

Office of INSPECTOR GENERAL

Audit Report

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

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February 12, 1990

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 Federal 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 system of internal controls. The objectives of this review were to: (1) determine the status of U.S. International Trade Commission's compliance with the Act and applicable guidelines for the year ended September 30, 1989; (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, 1989. During this review, nothing came to my attention that would indicate that the Commission did not substantially comply with the above-mentioned guidelines.

In a memorandum to the Chairman dated December 12, 1989, the Commission's Internal Control Officer reported that there were no material internal control weaknesses to report for the Commission. Based on the applicable criteria and my reviews and observations of Commission operations, I concur with this conclusion.

As discussed in the body of the report, I did find that several changes need to be made for full compliance with the guidelines. These are:

The Commission's Directive 1601.1 needs to be updated to include provisions for coordination on internal control matters and enforcement procedures (page 5);

A clear statement on responsibility for internal controls was not included in the performance agreements for all responsible officials (pages 5 and 6);

The preparation of internal control reviews could be improved by providing training (pages 6 and 7); and

The followup system contains some items that need to be deleted or rephrased (page 8).

On page 9 of the report, I recommend that the Director, Office of Administration:

1. Revise USITC Directive 1601.1 to:

include provisions for coordination on internal control and enforcement procedures;

clarify the requirement that performance plans for all responsible officials must have a clear statement of responsibility for internal controls; and

establish as a responsibility of the Internal Control Officer the requirement to provide training as needed to responsible officials.

2. Review items in the followup system for appropriateness and delete or rephrase items as necessary.

The Director, Office of Administration agreed with the recommendations. His comments are discussed in more detail on page 9 and presented in entirety as an Appendix to this report.

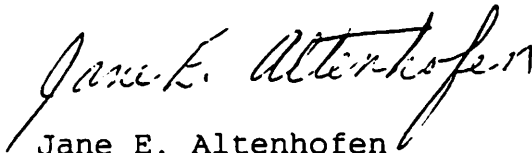

Jane E. Altenhofen
Inspector General

TABLE OF CONTENTS

	Page
INTRODUCTION AND SCOPE	1
BACKGROUND	2
FINDINGS AND RECOMMENDATIONS	3
NO MATERIAL INTERNAL CONTROL WEAKNESSES.	3
PROCESS IMPROVEMENTS	4
Provide for Coordination	5
Enforcement Procedures	5
Performance Agreements	5
Internal Control Reviews	6
Followup System	8
Recommendations	9
Commission Comments	9
Attachment - Guidance on Determining Material Weaknesses	
Appendix - Response to Draft Report from the Director, Office of Administration	

INTRODUCTION AND SCOPE

This review was scheduled to fulfill the function of the Office of Inspector General (OIG) to report annually to the Chairman on the adequacy of the Commission's system 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, 1989; (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 by the Commission on prior deficiencies.

The review was conducted intermittently from August through December 1989. I evaluated the Commission's efforts to comply with the requirements of the FMFIA and guidance issued by the Office of Management and Budget (OMB) and the Comptroller General for the reporting period ended September 30, 1989. The review focused on the internal control reviews conducted in fiscal year (FY) 1989 for four assessable units: TSUS/Harmonized Tariff Schedule (HTS), Building Maintenance and Security, Dockets, and Records Management. The internal control review for the Equal Employment Opportunity program was reviewed for content, but the responsible official was unavailable for comment due to being absent on extended leave.

The Trade Remedy Assistance Office was originally scheduled for an internal control review. However, since the office was established less than a year ago, the review was postponed for six months.

I worked closely with the Office of Administration in reviewing the FY 1989 annual call for assurance. Several recommendations for improvements were adopted at that time and are not addressed in this report.

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 Federal 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.

To comply with the FMFIA and the Comptroller General standards, the OMB issued Circulars A-123 (Internal Control Systems) and A-127 (Financial Management Systems). Circular A-123, 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. The Circular is supplemented by detailed Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government issued in December 1982, and a Questions and Answers Booklet published in August of 1984. Circular A-127, issued on December 19, 1984, defines policies and procedures executive agencies must adhere to in developing, operating, evaluating, and reporting on financial management systems.

The Director, Office of Administration is the Commission's Internal Control Officer. He is responsible for:

- Developing overall policies and procedures for the internal control system;
- Monitoring the system to assure its proper functioning;
- Serving as the Commission's liaison with the OMB;
- Providing guidance and assistance to office heads and their subordinate supervisors in performing risk assessments and internal control reviews;
- Issuing a five year Management Control Plan; and,
- Preparing a comprehensive annual report and letter of assurance to the Chairman.

