



U.S. ENVIRONMENTAL PROTECTION AGENCY  
OFFICE OF INSPECTOR GENERAL

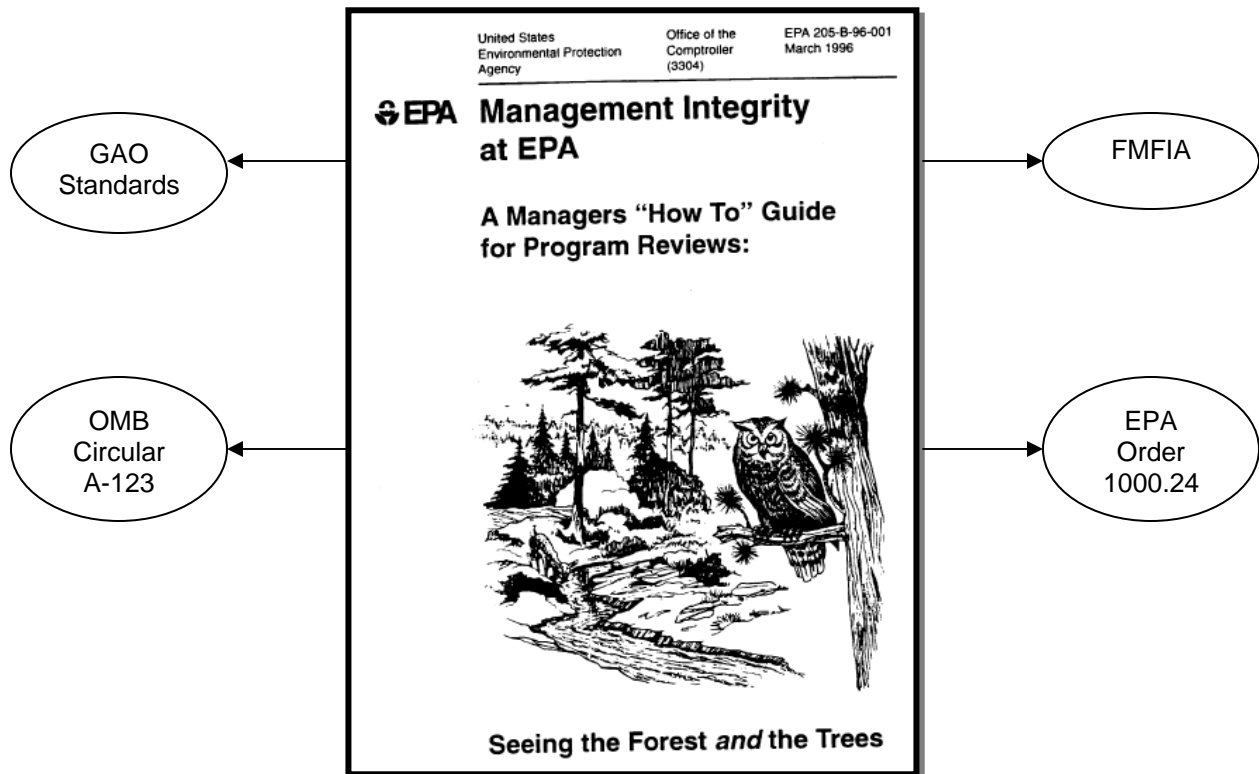
*Catalyst for Improving the Environment*

## Early Warning Report

# EPA Should Use FMFIA to Improve Programmatic Operations

Report No. 09-P-0203

August 6, 2009



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## Abbreviations

EPA	U.S. Environmental Protection Agency
FMFIA	Federal Managers' Financial Integrity Act
FY	Fiscal Year
GAO	Government Accountability Office
GPRA	Government Performance and Results Act
NPM	National Program Manager
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPPTS	Office of Prevention, Pesticides, and Toxic Substances
ORD	Office of Research and Development
OSWER	Office of Solid Waste and Emergency Response
PART	Program Assessment Rating Tool

**Cover photo:** Cover of EPA guidance document, *Management Integrity at EPA: A Manager's "How To" Guide for Program Reviews: Seeing the Forest **and** the Trees* (EPA-205-B-96-001, March 1996), and other management integrity guidance.



# At a Glance

*Catalyst for Improving the Environment*

## Why We Did This Review

We conducted this review to determine how the U.S. Environmental Protection Agency (EPA) develops annual guidance under the Federal Managers' Financial Integrity Act (FMFIA). We asked whether EPA offices integrate FMFIA internal control standards into programmatic operations. We also asked whether offices use Government Accountability Office (GAO) guidance to develop and monitor internal controls.

## Background

FMFIA requires federal agency managers to annually evaluate and indicate whether their agencies' internal controls comply with standards prescribed by GAO. FMFIA requirements purport to provide reasonable assurance that agencies maintain adequate internal control systems to prevent against fraud, waste, abuse, and mismanagement.

For further information, contact our Office of Congressional, Public Affairs and Management at (202) 566-2391.

To view the full report, click on the following link:  
[www.epa.gov/oig/reports/2009/20090806-09-P-0203.pdf](http://www.epa.gov/oig/reports/2009/20090806-09-P-0203.pdf)

## ***EPA Should Use FMFIA to Improve Programmatic Operations***

### **What We Found**

EPA has not implemented and used FMFIA to improve program operations, as intended by federal and Agency guidance. Although EPA offices rely on annual guidance that the Office of the Chief Financial Officer (OCFO) issues,

- EPA offices have not developed internal control review strategies that include elements such as the Government Performance and Results Act (GPRA);
- OCFO's guidance and training have not provided staff and managers with adequate awareness of GAO's internal control standards;
- OCFO's guidance, until recently, has not required offices to report on compliance with all GAO standards; and
- OCFO did not devote needed resources to validate assurance letters.

Per Agency guidance, OCFO is responsible for ensuring and implementing a strategy for validating EPA's compliance with FMFIA. However, OCFO relies on Assistant and Regional Administrators to verify letters' program elements before certifying them. EPA offices view FMFIA reporting as an administrative task, rather than an opportunity to assess program results and identify risks toward achieving goals. As a result, the Administrator has little assurance when signing EPA's letter that offices reviewed program operations. Additional emphasis on FMFIA's importance could result in more certain, documented assurance in the Agency's Performance and Accountability Report that EPA programs annually evaluate internal controls to comply with GAO's standards and deter fraud, waste, and mismanagement.

