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Ernst & Young LLP  
1101 New York Ave., NW  
[REDACTED]

Mr. James Dalkin  
Director, Financial Management Assurance  
U.S. Government Accountability Office  
[REDACTED]

14 February 2014

Reference: Standards for Internal Control in the Federal Government –  
2013 Exposure Draft

Dear Mr. Dalkin:

Ernst & Young LLP (EY) is pleased to submit comments on the United States Government Accountability Office's Exposure Draft, *Standards for Internal Control in the Federal Government* (Green Book), published for comment in September 2013. We support the United States Government Accountability Office's (GAO) efforts to update the 1999 Green Book for the changes in the business and operating environment since its development 15 years ago and to incorporate recent revisions to the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control – Integrated Framework* (the COSO Framework). Additionally, inclusion of the Green Book as applicable criteria for grantees to consider in the recent update to OMB Circular A-133 heightens the importance of GAO's work in updating and providing examples to help implement the Green Book.

We agree that the updates and enhancements should enable users to better develop, implement and monitor systems of internal control; however, we believe that additional considerations be made to allow for consistent adoption, including (1) clarifying certain terminology; (2) elaborating on how factors potentially within control of management can also impact the ability to achieve all of an organization's objectives and the role of trade-offs, risk tolerance and cost benefit considerations in the design and implementation of internal control; (3) further developing certain concepts related to smaller entities and the cost/benefit, documentation sufficiency and risk tolerance considerations in application of the guidance that merit development beyond the existing references when such smaller entities are considered; (4) requiring additional documentation regarding the concepts of materiality and precision used by management in applying review and other controls; (5) providing examples, tools and checklists to make the COSO Framework more easily adaptable; and (6) providing further discussions to better clarify to the user what constitutes "application material." Our response comprises two sections: (1) Comments and Questions Regarding Specific Paragraphs Within the Exposure Draft and (2) Answers to the Questions for Commenters.



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James Dalkin  
U.S. Govt. Accountability Office

Thank you again for the hard work put forward by your Committee. Please feel free to contact me at [REDACTED] or by email at [REDACTED] if you should have any questions regarding this response.

Sincerely,

A handwritten signature in black ink, appearing to read 'Dan Murrin', with a long horizontal flourish extending to the right.

Daniel Murrin  
Partner

## **Comments and Questions Regarding Specific Paragraphs Within the Exposure Draft**

### **How to Use the Green Book**

**Page 3:** Users of the Green Book may not be familiar with the application of the “must” and “should” terminology that has been emphasized in audit guidance, including *Government Auditing Standards*. Further elaboration here would be helpful.

### **Section 1 – Fundamental Concepts of Internal Control**

**An Internal Control System – Subsection 01.07 – Page 5:** The 2013 COSO Framework essentially bifurcates the exceptions for “reasonable assurance” between the (1) operational objectives and (2) the reporting/compliance objectives. It presumes that achievement of reporting/compliance objectives are always within the control of management, while certain operational objectives may not be met. A similar model appears to be an appropriate consideration in the government environment and can provide useful context for this section.

Additionally, please elaborate on how factors potentially within control of management can also impact the ability to achieve all of an organization’s objectives and the role of trade-offs, risk tolerance and cost benefit considerations in the design and implementation of internal control. This passage appears to emphasize the role of external events in control failures, but such factors may not be the predominant components of an inability to provide absolute assurance that all of an organization’s objectives will be met. Human error, competency and the degree of difficulty of a particular task, among other items, may well loom larger than such external factors in impacting the ability of an organization to achieve its objectives. Such failures may not be appropriately assessed as a result of ineffective internal controls, at least within the context of reasonable cost benefit and risk tolerance determinations.

### **Section 2 – Establishing an Effective Internal Control System**

**Components, Principles, and Attributes – Subsection 02.07 – Page 7:** Please expand on the “application material” discussion, which may include either referencing specific appendix material or sections within the Green Book, to better clarify to the user what constitutes “application material.”