USITC Directive 1601.1, issued on December 9, 1983 and revised as of December 12, 1988, establishes the Commission's Guidelines for Conduct of Risk Assessments and Internal Control Reviews. The Guidelines voluntarily incorporate the OMB Circulars that provide guidance. Related guidelines are also set forth in USITC Directive 2102, dated June 22, 1989, on Financial Management System Policies.

FINDINGS AND RECOMMENDATIONS

The FMFIA requires that each Executive agency's internal accounting and administrative controls be established in accordance with standards prescribed by the Comptroller General, and provide reasonable assurance that:

- Obligations and costs are in compliance with applicable law;
- Funds, property, and other assets are safeguarded; and
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for.

The Commission's Internal Control Officer has determined that the system of internal accounting and administrative control of the Commission in effect during the year ended September 30, 1989, taken as a whole, and within established limits, complies with the requirement to provide reasonable assurance that the above-mentioned objectives were achieved. Furthermore, there are no material internal control weaknesses to report for the Commission. Based on the criteria established by the OMB and my reviews and observations of Commission operations, I concur with these conclusions.

During this review, nothing came to my attention that would indicate that the Commission did not substantially comply with the applicable guidelines. As discussed below, I did find that several process improvements need to be made for full compliance with the guidelines.

NO MATERIAL INTERNAL CONTROL WEAKNESSES

According to OMB, agency letters to the President and the Congress should report the most critical weaknesses and non-conformances. Guidance provided by OMB on what constitutes a material weakness is presented in the Attachment.

The Commission's Internal Control Officer determined there were no material internal control weaknesses to report for the FY ended September 30, 1989. Based on the criteria established by the OMB and my reviews and observations of Commission operations, as discussed below, I concur with this conclusion.

1. My review of the Commission's internal control review process found substantial compliance with OMB guidelines on the process.

2. Arthur Andersen & Co. conducted a review of the Commission's FY 1987 and 1988 financial statements which included evaluations of compliance and internal controls. In January 1989, Arthur Andersen issued a clean opinion on the financial statements and statements on compliance and internal controls. The management letter issued in June 1989 had only two observations that were not material.
3. I have completed or initiated several reviews on Commission operations and have had numerous opportunities to observe various aspects of Commission operations. No internal control weaknesses meeting the OMB guidance on materiality came to my attention while conducting the reviews or during other contacts.

PROCESS IMPROVEMENTS

As stated in OMB Circular A-123, which has been adopted as guidance by the Commission, agencies are required to meet the following requirements in a cost-effective manner:

- a. Maintain a current internal control directive assigning management responsibility for internal controls in accordance with this circular and the Internal Control Guidelines with the following provisions.
- b. Develop a Management Control Plan or plans to be updated annually.
- c. Make risk assessments to identify potential risks in agency operations which require corrective action or further investigation through internal control evaluations or other actions.
- d. Make internal control evaluations using the procedures in the Internal Control Guidelines or alternative reviews to determine whether the internal control system is effective and is operating in compliance with the Integrity Act and this circular.
- e. Implement corrective actions identified by agency internal control evaluation efforts on a timely basis.

The Commission has substantially complied with these requirements, but a few changes are needed for full compliance.

Provide for Coordination

Paragraph 8a of the Circular states that a current internal control directive should provide for coordination on internal control matters among the designated internal control official, heads of agency components, program managers and staffs, and the OIG or its equivalent.

USITC Directive 1601.1 was revised as of December 12, 1988, but at least two changes have occurred since then that need to be incorporated.

1. Some responsibilities assigned to the Director, Finance and Budget have been transferred to the Special Assistant to the Director, Office of Administration.
2. The OIG was established. The Inspector General would be happy to provide a description of the OIG's role in the internal control process.

The Circular also states that the Internal Control Officer is responsible for "coordinating the agency-wide effort" and "evaluating compliance." The responsibilities set forth in the Directive include, among others, that the Director, Office of Administration is to develop overall policies and procedures and monitor the system. These may fulfill the intent of the regulation, but it would be clearer to use the same wording.

Enforcement Procedures

Paragraph 8a of the Circular states that agencies should establish administrative procedures to enforce the intended functioning of internal controls. The OMB Questions and Answers book (questions 16 and 38 specifically) states that the requirement for administrative procedures to enforce the intended functioning of internal controls means the agency should have procedures that constitute a Quality Control Review.