### **What We Recommend**

We recommended that EPA's Administrator support internal controls by announcing the Fiscal Year (FY) 2010 FMFIA process and requiring that senior managers attend training. We also recommended that the Chief Financial Officer develop comprehensive, tiered FMFIA training for managers and staff; revise the internal checklist used as part of the strategy for validating Agency-wide FMFIA compliance; codify its validation strategy; and develop FY 2010 FMFIA guidance that contains OCFO FY 2009 supplemental guidance. EPA initially agreed with all but one of our recommendations. The Agency agreed when we revised that recommendation's language to focus on OCFO's internal tool to validate letters.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

OFFICE OF  
INSPECTOR GENERAL

August 6, 2009

**MEMORANDUM**

**SUBJECT:** EPA Should Use FMFIA to Improve Programmatic Operations  
Report No. 09-P-0203

**FROM:** Melissa M. Heist *Melissa M. Heist*  
Assistant Inspector General for Audit

**TO:** Lisa P. Jackson  
Administrator  
Office of the Administrator

Maryann Froehlich  
Acting Chief Financial Officer  
Office of the Chief Financial Officer

The Office of Inspector General (OIG) of the U.S. Environmental Protection Agency (EPA) conducted this report on the subject audit. This report contains findings that describe problems we identified and corrective actions we recommend. This report represents our opinion and does not necessarily represent the final EPA position. EPA managers will make final determinations on matters in this report in accordance with established audit resolution procedures.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$212,476.

**Action Required**

In accordance with EPA Manual 2750, EPA's Audit Management Process, you are required to provide a written response to this report within 90 calendar days. You should include a corrective actions plan for agreed upon actions, including milestone dates. We have no objections to the further release of this report to the public. This report will be available at <http://www.epa.gov/oig>.

If you or your staff has any questions regarding this report, please contact me at (202) 566-0899 or [heist.melissa@epa.gov](mailto:heist.melissa@epa.gov), or Patrick Gilbride, Director for Audit, Risk and Program Performance Issues, at (303) 312-6969 or [gilbride.patrick@epa.gov](mailto:gilbride.patrick@epa.gov).

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## Purpose

We conducted this review to determine how EPA develops and uses annual guidance under the Federal Managers' Financial Integrity Act (FMFIA). We asked whether EPA offices fully integrate internal control standards under FMFIA into their programmatic operations. We also asked whether EPA offices use available Government Accountability Office (GAO) guidance to develop and monitor their internal controls. We found that several EPA offices had not demonstrated compliance with GAO's *Standards for Internal Control in the Federal Government* in Fiscal Year (FY) 2008 assurance letters. While EPA's FY 2009 FMFIA reporting ends in mid-August 2009, we wanted to communicate our observations and recommendations to influence the FY 2009 process and enhance how the Agency develops FY 2010 guidance.

## Background

### ***Federal Management Integrity Criteria***

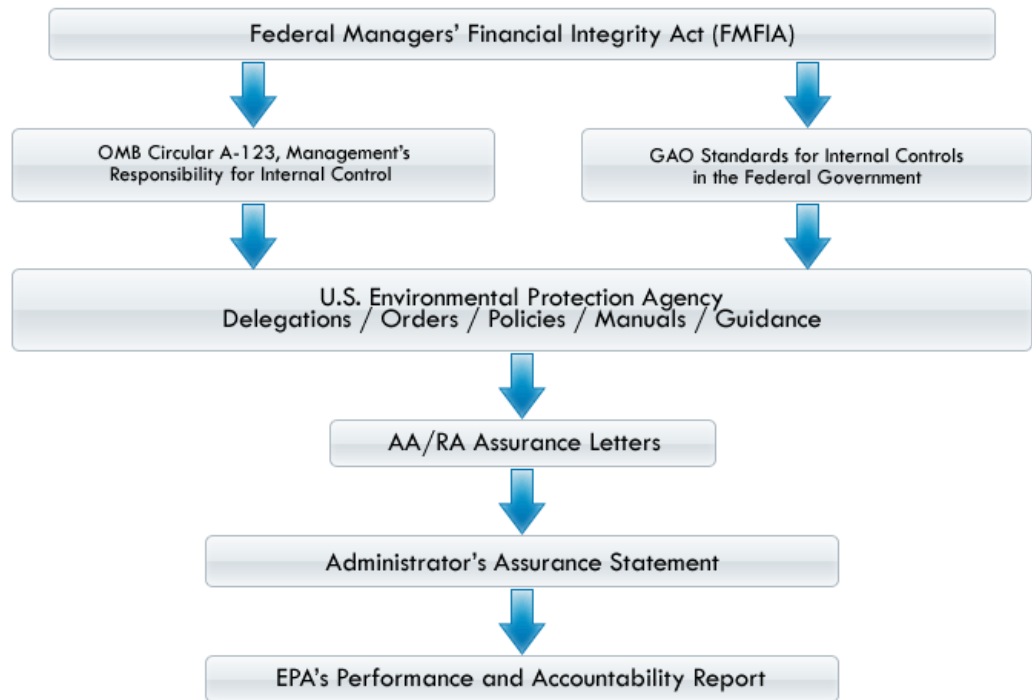
FMFIA requires federal agency managers to establish internal accounting and administrative controls in accordance with standards prescribed by the Comptroller General (hereafter referred to as "GAO's *Standards*"). FMFIA requires federal agency managers to annually evaluate and report on the effectiveness of internal controls and financial accounting systems in accordance with, respectively, Sections 2 and 4 of FMFIA. FMFIA also requires federal agency managers to annually evaluate, in accordance with Office of Management Budget (OMB) guidelines, whether their agencies' internal controls comply with GAO's *Standards* and issue a statement of assurance and indicate full compliance or non-compliance.