**Internal Control and the Entity – Subsection 02.13 – Page 9:** Further discussion of the range of potentially acceptable judgments regarding risk tolerance would provide helpful context.

**Role in an Internal Control System – Subsection 02.15 – Page 10:** Please discuss the role of internal review; quality assurance groups; and, within the context largely of non-federal entities, internal auditors.

### **Objectives of an Entity**

- **Subsections 0-2.17 through 0.2.20 – Pages 10 and 11:** Given the importance of this aspect, it may be useful to explore whether these goals “must” be documented.
- **Subsection 02.21 – Page 11:** In the third bullet, “monitoring” is an appropriate consideration as well.

- **Subsection 02.25 – Page 12:** Challenge whether a “must” statement (defining sub-objectives in specific and measurable terms) is appropriate within an overarching context of something management “can” do – filtering sub-objectives.

### **Section 3 – Evaluation of an Effective Internal Control System**

**Requirements for Effective Internal Control – Subsection 03.01 – Page 13:** Use of “relevant” here is critical in potentially filtering the need to assess and document potentially hundreds of elements of attributes that comprise the 17 principles of the 5 components. Additional discussion regarding how to make relevance judgments, context, the role of cost/benefit considerations, and risk tolerance and other considerations is appropriate. To the extent the degree of relevance is variable based on the size of an entity, and the significance of a particular activity to the entity as a whole, such factors will inform critical judgments made in designing, implementing, operating, documenting and assessing internal control.

#### **Evaluation of Deficiencies in Internal Control**

- **Subsection 03.09 – Page 15:** Implementation guidance that highlights what “must,” “should,” or “can/may” be done in meeting the spirit of this key section of the guidance will be important in calibrating the work needed to meet the objectives of the Green Book. Further context embedded within the Green Book, as noted throughout our comments, would be useful. In the same vein, further elaboration on “relevant” and how management can determine whether the components are operating together would also be useful.
- **Subsection 03.11 – Page 15:** The 2013 COSO Framework provides some additional perspective regarding components and principles functioning and working together (pages 19–21 of the framework). It can be summarized that two situations must exist: (1) all principles are present and functioning and (2) internal control deficiencies aggregated across all components do not result in the determination that one or more material weaknesses exist. Further discussions related to the second element would be useful.

### **Section 4 – Additional Considerations**

**Documentation – Subsection 04.08 – Page 17:** Additional documentation requirements should be considered regarding the precision used by management in applying review and other controls (subsections 06.12–06.13). Similarly, the basis for conclusions that relevant data is reliable merits additional attention and documentation of the ongoing basis for assessing reliability of such information, which can be critical underlying information in application of review and other detect controls and is critical documentation (subsection 13.07).

#### **Principle 3 – Establish Structure, Responsibility, and Authority**

**Document Internal Control System – Subsection 3.12 – Page 28:** Further elaboration on maintaining documentation of an internal control system is needed. The text is very broad. Questions may arise (1) whether the entity needs to either maintain documentation specific for this purpose or can rely on existing books and records or (2) whether the documentation solely relates to design or operating effectiveness. The 2013 COSO Framework differentiates between what level of documentation is needed to support an effective system of internal control and what may be needed to support an assessment of an internal control system.

### **Principle 5 – Enforce Accountability**

**Consider Excessive Pressures – Subsection 5.09 – Page 33:** Resource allocation decisions are some of the most complex tasks executed by management. It may be more appropriate to frame this aspect of Principle 5 with a more dispassionate discussion of the role of resource allocation in fulfilling management’s objectives and potential importance of having an adaptive organization that can weigh the benefits of shifting resources to meet an organization’s needs. A root cause of an internal control deficiency may ultimately lie in a resource allocation decision that in hindsight was suboptimal. However, other aspects can lead to not meeting management’s objectives. Emphasis on only one such factor potentially within management’s control, to varying extents, can overstate the role that aspect can play within the myriad reasons organizations ultimately are not fully successful in meeting their objectives. Acknowledging other risk factors may be useful context and avoid a binary conclusion that either a resource allocation error was made or a specific instance must lead to an enforcement of accountability where no culpability may exist.

