

DEPARTMENT OF THE TREASURY
OFFICE OF INSPECTOR GENERAL



COMMENTS ON "STANDARDS FOR INTERNAL CONTROL
IN THE FEDERAL GOVERNMENT 2013 EXPOSURE DRAFT"

Enclosure II: Questions for Commenters

1. *Is the hierarchy of components, principles, and attributes clearly explained?*

The hierarchy of internal control components, principles and attributes are clear within the standard sections on pages 19-74. However, the applicability of principles and attributes is somewhat confusing within the "Overview" (pages 1-18). Please refer to responses to questions 4 and 5 for suggested changes to better understand their applicability.

2. *Are there any internal control concepts unique to the government environment that should be in the Green Book that are not currently included?*

We did not note other unique control concepts not already identified in the Green Book Exposure Draft.

3. *Does the framework provide the necessary information to allow program managers to evaluate the internal controls for their programs?*

Although Section 3, *Evaluation of an Effective Internal Control System*, pages 13-15 of the "Overview" provides information for managers to evaluate its internal control, it is unclear whether this section is required criteria for managers of federal programs and systems. Please see our response to question 6 regarding evaluation of control deficiencies.

4. *Does the Green Book provide adequate criteria for auditors?*

We found that the applicability of concepts, principles, and attributes as criteria somewhat confusing in the "Overview". It is noted on page 3, "We have clearly marked the requirements for the Green Book through the use of 'must' and 'should'." However, we noted only 2 instances in which "must" is used in the "Overview" on pages 3 and 5 and over 100 instances in which "should" appeared with respect to principles and attributes (pages 19-74).

Section O2.05, page 6, provides that all concepts, principles, and attributes are required to achieve the standards of internal control as follows:

“These five components represent the highest level of the hierarchy of standards for internal control in the federal government. The principles and underlying attributes represent the requirements necessary to achieve the standards of internal control. In the Green Book, these requirements are identified through the use of specific language. The Green Book uses the word ‘should’ to denote a principle or attribute statement.”

The requirement for all concepts, principles, and attributes to be applied is further supported in Section O2.06 as follows:

“In general, all components, principles, and attributes are relevant for an effective internal control system. However, there may be an operating or regulatory situation in which management has determined that a principle or attribute is not relevant for the entity to achieve its objectives and address related risks. Relevance refers to management’s determination that each principle and attribute has a significant bearing on the design, implementation, and operation of its associated component. If management decides a principle or attribute is not relevant, management supports that determination with documentation that includes the rationale of how, in the absence of that principle or attribute, the associated component could be designed, implemented, and operated effectively.”

If it intended that principles and attributes are required by those responsible for an entity’s system of internal control, we suggest defining “must” and “should” and their force and effect on requiring either all or some principles and attributes as criteria similar to the terminology auditors use when applying generally accepted government auditing standards (GAGAS) as defined in *Government Auditing Standards* (GAS). For example, GAGAS defines “must” and “should” in GAS Chapter 2, *Use of Terminology to Define GAGAS Requirements* as noted below.

Section 2.15:

“GAGAS uses two categories of requirements, identified by specific terms, to describe the degree of responsibility they impose on auditors and audit organizations, as follows:

Section 2.15(a):

“Unconditional requirements: Auditors and audit organizations must comply with an unconditional requirement in all cases where such requirement is relevant. GAGAS uses the word must to indicate an unconditional requirement.”

Section 2.15(b):

“GAGAS uses the word should to indicate a presumptively mandatory requirement.”

The suggested clarification of terminology would better describe applicability noted in response to question 5.

5. *Are the requirements for management to design, implement, and operate an internal control system clear, understandable, and adequate?*

The five internal control components, 17 principles, and underlying attributes are presented on pages 19-74 in a consistent and understandable manner. However, we found the “Overview” to be lengthy and to provide more of what appears to be internal control criteria not noted within the components, principles, and attributes.

For example, in Section O2.06, pages 6-7, sets what appears to be a requirement that management document why a principle and/or attribute is not relevant to an entity:

“In general, all components, principles, and attributes are relevant for an effective internal control system. However, there may be an operating or regulatory situation in which management has determined that a principle or attribute is not relevant for the entity to achieve its objectives and address related risks. Relevance refers to management’s determination that each principle and attribute has a significant bearing on the design, implementation, and operation of its associated component. If management decides a principle or attribute is not relevant, management supports that determination with documentation that includes the rationale of how, in the absence of that principle or attribute, the associated component could be designed, implemented, and operated effectively.”

Additionally, Section 3, *Evaluation of and Effective Internal Control System*, pages 13-16, is written in active voice that management perform certain activities as part of evaluating the effectiveness of internal control. For

example, in Section O3.06, page 14, regarding evaluation the effectiveness of internal control operation, it is stated:

“In evaluating operating effectiveness, management determines if controls were applied at relevant times during the period under evaluation, the consistency with which they were applied, and by whom or by what means they were applied.”

Was it intended that the “Overview” also provide internal control criteria for management in addition to the concepts, principles, and attributes? If so, we suggest clarification in use of terminology “must” or “should” in the “Overview” as noted in our response to question 4.

6. *Is the evaluation of deficiencies discussion clear, understandable, and adequate?*

It is unclear whether Section 3, *Evaluation of an Effective Internal Control System* of the “Overview” on pages 13-15 is considered part of the internal control standard criteria required of management. As noted in response to questions 5 regarding the adequacy of requirements for management to design, implement, and operate an internal control system, active voice is used in describing activities performed by management when evaluating internal control. As noted in our response, we suggest clarification through defining “must” and “should” terminology and applying clarified terminology to applicable sections of the “Overview” if intended as required criteria. Please refer to our response to question 4 regarding “must” and “should” terminology.