OMB Circular A-123, dated December 21, 2004, describes federal managers' responsibilities for internal control, stating that management is responsible for establishing and maintaining internal control to achieve the objectives of (1) effective and efficient operations, (2) reliable financial reporting, and (3) compliance with applicable laws and regulations. Appendix A of the Circular requires federal agencies to separately assess effectiveness of internal controls over financial reporting. The Circular also states that "Management shall consistently apply the internal control standards to meet each of the internal control objectives and to assess internal control effectiveness." OMB Circular A-123 provides guidance to federal managers on meeting requirements of FMFIA. The Circular states that "Internal control guarantees neither the success of agency programs, nor the absence of waste, fraud, and mismanagement, but is a means of managing the risk associated with Federal programs and operations." By including "programs and operations," OMB emphasized goals set by the organization, risks agencies face in meeting those goals, whether agencies have identified and assessed risks, and whether agencies have taken steps to manage those risks. The Circular requires federal managers to take systematic and

proactive measures to develop and implement appropriate internal controls for results-oriented management.

The Circular describes the requirements of FMFIA as “an umbrella under which other reviews, evaluations, and audits should be coordinated and considered to support management’s assertion about the effectiveness of internal control over operations, financial reporting, and compliance with laws and regulations.” “Other reviews” that FMFIA reporting should coordinate and consider include activities under the Government Performance and Results Act (GPRA), such as developing strategic plans, setting performance goals and measures, and reporting annually on actual performance results compared to goals. These efforts all support an overall internal control framework illustrated in Figure 1.1.

**Figure 1.1: EPA’s Internal Control Program – A Visual Overview**



Source: EPA training, *EPA Internal Control and Management Integrity: Make It Second Nature*, issued (via EPA’s Intranet) on May 28, 2008 (slide 11 of 21).

As required by FMFIA, GAO established the *Standards for Internal Control in the Federal Government* listed in OMB Circular A-123 (see Table 1.1 on the next page).

The *Standards* provide the overall framework for establishing and maintaining internal control, and for identifying and addressing performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement. The *Standards* compose a major part of managing an organization, including plans, methods, and procedures used to meet missions, goals, and objectives and, in doing so, support performance-based management.

**Table 1.1: GAO's Standards for Internal Control in the Federal Government**

1.	<b>Control Environment</b>	This standard establishes and maintains an environment throughout the organization that sets a positive and supporting attitude toward internal control and conscientious management. This includes establishing goals, objectives, and performance measures at the entity and activity level.
2.	<b>Risk Assessment</b>	Once the goals, objectives, and measures have been defined, the risks that could impede the efficient and effective achievement of those objectives are identified. This includes an assessment of the risks the agency faces from both internal and external sources. Risk assessment includes identifying and analyzing relevant risks associated with achieving objectives, such as those defined in strategic and annual performance plans developed under GPRA, and form a basis for determining how to manage risks. Management needs to comprehensively identify risks and should consider all significant interactions between the entity and other parties as well as internal factors at both the entity-wide and activity levels.
3.	<b>Control Activities</b>	These are the policies, procedures, techniques, and mechanisms that implement management's direction toward achievement of goals. Internal control activities help ensure that management's directives are carried out.
4.	<b>Information and Communications</b>	This standard includes data and information (performance and financial) to determine whether the organization is meeting its goals and objectives and maintaining accountability over resources.
5.	<b>Monitoring</b>	Internal control monitoring should assess the quality of performance over time and ensure that findings of audits and other reviews are promptly resolved.

Source: OIG summary of GAO's *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (November 1999).

### ***EPA Management Integrity Guidance and Policy***

EPA issued Order 1000.24, *Management's Responsibility for Internal Control*, as the Agency's strategy for implementing FMFIA. The Order specifies how EPA:

- Prescribes policies, procedures, and standards for internal controls at EPA.
- Outlines Agency senior managers' roles and responsibilities for developing, implementing, assessing, documenting, improving, and reporting on internal controls.
- Incorporates specific requirements for assessing internal controls over financial reporting.
- Provides tools to help managers monitor both overall program progress and the effectiveness of day-to-day operations (e.g., EPA *Management Integrity Principles*<sup>1</sup>).

<sup>1</sup> EPA first developed its *Management Integrity Principles* in 1996. The 10 *Principles* are (1) guidance, (2) accountability, (3) feedback, (4) competency, (5) quality data, (6) separation, (7) comparison, (8) identification,



EPA Order 1000.24 requires the Administrator to foster an environment that supports awareness and compliance with internal controls. EPA's Order also requires Assistant and Regional Administrators to develop systematic review strategies and advises them to use GAO's *Standards* as the basis for determining the effectiveness of internal controls. The Order also requires senior managers to annually evaluate whether their programs' internal controls effectively meet GAO's *Standards* and attest to the soundness of internal controls for their respective organizations. Per EPA's Order, senior managers annually issue assurance letters to the Administrator that report results of evaluations and their programs' compliance status with GAO's *Standards*. The Order requires that systematic review strategies are consistent and coordinate with Agency-wide processes used to develop and report on program performance measures and results, such as GPRA and reviews under OMB's Program Assessment Rating Tool (PART). For example, EPA's Office of the Chief Financial Officer (OCFO) annually issues National Program Manager (NPM) guidance to promote consistency, describe priorities and strategies, and report on performance commitments in order to strengthen planning and accountability processes and better align measures.

The Order further designates senior managers (e.g., Deputy Administrator, Assistant, and Regional Administrators) to implement internal control frameworks and assure continual progress to strengthen internal controls (reported annually in EPA's *Performance and Accountability Report*). The Order also requires senior managers to designate a Management Integrity Advisor who serves as the organization's staff contact responsible for disseminating pertinent information regarding the Agency's management integrity program. The Order outlines specific responsibilities for OCFO listed in Table 1.2 (on the next page).

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(9) review, and (10) correction. EPA advocates that managers incorporate the *Principles* into existing management processes, program strategies, and guidance to strengthen program operations.

**Table 1.2: OCFO Responsibilities per EPA Order 1000.24**

<b>Chief Financial Officer</b>
<ul style="list-style-type: none"> <li>• Develop and administer EPA's guidance to ensure compliance with FMFIA and OMB Circular A-123;</li> <li>• Ensure that the Agency implements FMFIA and OMB Circular A-123 at appropriate organizational levels; and</li> <li>• Provide annual management integrity/A-123 guidance to the Agency.</li> </ul>
<b>Office of Planning, Analysis, and Accountability</b>
<ul style="list-style-type: none"> <li>• Plan, develop, and implement national policies for ensuring EPA's compliance with FMFIA;</li> <li>• Develop and implement a strategy for validating Agency-wide compliance with FMFIA;</li> <li>• Develop the form and content of the Administrator's annual statement of assurance on management controls based on recommendations and annual assurance letters from senior managers/senior assessment team;</li> <li>• Maintain technical expertise in the field of internal controls;</li> <li>• Provide technical assistance to program managers and staff; and</li> <li>• Provide supplemental guidance and training materials as needed to support senior managers in interpreting and applying EPA Order 1000.24.</li> </ul>

Source: EPA Order 1000.24 "Management's Responsibility for Internal Control" (July 18, 2008).