### **Principle 6 – Define Objectives and Risk Tolerances**

**Define Risk Tolerances – Subsection 6.12 – Page 37:** As noted earlier, additional documentation requirements should be considered regarding the precision used by management in applying review and other controls (see also Principle 10, subsection 10.06, particularly with respect to application of detect controls, and Principle 16 regarding ongoing monitoring activities). To the extent that risk tolerance and precision decisions are made in connection with the application of controls, for example, documentation of the basis for determining items that will merit further follow-up procedures based on quantitative and qualitative criteria can provide important context in understanding internal control.

### **Principle 8 – Assess Fraud Risk**

**Consider Types of Fraud – Subsection 8.04 – Page 41:** Layering the requirements related to execution of contractual and grant agreement terms to the Green Book guidance may require a number of changes to help apply the guidance for the grantee community. One area where further tailoring may be useful is the concept of noncompliance with contract and grant terms as one aspect of the discussion related to types of fraud.

### **Principle 13 – Use Quality Information**

**Process Data Into Quality Information – Subsection 13.09 – Page 62:** This section is critical in that the quality of information provides the underpinnings for the application of a variety of other control activities. Documentation of the processes used to make critical judgments regarding the quality of data and the effectiveness of controls, including ITGCs and application controls that led to such conclusions, should be added. Similarly, the precision and risk tolerance judgments applied here permeate other control activities and merit documentation and periodic reassessment.

## **Answers to the Questions for Commenters**

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

We believe that the hierarchy of components, principles and attributes are explained; however, as the Green Book applies by statute to the federal government and now, by regulation, to grantees, it is important to consider the broad context for applying the requirements. Additional consideration should be given to provide more examples to make the framework adaptable beyond the federal government to state and local governments as well as not-for-profit, hospital or higher education entities given the recent developments in the Uniform Grant Guidance. This broader application also suggests that the title for the Green Book be revisited or a subtitle added to make its potential applicability to a broader audience more clear. Finally, definitions related to internal control should be updated to ensure consistency with existing definitions.

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

Unique internal control concepts for the government environment appear to have been addressed within the Green Book draft. However, we do believe that additional context regarding certain concepts should be addressed related to smaller entities and that cost/benefit, documentation sufficiency and risk tolerance considerations in application of the guidance may merit development beyond the existing references when such smaller entities are considered. While these concepts are briefly addressed in O4.05–4.06, they loom large as considerations as the range of entities likely to apply the framework move beyond the largest federal agencies under, for example, the recent Uniform Grant Guidance.

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

We believe that additional clarity can be added by better aligning the Green Book to the COSO Framework. The pyramid that is developed as the Green Book moves from the 5 components to be built upon 17 principles, myriad attributes and each attribute's related elements may lead to an overwhelming level of detail. The treatments of attributes and other subsets of the system of internal control below the 5 components does vary from the COSO approach – with language that could be interpreted as requiring point-by-point assessments of attributes and elements, with documentation if an item is viewed as not significant for purposes of evaluation. This may be problematic. The COSO emphasis on achieving 17 principles transitions in the Green Book to attribute level and potentially to assessments if internal control has been effectively designed and implemented and is operating at an element level for each attribute.

Additionally, although paragraph O2.06 suggests that relevance can be a filter at the components, principles and attributes level, it is not clear how relevance determinations are to be made at the attributes level for "elements" or if the same context exists. It is also not clear how cost benefit considerations inform relevance determinations. Further, the Green Book