Additionally, Section O3.07, page 14, provides evaluation criteria for management to use when assessing the significance of identified deficiencies. However, the last sentence of this section may not be applicable to the federal government environment:

“The oversight body oversees management’s evaluation of significance to ensure that deficiencies have been properly considered.”

Although this statement may be applicable in the commercial sector as presented in the Committee of Sponsoring Organizations of the Treadway Commission’s (COSO) framework, the oversight body or those charged with governance may be legislative body or senior management of an organization which may not perform this function in the federal environment. If this section is considered criteria, suggest rephrasing for applicability to the federal environment after considering our response to question 7 with regard to the role of the oversight body.

7. *Are the roles, divisions, and overlaps of responsibility for the oversight body, management, and personnel clear, understandable, and adequate?*

The role of the oversight body is somewhat confusing and inconsistent with similar roles and responsibilities defined by COSO for the commercial sector as well as those described in *Auditing Standards* (GAS).

Section O2.14, pages 9-10, noted the oversight body as being *"...responsible for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing management's design, implementation, and operation of an internal control system."*

GAS, Appendix 1, "Supplemental Guidance," provides that those charged with governance as having these same responsibilities:

***"A1.06** Those charged with governance are responsible for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process, subject matter, or program under audit including related internal controls. In certain entities covered by GAGAS, those charged with governance may also be part of the entity's management. In some audit entities, multiple parties may be charged with governance, including oversight bodies, members or staff of legislative committees, boards of directors, audit committees, or parties contracting for the audit."*

***"A1.07** Because the governance structures of government entities and organizations can vary widely, it may not always be clearly evident who is charged with key governance functions. In these situations, auditors evaluate the organizational structure for directing and controlling operations to achieve the audited entity's objectives. This evaluation also includes how the audited entity delegates authority and establishes accountability for its management personnel."*

Furthermore, the Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, establishes the head of agencies as being those charged with governance.

Unlike the federal government environment where those charged with governance is commonly agency management responsible for setting the strategic direction and the design, implementation, and operation of internal control, the COSO framework provides oversight of these responsibilities to

“independent external” oversight bodies such as the board of directors and audit committees. Given that an agency’s oversight body may be a legislative committee, it is still agency management that is responsible for ensuring that internal control deficiencies are resolved. We suggest using terminology consistent with GAS Appendix 1 to adapt the internal control standards to the federal environment.

8. *Are the documentation requirements included in the Green Book clear, understandable, and adequate?*

The documentation requirements within the five components on pages 19-74 are clear and understandable. However, it is unclear if discussion of documentation within the “Overview” is considered criteria. For example, it is noted in Section O2.06 that management support its determination that a principle or attribute is not relevant through documentation as follows:

“If management decides a principle or attribute is not relevant, management supports that determination with documentation that includes the rationale of how, in the absence of that principle or attribute, the associated component could be designed, implemented, and operated effectively.”

If intended as required criteria, we suggest clarification in use of terminology “must” or “should” in the “Overview” as noted in our response to question 4.

9. *Is there a need for additional internal control implementation guidance? If so, what form should it take?*

We suggest updating the *Internal Control Management and Evaluation Tool* (GAO-01-1008G; issued August 2001) for consistency with changes to the Green Book Exposure Draft

10. *Is this Green Book written in such a way to allow state, local, and quasi-government entities, as well as not-for-profit organizations, to adapt it for its own use?*

If suggested clarification is adopted, the proposed Green Book would be useful criteria for nonfederal entities. However, the level of applicability is unclear as noted in our responses to the previous questions. That is, we noted contradicting statements in Section O4.10, page 18:

“The Green Book may be applied as a framework for internal control system for state, local, and quasi-governmental entities, as well as not-for-profit organizations. Management of these entities determines

based on applicable laws and regulations, the applicable requirements for their entities. If management elects to use the Green Book as criteria, management follows all applicable requirements presented in these standards.”

Furthermore, the “Forward” on page 1 provides that applicability of the Green Book may be left to the non-federal entity’s management as follows:

“The Green Book may also be applied by state, local, and quasi-governmental entities, as well as not-for-profit organizations, as a framework for an internal control system. Management of these entities determines, based on applicable laws and regulations, how to appropriately adapt the framework presented in the Green Book for an entity.”

Can management of other entities be required to follow all Green Book requirements if they elect to use the Green Book at all? We suggest providing more clarification on this.

GENERAL COMMENTS AND SUGGESTIONS FOR CONSIDERATION

- We suggest quantifying the attributes in the “Overview” similar to the 17 principles if the attributes are intended as required criteria. For example, the last sentence in Section O2.03 introduces the structure of internal control as “...*While there are different ways to present internal control, the Green Book approaches internal control through a hierarchical structure of five components, 17 principles, and relevant attributes*.” This implies that the not all attributes may be required. However, this is inconsistent with Sections O2.05 and O2.06 that the underlying attributes are “...*requirements necessary to achieve standards of internal control...*” and “*If management decides a principle or attribute is not relevant, management supports that determination with documentation that includes the rationale of how, in the absence of that principle or attribute, the associated component could be designed, implemented, and operated effectively.*”

When referring to the five components and 17 attributes, we suggest including “...*and the 48 relevant attributes.*”