OCFO issues annual guidance to program and regional offices on complying with FMFIA, and for FYs 2008 and 2009, OCFO's guidance included a reporting template with specific instructions for completing each section of assurance letters. For example, in FYs 2008 and 2009, OCFO's annual guidance included seven specific elements program and regional offices needed to address in assurance letters under the Control Environment standard.<sup>2</sup> OCFO's guidance also listed significant financial processes to review, such as accounts receivable, grants, procurement, accounts payable, and payroll, as well as core administrative areas (e.g. purchase card, property management, funds control). OCFO also attached the *Internal Control Evaluation Checklist*, an abbreviated version of GAO's full *Internal Control Management and Evaluation Tool* that Assistant and Regional Administrators could use to evaluate their internal controls. The FY 2009 guidance required offices to complete the *Checklist* and retain a copy as supporting documentation. The FY 2009 guidance also provided references to obtain full text of GAO's *Standards* and EPA's Order. Program and regional office assurance letters provide the basis for the Agency's annual assurance statement. The Agency's Performance and Accountability Reports due to the President and Congress each year describe progress made to strengthen internal controls.

<sup>2</sup> OCFO identified the following seven "control environment" elements for which offices needed to report in assurance letters: (1) integrity and ethical values, (2) commitment to competence, (3) management's philosophy and operating style, (4) organizational structure, (5) assignment of authority and responsibility, (6) human resource policies and practices, and (7) oversight groups. OCFO said it drew these elements from GAO's *Standards* and focused on them due to past questions from Agency offices on the control environment.

## Scope and Methodology

We conducted our review, in accordance with *Government Auditing Standards*, from January to May 2009.<sup>3</sup> *Government Auditing Standards* require that we plan and perform the review to provide a reasonable basis for our findings and conclusions, and we believe the evidence we obtained meets that standard based upon our review objectives. Our review findings only address EPA's implementation of Section 2 of FMFIA (internal control over programs), and not Section 4 (financial accounting systems) or Appendix A of OMB Circular A-123 (internal control over financial reporting). While evaluating how EPA's Office of Research and Development (ORD) implements FMFIA,<sup>4</sup> we identified issues related to OCFO's Agency-wide management integrity guidance. We reviewed OCFO's FY 2009 FMFIA guidance issued on December 22, 2008. Following OCFO's issuance of FY 2009 guidance, we participated in meetings that OCFO held on the Agency's FY 2009 FMFIA reporting process, and spoke with OCFO about enhancing its reporting template. We provided written comments to OCFO on January 30, 2009, suggesting that they revise the FY 2009 FMFIA guidance reporting template. We also reviewed FY 2008 assurance letters from three program<sup>5</sup> and four regional<sup>6</sup> offices, and interviewed the Management Integrity Advisors in each office on their awareness and understanding of internal controls and examples of internal control compliance in assurance letters. The size/resource budget of program and regional offices we reviewed include some of the largest dollar and full-time equivalent components of the Agency, and OCFO recommended three of the seven offices as examples of good FMFIA processes/assurance letters.<sup>7</sup>

Recently, the Office of Inspector General (OIG) issued a memorandum recommending ways to strengthen management integrity processes affecting specific activities under the American Recovery and Reinvestment Act of 2009,<sup>8</sup> whereas this report addresses EPA's FMFIA reporting process generally. We issue this early warning report to bring to the Agency's attention findings that could impact FMFIA reporting by EPA offices in FY 2009 (reports due to the Administrator by August 14, 2009) and to influence development of FY 2010 guidance.

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<sup>3</sup> Related facts and observations arose during our current review of ORD's FMFIA implementation.

<sup>4</sup> We anticipate issuing our final report on ORD's FMFIA implementation in the fall of 2009.

<sup>5</sup> We reviewed fiscal 2008 FMFIA assurance letters from EPA's ORD, Office of Solid Waste and Emergency Response (OSWER), and Office of Prevention, Pesticides, and Toxic Substances (OPPTS).

<sup>6</sup> We reviewed fiscal 2008 FMFIA assurance letters from EPA Regions 1, 2, 5, and 9.

<sup>7</sup> OCFO recommended that we review assurance letters from OSWER, OPPTS, and Region 5.

<sup>8</sup> US EPA OIG Special Report, *Recommendation to Strengthen Management Integrity Processes Affecting Recovery Act Activities*, Report No. 09-X-0145, April 27, 2009.

## Findings

### ***EPA Offices Have Not Developed Systematic Internal Control Review Strategies***

Based on our review of FY 2008 assurance letters, all seven EPA offices we examined had not developed strategies that systematically and annually assess the effectiveness and compliance of their programmatic internal controls with GAO's *Standards*. Our review found that strategies did not address whether offices established and evaluated internal controls over their programs in accordance with GAO's *Standards*. In addition, strategies did not address implementation of other statutory requirements such as GPRA or annual performance plans and performance measures associated with NPM Guidance. For example, 2008 NPM Guidance for OSWER identified six priority areas under its remedial program; however neither the OSWER nor regional assurance letters we reviewed addressed these priority areas or measures. Similarly, NPM Guidance for EPA's clean air program identified priority areas specifically for the Agency's regional offices, such as reducing diesel emissions; however, no regional letter we reviewed mentioned risks or accomplishments related to that goal. We found that strategies did not use GAO's *Standards* and did not consider program performance information such as GPRA measures. Further, most Advisors described FMFIA as primarily addressing administrative and financial elements (as opposed to program performance), and all Advisors acknowledged that their offices had not conducted risk or vulnerability assessments to identify needed controls. OCFO recently issued a document to explain roles and responsibilities between Advisors and lead region program staff. OCFO believes its document will allow regions an opportunity to provide a consolidated regional perspective to the appropriate NPM on current weaknesses or other emerging issues.

