not designated as a critical element. FMFIA responsibilities were not included in performance plans for 6 of 10 assessable unit managers and, therefore, the managers were not evaluated on their internal management control program duties. Performance plans for the remaining four managers included FMFIA responsibilities, but for three managers' performance plans, the responsibilities were not designated critical elements. The remaining manager was evaluated for FMFIA responsibilities, and the responsibilities had been designated as a critical element.

DISA Instruction 630-125-6 requires that the directors of DISA field organizations include FMFIA responsibilities in an assessable unit manager's performance plan as a critical element in order to ensure maximum effort in implementing the FMFIA program. In March 1993, DISA's Internal Management Control (IMC) focal point sent the DECCO IMC focal point a sample performance plan and directed that FMFIA responsibilities be included as a critical element in all assessable unit managers' performance plans. By including those responsibilities as a critical element in the performance plan as directed by DISA, DECCO will be in compliance with FMFIA requirements.

FY 1991 Risk Assessments. FY 1991 risk assessments did not include sufficient information to support managers' decisions on identifying, evaluating, and testing internal control techniques. The risk assessment documents did not provide reasonable assurance to third parties that controls were in place and worked as intended (see Enclosure 2). Only two documents referenced supporting evidence that techniques had been tested. Despite seven medium-risk ratings, DECCO's assessment documents concluded that no further action was necessary because safeguards were in place to counter risks. However, the assessment documents did not mention what the safeguards were or whether the safeguards worked. In addition, assessable unit mangers told the audit team that they had not documented the "safeguards" specified in their risk assessment documents. Internal control focal points for both the DISA and DECCO said that risk documents were neither informative nor convincing.

In an August 12, 1992, memorandum to all field organizations, the DISA Comptroller questioned the risk assessment process used during the FY 1988 to FY 1992 period. The memorandum stated that "since our managers reported that virtually no risk existed in the agency, few follow-on reviews or corrective actions were performed," but that "it is not credible that our agency would be mostly without risk. . . . Accordingly, we will implement some changes in the approach to the Internal Management Program for FY 93-97." He directed that top-level field managers participate in the risk evaluation process, consolidate assessable units to enhance risk identification, and prioritize risk areas to ensure that resources are used in the most important risk areas. By implementing those directed improvements to the risk assessment process, DECCO will be in compliance with the FMFIA requirements.

Internal Control Evaluations. For 8 of the 12 units assessed, internal control evaluations or alternative reviews were not performed to provide reasonable assurance that internal control techniques were adequate and worked. Risk assessment documents showed that medium risk ratings were assigned to seven of the eight assessable units. One unit was assigned its risk rating based on external testing. For the remaining three assessable units, limited control tests were performed (see Enclosure 2).

The control tests for the three assessable units were not in full compliance with DISA Instruction 630-125-6. For example, documentation supporting the tests did not identify control objectives or control techniques and did not define test objectives, testing universe, and sampling methodology. However, the tests included cross-references of account balances and reconciliations to supporting documents. Therefore, we believe the tests provided reasonable assurance that the financial transactions were accurate and supported.

During the audit, DISA initiated actions to ensure increased internal control testing by assessable unit managers. In the August 12, 1992, memorandum mentioned above, the DISA Comptroller mandated that at least 10 tests were to be performed over the next 5 years for each major program and functional area to ensure a reasonable level of testing of the most important controls within a major program or function. The memorandum stressed that top-level managers at each organization should be directly involved in control test planning and implementation. By implementing directed improvements in internal control testing, DECCO will be in compliance with FMFIA requirements.

FMFIA Training. Adequate training was not provided to personnel with internal management control responsibilities. None of the 10 assessable unit managers received FMFIA training in FY 1991. Six of ten assessable unit managers had not received FMFIA training in the past 5 years. In April 1993, DISA, at DECCO's request, conducted a training session on FMFIA requirements for DECCO assessable unit managers. Future training sessions, when requested, will also be conducted. Therefore, no further corrective action is required on FMFIA training.

Management Comments

We provided a draft of this report to the addressee on June 15, 1993. The DISA provided comments (Enclosure 3) on July 1, 1993. The DISA concurred with the report, stating DISA will take follow-up actions to ensure that established procedures are followed and that the FMFIA program is implemented effectively. The comments also stated that the DECCO was a participant in detecting and correcting two material internal control weaknesses reported during the audit period. DISA indicated further, that the detection of the weaknesses suggests that DECCO is performing internal control evaluations, but not adequately documenting them.

There are no unresolved issues on this report; therefore, additional comments are not required.

The courtesies extended to the audit staff are appreciated. If you have questions on this audit, please contact Mr. John M. Donnelly at (703) 692-2899 (DSN 222-2899) or Ms. Mary Lu Ugone at (703) 692-3320 (DSN 222-3320). Copies of this report will be distributed to the organizations listed in Enclosure 4.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosures

FMFIA Program Requirements

Risk assessments, internal control evaluations, documentation, and internal management control (IMC) responsibilities are elements that each executive agency must consider in its evaluation of compliance with the FMFIA.