The Office of Administration purportedly does such a review, but this is not set forth as a responsibility or procedure in the Directive. The enforcement procedures done by the Office of Administration should be established taking into consideration the suggestions in the OMB Questions and Answers book and set forth in the Directive.

Performance Agreements

Paragraph 8a of the Circular requires performance agreements, for each Senior Executive Service and Merit Pay or equivalent employee with significant responsibility for internal controls,

which result in recognition for positive internal control accomplishments such as timely correction of internal control weaknesses and appropriate action for violations of internal controls.

Subparagraph 4c(3) of USITC Directive 1601.1 addresses the requirement concerning performance agreements. However, the Directive is not clear on whether it applies to all responsible officials. The Directive appears to cover Office Directors that report to an Office Director (e.g., the Offices of Administration and Operations). However, a similar provision is not provided for the responsible officials that report directly to the Chairman.

I reviewed the performance plans ending in FY 1989 for responsible officials to determine whether they included provisions that result in recognition for positive internal control accomplishments and appropriate action for violations of internal controls.

For the seven SES members, I found that a provision on internal controls was included in the work plans that were part of the employees' performance plans. The provisions in the work plans were generally more specific than the performance elements in the performance plans, and did not have specific standards set forth. The Director of Personnel stated that the work plan provisions are related to the performance elements and standards in the performance plans, but I did not find the relationship very clear.

At the GM level, staff in the Office of Administration had provisions on internal controls in their work plans for the year ending August 15, 1989. The comments made above apply to them.

Performance plans for four GM employees designated as responsible officials did not have an element on internal controls. As responsible officials, these employees should have a provision on internal controls in their performance plans.

The OMB requirement concerning internal control provisions in performance agreements could be accomplished in several ways. A separate element (either critical or required) could be established in the performance plans or the elements in the performance plan could include phraseology on internal controls. Another alternative would be to establish a direct relationship between the work plans and performance plans.

Internal Control Reviews

An internal control review is a detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner. As stated in OMB Circular A-123, these reviews should identify

internal controls that need to be strengthened or streamlined. The composite of all information that management relies upon to judge their system's effectiveness must include information on the results of tests of their operating internal control systems.

Six recommended steps for an internal control review are:

- Identification of the event cycles.
- Analyses of the general control environment.
- Documentation of the event cycle.
- Evaluation of the internal controls within the event cycle.
- Testing of the internal controls.
- Reporting the results.

USITC Directive 1601.1 provides fairly detailed guidance on conducting an internal control review that is consistent with the OMB Guidelines. However, the method in which the reviews were conducted and documented varied greatly within the Commission.

Five internal control reviews were conducted in FY 1989. For the most part the responsible officials adequately identified the cycles, controls and testing. However, there were some areas that could have been improved as discussed below.

- Three cycles were identified in the TSUS/HTS assessable unit. Only one internal control objective and corresponding technique was listed. The responsible official stated that there were too many controls to list and the one objective was all encompassing. While I believe that the reviews need not be lengthy, I think identifying four or five objectives per cycle is not unreasonable.
- Circular A-123 and the implementing guidelines emphasized that all internal control techniques must be tested and documentation on the testing must be maintained by the responsible official. The USITC Directive 1601.1 reiterates this requirement and provides a form. 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. Only one of the five reviews included the required form.
- Each assessable unit is made of event cycles. In two cycles, the routine work of the unit was not addressed. The cycles should encompass most of the activities and functions performed by the unit.

A recent report by the General Accounting Office found that more and better training is needed in Financial Integrity Act issues. They cited one or more of the following as needing improvement.

- Defining the purpose and objective of internal control evaluations.
- Identifying the methodology to be used in evaluating internal controls of ADP systems.
- Identifying the procedures required to perform evaluations.
- Explaining how to analyze and evaluate the results.
- Identifying the documentation needed to support the evaluations.

I think the internal control reviews indicate such training is needed in the Commission. Even though the Directive provides good and detailed guidance, the reviews are only done once every five years and responsible officials could benefit from a brief discussion of the process. A training session (1/2 day or less) to review the Directive could be provided to the responsible officials scheduled to conduct internal control reviews that year. The training could be done in-house or by a firm that specializes in conducting internal control reviews and offers individual office consultations.

Followup System

According to OMB Circular A-123, a formal followup system should be established that records and tracks recommendations and projected action dates, and monitors whether the changes are made as scheduled. The Commission has developed a followup system to track weaknesses. Responsible officials are asked to report quarterly on the status of planned corrective action.