EPA Order 1000.24 requires that Assistant and Regional Administrators develop and implement strategies to show how they will evaluate their internal controls and the information they will use to report how they comply with FMFIA in their annual assurance letters. The Order states that program managers have flexibility in designing review strategies and directs them to use all credible sources of information to assess effectiveness of internal controls. Information sources specified by the Order include OIG and GAO audits, program evaluations, PART or other similar reviews, and knowledge gained from daily operations. The Order also notes that, in addition to FMFIA, managers should consider "other statutory requirements" (such as GPRA) as part of the Agency's system of internal controls, and that "processes, plans, policies, procedures, and performance measures help organizations achieve results." The Order further states that Assistant and Regional Administrators should conduct their own reviews to ensure they have the information necessary to make their evaluations (including a plan to validate whether they achieved desired results). Further, OCFO's FY 2008 FMFIA guidance required that Assistant and Regional Administrators provide a detailed description of their review strategies for assessing how well

internal controls over their programs perform, may be improved, and the degree to which they identify and address significant vulnerabilities. Results of these systematic review strategies provide the basis for annual assurance letters upon which the Administrator relies to assess the Agency's overall compliance with FMFIA.

### ***Agency Staff and Managers Need Additional Internal Control Training***

Advisors we interviewed had a range of training experience on FMFIA requirements. The majority of Advisors (four of seven) we interviewed believed they could benefit from additional training, especially on internal control standards and programmatic reviews.<sup>9</sup> One senior manager suggested that OCFO consider tiered training for senior managers and Advisors that emphasizes, respectively, requirements per EPA Order 1000.24 and "nuts and bolts" of implementing and reporting (such as required administrative reviews, reporting elements, and milestone dates). Advisors suggested other elements, including training on:

- Conducting internal control reviews for program staff (not just financial staff), and
- Making OCFO's checklist useful for senior managers, perhaps by including specific programmatic examples.

EPA Order 1000.24 requires OCFO's Office of Planning, Analysis, and Accountability to provide technical assistance and training to support program managers and staff. In FY 2008, OCFO offered a discretionary online training course, moderated by the Deputy Administrator, to briefly introduce internal control responsibilities. In 2008, in collaboration with OIG staff, OCFO offered staff-level training for Management Integrity Advisors that outlined basic steps for conducting a program review and provided tools and examples of how to document results of reviews. In response to requests for technical assistance, OCFO staff conducted individual management integrity briefings for senior managers in two offices.<sup>10</sup> Additionally, OCFO holds one to two "kick-off" meetings or teleconferences with Management Integrity Advisors and senior managers upon issuing the annual guidance/template, which both OCFO and Advisors view as training on FMFIA requirements.

OCFO agrees on the need for more in-depth training on assessing risk, developing program review strategies based on GAO's *Standards*, and reporting on how key activities fit together and expects to develop a strategy for comprehensive, tiered training by the end of FY 2009.

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<sup>9</sup> During our interviews, we had to define and describe GAO's *Standards* to most Advisors. Most Advisors were also not familiar with EPA's 1996 guidance document that listed the Agency's ten management integrity principles.

<sup>10</sup> OCFO said it briefed managers in OSWER and the Administrator's Office.

### **OCFO Recently Strengthened Its FMFIA Guidance to Better Align with EPA Order 1000.24**

In FY 2008 OCFO revised its guidance from previous years to require that Agency senior managers evaluate their program’s internal controls in accordance with GAO’s five standards. As an attachment to the guidance, OCFO included an assurance letter template that provided “specific instructions” for reporting results of internal control evaluations. However, the template only required reporting on one of the five GAO *Standards*, “control environment.” OCFO explained that it outlined this standard in detail because Advisors and others expressed the greatest confusion over what to include in a discussion of “control environment.” OCFO believes its guidance implicitly requires program and regional offices to apply GAO’s *Standards* and that, by following OCFO’s guidance, offices will in effect address all five standards. OCFO staff said it was not their responsibility to dictate to program and regional offices what to include in their program review strategy or how to conduct their assessments. However, OCFO agreed that its responsibility includes providing direction on steps in the FMFIA reporting process, and OCFO’s annual guidance and template specifies the reporting format EPA offices must follow. OCFO acknowledges that most offices follow their template. Management Integrity Advisors we interviewed said OCFO’s guidance provides administrative processes for completing assurance letters, and all Advisors stated they followed OCFO’s guidance/template. During our interviews, we found that half of the Advisors were not familiar with GAO’s *Standards*. Despite this, all Advisors we interviewed believed their offices’ assurance letters addressed all five standards, but could not provide examples as to how letters addressed the *Standards*. All but one assurance letter we reviewed did not comprehensively address the seven “control environment” elements specified in Agency FMFIA guidance.<sup>11</sup> All assurance letters we reviewed did not indicate that offices had conducted “risk assessment” on vulnerabilities toward meeting program goals, and did not assess and report on performance measures (a “control activity”).

In its FY 2009 FMFIA guidance issued on December 22, 2008, OCFO maintained the same template from FY 2008 guidance requiring that assurance letters address only the “control environment” standard, but not the other four GAO *Standards*. We met with OCFO in January 2009 on ways to enhance the FY 2009 template to address all standards and documented our suggestions in a memorandum to the Acting Chief Financial Officer.<sup>12</sup> We undertook our review of seven offices’ FY 2008 assurance letters to find further support for our suggestions to OCFO. Our ongoing communications with OCFO,<sup>13</sup> coupled with newly developed management integrity processes affecting specific activities under the American

<sup>11</sup> Region 9’s fiscal 2008 assurance letter provided a detailed description of activities related to all seven control environment elements.

<sup>12</sup> Melissa Heist, OIG’s Assistant Inspector General for Audit, issued the memorandum to Maryann Froehlich, EPA’s Acting Chief Financial Officer, on January 30, 2009.

<sup>13</sup> We briefed OCFO on our letter review results on April 14, 2009, and in a draft report issued on May 5, 2009.