Risk Assessments. A risk assessment is used to determine the potential for fraud, waste, abuse, or mismanagement within a program or function. The risk assessment helps the manager weigh the safeguards against the risks associated with a unit's program or functions. Risk assessments should be documented and should provide a reasonable basis for an assessable unit's risk rating. Risk assessments are required whenever the risk changes, or at least every 5 years. Managers must review their units annually to ensure that proper controls are in place and to prepare revised risk assessments if changes occur in the risks or controls. DISA Instruction 630-125-6 emphasizes that risk assessments are preliminary tools in the FMFIA process. Managers may follow up with internal control reviews, which are detailed analyses of the unit's process to determine whether controls should be adjusted.

Internal Control Evaluations. An internal control evaluation includes detailed tests of a program or administrative organization to determine whether adequate techniques exist and have been implemented to achieve cost-effective compliance with the FMFIA. There are two types of internal control evaluations: internal control reviews, which are detailed examinations of a system of internal controls; and alternative IMC reviews, which include audits, investigations, studies, and other management and consulting reviews.

Documentation. Documentation is a key requirement of the FMFIA process. Documentation on internal control evaluations must show the type and scope of review; responsible officials; pertinent dates and facts; key findings; and when appropriate, recommended corrective actions. All documentation must show the control testing procedures used. Those procedures include observation, sampling, examination, verification, or other procedures to ensure that internal control systems are working in accordance with internal control objectives and GAO standards.

Documentation for each internal control review must show how the review was done and what was found. Documentation for each alternative IMC review must show whether compliance with the FMFIA has been determined and that testing of controls has been performed.

IMC Responsibilities. DISA Instruction 630-125-6 states that directors of DISA field organizations will ensure that civilian and military managers with internal management control responsibilities are identified and that performance standards include, as a critical element, internal management control responsibilities. The Instruction requires that field organization officials certify by September 1 of each fiscal year whether internal management controls are in place and working.

Defense Commercial Communications Office FY 1991 Risk Assessments and Internal Control Evaluations

Function/Assessable Unit	Risk	Internal Control Reviews	Alternative Reviews
Procurement			
Contract Support Division	H[1]	No	Yes[2]
DECCO, Pacific	M[3]	No	No
Contract Administration			
Strategic Planning Division	M[3]	No	No
Contract Policy Division	M[3]	No	No
Plans and Procedures Division	L	No	No
Supply Operations			
Supply and Equipment	M[3]	No	No
Imprest Fund	L	Yes[4,5]	Yes[2,4]
Information Technology			
Financial Management	M[3]	No	No
Information Management	M[3]	No	No
Automatic Data Processing Equipment Control	M[3]	No	No
Comptroller/Resource Management			
Disbursing Funds[6]	L	Yes[5]	Yes[2]
Accounting System[6]	L	Yes[5]	Yes[2]

Legend: H=High M=Medium L=Low

See footnotes on the next page.

1. The high-risk rating was based on the recent IG, DoD, inspection referenced in footnote 2. The inspection was performed from April 23 to July 27, 1990. The assessment document for this unit stated that although the risk was high, adequate safeguards were in place to counter the risks. However, because the safeguards were not specified, their effectiveness is suspect.

2. The alternative internal management control reviews included a completed IG, DoD, inspection concerning the Contract Support Division, ("Defense Communications Agency Inspection," Report No. 91-INS-08, May 10, 1991) and ongoing IG, DoD, audits. No other alternative reviews were performed.

3. Risk assessment documents for the seven medium-risk ratings included statements that adequate safeguards were in place, but the documents did not specify the safeguards. In addition, no internal control evaluations were performed by the managers of the seven units.

4. Based on discussions with appropriate officials, we determined that the Imprest Fund unit had performed internal control and alternative reviews; however, the risk assessment document gave no indications that such reviews were performed.

5. The internal control reviews provided only limited assurance that adequate controls were in place and working.

6. The risk assessment documents for the assessable unit referenced an internal control evaluation and quality review to indicate that the internal control techniques were tested.

Defense Information Systems Agency Comments

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IN REPLY REFER TO: CMI

1 JUL 1993

MEMORANDUM FOR THE INSPECTOR GENERAL, DOD

SUBJECT: Draft report on Compliance with the Federal Managers' Financial Integrity Act at the Defense Commercial Communications Office (Project No. 2RE-2015.01)

1. We have reviewed the subject report. Overall, we concur with the findings of the report. As noted in the report, both DISA Headquarters and DECCO have taken positive actions to correct the deficiencies noted. While we agree with the audit assessment, it should also be noted that of the two DISA Internal Control Material weaknesses reported on during the period of the audit, DECCO was a key participant in the identification and correction of these weaknesses. Had DECCO documented their evaluations better, it is DISA's position that the audit would have noted a significant amount of evaluation of the risks and controls of DECCO. Since current DoD program emphasis is currently on results, not process, it should be noted that DECCO has made positive contributions towards improvement of agency controls. Nevertheless, for a program to be fully effective, established agency procedures must be followed. DISA will take followup action to ensure the corrective actions underway at DECCO and other agency elements are implemented and effective.

2. If there are any questions regarding this response, please contact Mr. Philip Lavietes or Mr. Bruce Ingalls at (703) 692-4524.

FOR THE DIRECTOR:

GEORGE J. HOFFMAN
Comptroller

ENCLOSURE 3

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House Committee on Budget
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