My review of items included in the system indicates that closer review is needed in identifying items to be placed in the system. Items in the system that I believe are inappropriate include citing a lack of staff and/or resources which is neither a weakness nor a corrective action.

Other inappropriate items involve planned corrective actions that are an ongoing activity. The system should identify specific weaknesses and planned corrective actions that can be accomplished by a set date. For example, if the weakness was a lack of review, the corrective action would be to arrange for that review, e.g., via a memorandum or office procedure. The corrective action would not be to do the review which is a continuing action.

Recommendations

I recommend that the Director, Office of Administration:

1. Revise USITC Directive 1601.1 to:
 - a. Include provisions for coordination on internal control and enforcement procedures;
 - b. Clarify the requirement that performance plans for all responsible officials must have a clear statement of responsibility for internal controls. Responsible officials and their rating officials should be reminded of this provision; and
 - c. Establish as a responsibility of the Internal Control Officer the requirement to provide training as needed to responsible officials.
2. Review items in the followup system for appropriateness and delete or rephrase items as necessary.

Commission Comments

The Director, Office of Administration agreed with the above recommendations. He has agreed to issue a revised directive by June 30, 1990. He also intends to monitor more closely the items in the followup system and provide further guidance to the responsible officials during the next quarterly update (April 1990), at which time items will be deleted or rephrased as necessary.

GUIDANCE ON DETERMINING MATERIAL WEAKNESSES

For purposes of determining what constitutes a material weakness in internal control systems (Section 2), the criteria set forth in OMB Circular A-123 should be used. The criteria require reporting weaknesses that:

- 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.

Since the above factors are obviously judgmental and have been widely interpreted, the following additional factors should be used to determine whether weaknesses are to be reported to the President and the Congress. 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.

For determining whether non-conformances (Section 4) are material, the non-conformance 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 non-conformances in a subsidiary or program system that causes non-conformances 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.



UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, DC 20436

February 7, 1990

MEMORANDUM

TO: Inspector General

FROM: Director, Office of Administration

*Lynn L. Foodrich*SUBJECT: Draft Report, "Review of the USITC's Compliance with the
Federal Managers' Financial Integrity Act of 1982"

As requested by your memoranda dated December 15, 1989 (IG-M-079 and IG-M-080), submitted as an attachment to this memorandum is the Office of Administration's response to the subject draft audit report issued on December 15, 1989. In accordance with Section 11 of the USITC Directive 1701, the Commissioners have had an opportunity to comment on the response and the Chairman has approved it.

We are pleased that during the review nothing came to your attention that would indicate the Commission did not substantially comply with the guidelines provided by the Office of Management and Budget.

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

Attachment

cc: The Commission
Special Assistant to the Director, Office of
Administration

Office of Administration's response to the December 15, 1989,
Draft Audit Report "Review of the USITC's Compliance with the
Federal Managers' Financial Integrity Act of 1982"

Recommendation 1

Revise the Commission's Directive 1601.1, "Guidelines for the
Conduct of Risk Assessments and Internal Control Reviews to:

- a. Include provisions for coordination on internal control matters and enforcement procedures;
- b. Clarify the requirement that performance plans for all responsible officials must have a clear statement of responsibility for internal controls. Responsible officials and their rating officials should be reminded of this provision;
- c. Establish as a responsibility of the Internal Control Officer the requirement to provide training as needed to responsible officials.

Agree. A revised directive will be issued by June 30, 1990 which will include the following:

- a. Change the responsibilities assigned to the Director, Finance and Budget to the Special Assistant to the Director, Office of Administration;
- b. Include a description of the Inspector General's role in the internal control process;
- c. Clarify the Internal Control Official's responsibilities to coordinate the Commission-wide effort and monitor compliance;
- d. Expand the responsibilities of the Internal Control Official's to include enforcement procedures;

- e. Revise paragraph 4 c (3) to more accurately reflect the OMB requirement concerning performance plan results; to provide examples of how the requirement can be incorporated in individual performance and/or work plans. The relationship between the two plans can also be described.
- f. Establish as a responsibility of the Internal Control Officer the requirement to provide training as needed to the responsible officials.

Recommendation 2

Review items in the followup system for appropriateness and delete or rephrase items as necessary. The system should identify specific weaknesses and planned corrective actions that can be accomplished by a set date.

Agree. In addition to monitoring more closely the items in the followup system, we intend to provide further guidance to the responsible officials during our call for the next quarterly update.* Your suggestions on page 8 will be useful in providing guidance to the responsible officials.

- * (by March 5,1990.) At that time, items will be deleted or rephrased as necessary.