Recovery and Reinvestment Act of 2009, resulted in OCFO's decision to issue supplemental FY 2009 FMFIA guidance. We reviewed OCFO's draft supplemental guidance and suggested specific text – including programmatic examples – for OCFO to provide in its guidance. OCFO's supplemental FY 2009 FMFIA guidance, issued on May 19, 2009, included our suggestions. OCFO's supplemental guidance:

- Revised language for the general statement of assurance that all Assistant and Regional Administrators must include in assurance letters to more clearly address whether they assessed internal controls and comply with GAO's *Standards*;
- Defined all five GAO *Standards*; and
- Provided examples of programmatic activities related to each GAO *Standard*.

### ***OCFO Has Not Validated Annual Assurance Letters***

OCFO said its validation strategy does not include validating the content and accuracy of offices' assurance letters. OCFO assumes offices take seriously statements in assurance letters asserting compliance, and noted that accountable officials – Assistant and Regional Administrators – should verify assurance letter content to make compliance determinations. Management integrity staff in OCFO's Office of Planning, Analysis, and Accountability said they assume that if an office conducted a review and indicated no material weaknesses, then that office did what it was supposed to do. OCFO does not ask offices to show that everything is fine.

EPA Order 1000.24 requires OCFO to develop and implement a strategy for validating Agency-wide compliance with FMFIA and OMB Circular A-123. To date, OCFO has not compiled a written strategy but said it will to include activities such as annual guidance, kick-off meeting and update meetings, and ongoing communication with Advisors – all of which we view as providing guidance and advising up-front as opposed to validating end results. Management Integrity Advisors we interviewed expect OCFO to communicate any problems with their offices' assurance letters. Advisors assumed their FY 2008 assurance letters met reporting requirements since OCFO accepted letters without comment. OCFO told us that when it receives assurance letters from program and regional offices, OCFO reviews them primarily for completeness against guidance and to identify current and new material weaknesses, management challenges, and emerging issues that warrant the Administrator's attention. OCFO uses an internal checklist to ensure that offices' letters addressed template headings and other requirements from OCFO's annual guidance. OCFO acknowledged that it does not review assurance letters to verify that offices reported all internal and external reviews, results of those reviews related to programmatic controls, or whether offices addressed all elements in the checklist excerpted from GAO's

tool. To date, OCFO has limited resources to oversee annual FMFIA reporting on programmatic elements,<sup>14</sup> and OCFO considers its staffing levels adequate.

OCFO acknowledged, however, that financial reporting has received emphasis over the past few years given extensive reporting requirements in that area in OCFO's annual guidance (e.g. accounts receivable, grants, procurement and accounts payable, payroll, purchase card, property management, funds control). OCFO's staff person responsible for management integrity said focus swung too far in the direction of financial reviews, thus missing programmatic elements.<sup>15</sup> When we asked whether OCFO intended to review fiscal 2009 assurance letters against GAO's *Standards*, OCFO responded, "Only in that we have asked offices to comply with the checklist." OCFO has not required offices to provide copies of completed checklists; rather offices will retain them for their records. We found that for FY 2008 letters we reviewed, offices did not use or complete the checklist. This year, OCFO has planned a new program compliance review to identify major problem areas and "work with a contractor on where weaknesses are in the FMFIA implementation process" at selected Headquarters and regional offices to correct the Agency's management integrity approach in FY 2010. OCFO's review will identify areas where OCFO should strengthen its guidance, and gather specific input for developing training plans. We believe OCFO could use program compliance review results to also revise its validation strategy to include, at a minimum, how EPA offices meet each of the five GAO *Standards* and annually evaluate internal controls established under GAO's *Standards*. Program compliance reviews could also determine the extent to which offices incorporate GPRA measures and NPM Guidance elements into their FMFIA reporting and internal control structure. Additionally, OCFO should describe components of its validation strategy in FY 2010 guidance to make clear to EPA offices what OCFO uses to review assurance letters.

## Conclusion

Because OCFO did not require – and program and regional offices did not evaluate and report on – compliance with GAO's *Standards* in FY 2008, EPA risked not fully complying with FMFIA. These actions gave the Administrator no documented basis upon which to make a compliance determination when signing the Agency's FY 2008 letter. Assistant and Regional Administrators issue

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<sup>14</sup> OCFO said it relies on a "team" to focus on the programmatic aspect; however we found that OCFO relies upon one project lead in its Office of Planning, Analysis, and Accountability. OCFO said other groups help review financial/administrative elements, such as financial reporting and oversight on grants and contracts.

<sup>15</sup> OCFO staff said focus shifted shortly after Congress enacted the Sarbanes-Oxley Act on July 30, 2002. The legislation set new or enhanced standards for all U.S. public company boards, management and public accounting firms and addressed issues relating to (1) auditor independence, (2) corporate responsibility, (3) enhanced financial disclosures, and (4) accountability and certifying financial results. OMB revised Circular A-123 on December 21, 2004, in light of new internal control requirements for publicly-traded companies contained in the Sarbanes-Oxley Act of 2002. Then Comptroller Linda Springer said in a memorandum, "The policy changes in this circular are intended to strengthen the requirements for conducting management's assessment of internal control over financial reporting."



assurance letters to the Administrator without utilizing strategies that provide a sound, documented basis for reasonably assuring that their programs implement effective internal controls consistent with EPA Order 1000.24 and comply with GAO's *Standards*. The Agency's OCFO-driven FMFIA process has emphasized administrative and financial reporting over programmatic performance and – until recently – has not integrated other relevant Agency-wide processes such as annual performance plans, measures, and results to evaluate internal controls. OCFO's recent emphasis on all five GAO internal control standards, as well as increased awareness through training, could help EPA offices improve certifications to the Administrator that they have effective and efficient program operations.

## Recommendations

We recommend that the Chief Financial Officer:

1. Develop a training course on FMFIA that provides (a) senior managers with an overall understanding on internal controls and their responsibilities in EPA Order 1000.24, and (b) Management Integrity Advisors with details on implementing and reporting.
2. Develop fiscal 2010 FMFIA guidance and a reporting template that requires reporting all five GAO *Standards* to ensure consistency with OMB Circular A-123 and EPA Order 1000.24. Incorporate language in supplemental FMFIA guidance issued on May 19, 2009, into fiscal 2010 guidance.
3. Revise the internal checklist that OCFO uses as part of its strategy for validating Agency-wide FMFIA compliance to confirm that EPA offices addressed each of the five GAO standards in evaluating their internal controls and identifying weaknesses. Describe, in its annual Agency guidance, OCFO's strategy for assessing offices' assurance letters for compliance.