also contains what can be helpful documentation requirements for management which can merit expansion and elaboration. In such areas as electronic audit evidence and the role of IT dependent controls and related ITGC and application controls underlying management's use of computer generated information, and precision in the application of review controls for example, there have been instances in which it has been problematic in getting client documentation from management to have "gone first" in gathering documentation for their controls. It would be helpful if the program managers had checklists, further guidance and examples to support the implementation of the Green Book and context for the documentation requirements. Finally, as discussed above, we believe that additional consideration should be given to provide more examples to make this adaptable beyond the federal government to state/local governments, not-for-profit entities, hospitals or higher education entity given the recent developments in the Grant Uniform Guidance to cite the Green Book and COSO as best practice documents regarding statutorily required internal controls over compliance for grant awards and execution. Further elaboration on how the Green Book may be applied within the context of developing, self-assessing and ultimately having internal controls over compliance audited would be useful for the community, perhaps leveraging some of the materials currently available in the Compliance Supplement issued by the Office of Management and Budget.

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

The draft Green Book does provide adequate criteria for auditors; however, the Green Book could touch more directly on internal control over compliance for grants, the requirements referenced in by OMB A-133. Internal control over compliance is not the same as internal control over financial reporting, so it is not necessarily intuitive for preparers or auditors familiar with internal control over financial reporting to transition to concepts related to internal control over compliance. More illustrations might be helpful. To the extent the criteria were originally developed within the context of some of the world's largest entities, some thought might also well be applied to helping operationalize a subset of the criteria for smaller entities, including at the margin the smallest grantees, which will still have these criteria cited in assessing their compliance with the requirements of OMB Circular A 133, notwithstanding that they may not be subject to an annual audit if they are below the applicable threshold.

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

Although the requirements for management to design, implement and operate an internal control system, at a high-level, are generally understood by management, we believe further clarification and additional tools are needed to provide a clear and adequate understanding. As discussed above, the adoption of the Green Book applies by statute to the federal government and now, by regulation, to grantees. It is important to consider the broad context for applying the requirements, particularly to entities much smaller when compared to a federal agency, and that cost/benefit considerations in applying the guidance may merit development.

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

Yes. We believe the evaluation of deficiencies discussion is clear, understandable and adequate.

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

Although we believe that description of roles, divisions and overlaps of responsibility are clear, adequate and understandable, we believe that additional discussions about the role of internal audit in an organization's internal control, including external government audit organizations, would be helpful. The draft primarily talks about the inspector general community in a federal context and stresses that this function is not part of internal control. The use of internal audit units at the state and local levels, where it is more common, should be addressed further. Similarly, the roles of internal audit for not-for-profits and other entities with such constructs merit elaboration.

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

We believe that documentation requirements require further clarification. To the extent documentation regarding the concepts of materiality and precision can be fleshed out by management in assessing control operating effectiveness, it may be useful to address concerns that have evolved under the COSO Framework as preparers/auditors address implementation issues. These may be touched on in 6.13, but additional clarity would be helpful.

Similarly, internal control and ITGCs over the quality of information used in other control activities have been a weak point, and more documentation of using electronic evidence (reports used in high-level reviews, for example) could further be addressed to ensure that internal control and ITGCs contain data suitable for the intended purpose and are reliable in executing other controls. Further documentation regarding the precision with which controls are intended to operate can also be a useful addition to the literature. It would also provide a level of consistency among program managers in developing and documenting their key judgments.

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

As noted above, although the Green Book provides the framework, we strongly suggest providing additional tools, examples and checklists to support the consistent adoption by users of the green book at all levels, including federal, state, local and not-for-profit. While the exposure draft references other application material, and such material may ultimately be responsive to the needs of the user community, it is difficult to assess the underlying intent of the Green Book without simultaneous access to the materials, which may hold the key in elaborating on how a particular passage in the Green Book is intended to be interpreted. We

applaud the GAO's efforts to develop such application material but also note that review of such material, when available, may lead to additional input regarding the content of the Green Book, not just the related application guidance.

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

As discussed above, we believe that additional consideration should be given to provide more examples to make this adaptable beyond the federal government to other governmental, not-for-profit, hospital or higher education entities given the recent developments in the Uniform Grant Guidance. Somewhat more fulsome changes, beyond the short paragraph included at O4.10, may be needed to facilitate application of the guidance to these entities.