We also recommend that the Administrator foster an environment that supports internal control by:

4. Announcing the FY 2010 FMFIA process that describes the significance of annual FMFIA reporting and certification that programs comply with GAO's *Standards*.
5. Requiring all Senior Executive Service members, GS-15 managers, and Management Integrity Advisors to attend OCFO's initial FMFIA training course and annual updates.

## Agency Comments and OIG Evaluation

The Agency agreed with our draft report findings and concurred with our recommendations for strengthening EPA's FMFIA implementation. Initially OCFO disagreed with our third recommendation previously worded, "Determine staffing levels needed to implement requirements in EPA Order 1000.24 and invest adequate resources to validate annual assurance letters against administrative, financial, and programmatic review elements." OCFO said it relies on Assistant and Regional Administrators' signed personal statements of assurance as the cornerstone of OCFO's validation strategy and as the primary form of validating compliance with GAO internal control standards. We met with OCFO to clarify that our recommendation did not imply that EPA Order 1000.24 required OCFO to independently test the content of EPA offices' assurance letters; a mandate which OCFO said would require detailed programmatic knowledge, technical expertise, and substantial resources. We agree that OCFO lacks the technical expertise and resources necessary to perform in-depth reviews of letter contents. However, we believe "validating" includes OCFO's assurance that offices applied all relevant information – consistent with our report findings – to support signed assurance statements. As such, we discussed with OCFO how its validation strategy should address *how OCFO assesses* how each EPA office met – and annually evaluated internal controls established under – each of GAO's five standards. We revised our recommendation wording to reflect our discussions and consensus with OCFO. OCFO agreed and said it plans to revise the internal checklist it uses to validate assurance letters to include GAO's five standards. OCFO believes it has adequate resources to revise and apply this validation strategy. OCFO also believes EPA offices are equipped to address expanded requirements (i.e. all five GAO standards) under the planned FY 2010 FMFIA process. Further, OCFO indicated that its validation strategy is unwritten but includes: (1) signed assurance statements, (2) annual guidance, (3) regular meetings, (4) training and technical assistance, (5) internal checklist against which to review assurance letters, and (6) program compliance reviews. We suggested – and OCFO agreed – that it should codify this validation strategy in annual guidance to make clear to EPA offices how OCFO validates Agency-wide FMFIA compliance. Appendix A includes EPA's full response.

## **Status of Recommendations and Potential Monetary Benefits**

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status <sup>1</sup>	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	12	Develop a training course on FMFIA.	O	Chief Financial Officer			
2	12	Develop FY 2010 FMFIA guidance and a reporting template that requires reporting all five GAO Standards to ensure consistency with OMB Circular A-123 and EPA Order 1000.24. Incorporate language in supplemental FMFIA guidance issued on May 19, 2009, into FY 2010 guidance.	O	Chief Financial Officer			
3	12	Revise the internal checklist that OCFO uses as part of its strategy for validating Agency-wide FMFIA compliance to confirm that EPA offices addressed each of the five GAO standards in evaluating their internal controls and identifying weaknesses. Describe, in its annual Agency guidance, OCFO's strategy for assessing offices' assurance letters for compliance.	O	Chief Financial Officer			
4	12	Announce the FY 2010 FMFIA process that describes the significance of annual FMFIA reporting and certification that programs comply with GAO Standards.	O	Administrator			
5	12	Require that all Senior Executive Service members, GS-15 managers, and Management Integrity Advisors attend OCFO's initial FMFIA training course and annual updates.	O	Administrator			

<sup>1</sup> O = recommendation is open with agreed-to corrective actions pending  
 C = recommendation is closed with all agreed-to actions completed  
 U = recommendation is undecided with resolution efforts in progress

## Appendix A

**Agency Response to Draft Report**

July 16, 2009

**MEMORANDUM**

**SUBJECT:** OCFO Response to Draft Audit Report: *EPA Should Use FMFIA to Improve Programmatic Operations* (Project No. 08-FY08-0323)

**FROM:** Maryann Froehlich /signed by/ *Joshua Baylson*  
Acting Chief Financial Officer

**TO:** Melissa M. Heist  
Assistant Inspector General for Audit

This memorandum responds to the Office of Inspector General (OIG) draft audit report, *EPA Should Use FMFIA to Improve Programmatic Operations* (Project No. 08-FY08-0323), dated June 22, 2009.

The Office of the Chief Financial Officer (OCFO) appreciates your consideration of the comments and suggestions we offered on the discussion draft report, *EPA Federal Managers' Financial Integrity Act (FMFIA) Process Improvements*, and the resulting modifications reflected in this draft report. We are now responding to you on behalf of both OCFO and the Office of the Administrator (OA), as your report was issued to both offices. We have worked closely with OA to prepare the following consolidated response, which represents the views of both offices.

In general, OA and OCFO agree with the findings presented in the draft report and support the majority of OIG's recommendations for strengthening EPA's FMFIA implementation. We will be working together to implement recommendations for the Administrator to continue emphasizing to senior managers the importance of FMFIA and of sound internal controls. We do, however, remain concerned about Recommendation 3—that OCFO “invest adequate resources to validate annual assurance letters against administrative, financial, and programmatic review elements.” We continue to work closely with program and regional offices to strengthen their implementation of FMFIA and ensure a sound basis for their letters of assurance to the Administrator, which provide the foundation for the Administrator's overall statement of assurance. We believe that OCFO is fulfilling its responsibility, outlined in EPA Order 1000.24, to implement a strategy for validating Agency-wide compliance with the Integrity Act.

Please find attached our responses to each of the recommendations contained in the draft report. As we have agreed with Patrick Gilbride (via a July 1, 2009 email exchange), we will provide planned completion dates for all recommendations once OIG has issued its final report.

In addition, I have attached a copy of the draft report that we have annotated with a few specific comments and suggestions. If you would like to discuss these attachments further, please have your staff contact Debbie Rutherford (202-564-1913) or Annette Morant (202-564-3671) in OCFO's Office of Planning, Analysis, and Accountability.

We appreciate your sharing these findings and recommendations with OCFO and OA, and we look forward to working with you to strengthen the Agency's management integrity program.

#### Attachments

cc: Scott Fulton  
Ray Spears  
Josh Baylson  
Rita Smith  
Stefan Silzer  
Patrick Gilbride  
Erin Barnes-Weaver

### **OCFO and OA Response to OIG Draft Report Recommendations:**

#### ***EPA Should Use FMFIA to Improve Programmatic Operations*** **Project No. OA-FY08-0323** **June 22, 2009**

1. Develop a training course on FMFIA that provides (a) senior managers with an overall understanding on internal controls and their responsibilities in EPA Order 1000.24, and (b) Management Integrity Advisors with details on implementing and reporting.

**Concur.** OCFO agrees that further training is needed at both senior manager and Management Integrity Advisor (MIA) levels. At a June meeting of Assistant Regional Administrators, Office of Planning, Analysis, and Accountability (OPAA) staff led a brief discussion to help identify training needs and potential approaches and mechanisms. We continue to consult with MIAs to determine their training and information needs. In addition, beginning in late July/early August, OCFO will be conducting contractor-supported Program Compliance Reviews in several selected regional and program offices. Preliminary surveys and the on-site reviews will help to diagnose training needs and inform development of training tools and materials. (OCFO expects the on-site reviews also to provide some "on the spot" training/assistance to MIAs in participating offices.) In addition, OCFO is dedicating contract resources to a more comprehensive training effort, and we will be working with training experts to explore vehicles/mechanisms for delivering the training. We expect to complete development of an Agency-wide strategy for comprehensive, tiered FMFIA training by the end of fiscal year 2009.

2. Develop fiscal 2010 FMFIA guidance and a reporting template that requires reporting all five GAO standards to ensure consistency with OMB Circular A-123 and EPA Order 1000.24. Incorporate language in supplemental FMFIA guidance issued on May 19, 2009, into fiscal 2010 guidance.

**Concur.** OCFO agrees on the need to revise our guidance and assurance letter template so that assurance letters clearly address all five GAO standards. The Acting CFO's February 19, 2009 memo to the Assistant Inspector General for Audit makes this commitment for FY 2010. In developing FY 2010 guidance, we will incorporate elements of the FY 2009 supplemental guidance issued on May 19, including an emphasis on the need for all programs to comply with the five GAO standards for internal control and the revised Assistant Administrator (AA) and Regional Administrator (RA) assurance statement certifying compliance with the GAO standards.

3. Determine staffing levels needed to implement requirements in EPA Order 1000.24 and invest adequate resources to validate annual assurance letters against administrative, financial, and programmatic review elements.

**Disagree.** EPA holds AAs and RAs accountable for their integrity programs and internal controls. OCFO relies on AAs' and RAs' signed personal statements of assurance as the primary form of validation of compliance with GAO standards for internal control. These signed statements testify to the soundness of the internal controls established to protect EPA programs from fraud, waste, and abuse. EPA Order 1000.24 requires that OPAA "develop and implement a strategy for validating Agency-wide compliance with FMFIA." The signed letters of assurance to the Administrator are the cornerstone of this strategy. OPAA staff use a checklist to review annual assurance letters for completeness, ensuring that AAs and RAs have adequately addressed all elements set out in annual guidance, as well as to identify potential weaknesses or areas of concern for the Administrator's attention. OPAA's strategy for fostering compliance with FMFIA also includes issuing annual guidance, conducting regular meetings with senior managers to review roles and responsibilities, and providing training and technical assistance to Agency staff and managers.

OCFO believes EPA Order 1000.24 was never intended to require that OCFO independently validate the content of each of 13 program office and 10 regional office assurance letters, a mandate which would require wide-ranging, detailed programmatic knowledge and technical expertise as well as substantial resources. OCFO does not agree that the responsibility for developing and implementing a strategy to validate the Agency's compliance with FMFIA requires OCFO to "verify that offices reported all internal and external reviews" and the "results of those reviews related to programmatic controls" (p. 10). However, OPAA staff do carefully review letters to ensure that "offices addressed all elements in the checklist OCFO provided along with its' FY 2008 and 2009 guidance (p. 10)," and we rely on AAs' and RAs' statements of assurance that they have reviewed internal controls in compliance with GAO standards.

OIG's statement that "OCFO has one project lead—supported by additional staff—to oversee EPA's management integrity program, including extensive administrative and financial reporting activities" is misleading. In fact, OCFO relies on a team within OPAA to focus on

the overall Agency FMFIA implementation process and, in particular, the programmatic aspect, and a team within its Office of Financial Management to focus on Agency-wide financial activities, including controls over financial reporting. In addition, in reviewing assurance letters, OCFO collaborates with appropriate program offices, such as the Office of Administration and Resource Management and the Office of Environmental Information, to assess such components of assurance letters as discussion of grants and contracts, human capital, or data quality/information reporting systems.

OCFO does, however, acknowledge the need to strengthen compliance with FMFIA and improve monitoring. Beginning in late July/early August 2009, OPAA will be initiating a series of Program Compliance Reviews in selected headquarters and regional offices. To augment OPAA efforts, contractor staff with expertise in FMFIA and internal controls will conduct on-site visits to assess offices' documentation for their assurance letters and assist them in improving their FY 2010 FMFIA process. These activities will support efforts to ensure that assurance letters adequately reflect and validate Agency-wide compliance with FMFIA.

4. Announcing the FY 2010 FMFIA process that describes the significance of annual FMFIA reporting and certification that programs comply with GAO's Standards.

**Concur.** OCFO will work with the Office of the Administrator to develop an announcement or other communication from the Administrator to help launch the FY 2010 FMFIA process. The Administrator's message will stress the importance of the integrity process and of AAs' and RAs' assurance statements certifying compliance with GAO standards.

5. Requiring all Senior Executive Service members, GS-15 managers, and Management Integrity Advisors to attend OCFO's initial FMFIA training course and annual updates.

**Concur.** OCFO will work with OA to incorporate such a direction from the Administrator as part of its strategy for tiered, Agency-wide FMFIA training.

**Appendix B**

***Distribution***

Office of the Administrator  
Agency Follow-up Official (the CFO)  
Agency Follow-up Coordinator  
Acting General Counsel  
Associate Administrator for Congressional and Intergovernmental Relations  
Associate Administrator for Public Affairs  
Audit Follow-up Coordinator, Office of the Administrator  
Audit Follow-up Coordinator, Office of the Chief Financial Officer  
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