



## **Navigating the revised OMB circular A-123**

### What are the new requirements for internal control?

#### **Overview**

With a rapidly changing landscape, evolving workforce, and emerging constituent demands, federal agencies' missions and programs have become more complex, impact-driven, risk-cognizant, and technology reliant. At the same time, budgets are shrinking leaving agencies to do more with less. The Office of Management and Budget (OMB) recognized this changing landscape and released the revised Circular A-123 "Management's Responsibility for Enterprise Risk Management and Internal Control" (A-123 or Circular) to modernize the Federal Managers' Financial Integrity Act (FMFIA). The focus of the revised Circular is to integrate risk management and agency internal control systems in an Enterprise Risk Management (ERM) framework to improve mission delivery.

At first glance, implementing the revised Circular's requirements may pose challenges and seem like an additional compliance burden; however, implementation provides agency executives a framework that helps make strategic, risk-based decisions that can help enhance agency value.

#### **What's changed?**

In addition to the revised Circular's ERM requirements, OMB has emphasized the operating effectiveness of an agency's internal controls and how these help the agency achieve its operations, compliance and reporting objectives.

To help agencies substantiate the operating effectiveness of their systems of internal control, in addition to complying with appendices A – D of the Circular, A-123 now requires agencies to:

- Conduct an evaluation of internal controls for each of the 17 Government Accountability Office (GAO) Green Book principles;
- Prepare a summary of internal control deficiencies to include specific GAO Green Book principles that an agency does not meet, but should meet, based on its mission and business; and
- Provide a summary of the agency’s determination of whether each GAO Green Book internal control component and associated principle(s) are designed, implemented and operating effectively. If an agency identifies internal control deficiencies within its system, it must assess the deficiencies’ severity when aggregated across all internal control components. If one or more internal control components are not operating effectively, the agency must report a material weakness and associated corrective action plan.

Deloitte’s CFO Insight [Navigating the Revised Green Book – Meeting the New Internal Control Standard](#) provides agency management with salient points to consider to help facilitate effective GAO Green Book and A-123 compliance. The “Implementation Considerations” section below provides additional tactical considerations for agencies to consider as they further strengthen their systems of internal control to meet OMB’s revised requirements.

In addition to OMB further emphasizing agencies’ needs to evaluate their entire systems of internal control, A-123 now requires agencies to leverage an ERM approach to identify, manage, and monitor risks. The table below summarizes OMB’s revised requirements:

<b>Deliverable</b>	<b>Due date</b>	<b>Description</b>
ERM Implementation Approach	As soon as practical, prior to the June 2017 Initial Risk Profile deliverable	Agencies are encouraged to implement ERM.
Initial Risk Profile	June 2, 2017	Agencies must complete their initial risk profiles. Key findings should be made available to OMB.
Integration with Management’s Evaluation of Internal Control	September 15, 2017	For those risks which formal internal control has been identified as part of the Initial Risk Profile, all agencies must present assurances on internal control processes in the FY 2017 Agency Financial Report (AFR), along with identified material weaknesses and corrective actions.
Updated Risk Profile	Annually by June 3	No less than annually, agencies must prepare a complete risk profile and include required risk components and elements required by this guidance.

Deloitte’s [Raising the Bar on Managing Enterprise Risks – OMB’s Requirements for Enterprise Risk Management in Federal Agencies](#) provides critical points for agencies to consider for standing up ERM programs to comply with the revised OMB Circular A-123.

**Implementation considerations**

Although required in the previous iterations of A-123, via the Chief Financial Officer’s Council (CFOC) Implementing Guidance to A-123, this revised Circular places additional emphasis on effective entity-level controls (ELCs) and their role in establishing and maintaining an agency’s effective system of internal control. As such, agencies should consider the ELCs that align to all five components of internal control, not just the control activities component.

The table below summarizes the five internal control components and 17 principles that demonstrate compliance with each component, as defined in the GAO Green Book:

Control environment	Risk assessment	Control activities	Information & communication	Monitoring activities
1. Demonstrates commitment to integrity and ethical values	6. Defines objectives and risk tolerances	10. Designs control activities	13. Uses relevant, quality information	16. Performs ongoing monitoring activities
2. Exercises oversight responsibilities	7. Identifies, analyzes and responds to risk	11. Selects and develops general controls for the information system	14. Communicates internally	17. Evaluates issues and remediates deficiencies
3. Establishes structure, authority and responsibility	8. Assesses fraud risk	12. Deploys and implements control activities	15. Communicates externally	
4. Demonstrates commitment to competence	9. Identifies, analyzes and responds to change			
5. Enforces accountability				

### Considerations for governance

ERM and its relationship to internal controls can sometimes be nebulous, making it seem daunting and overwhelming to effectively implement. Internal controls is a type of risk mitigation strategy and is, therefore, an integral component to ERM. However, strong ERM programs are much larger than just effective internal controls or OMB Circular A-123 Appendix A compliance. As such, one of the greatest potential pitfalls to effectively implementing an effective ERM program, and ultimately complying with A-123's revised requirements, is failing to adequately establish, and consistently apply, the required governance needed to routinely identify, assess, manage and monitor risk across an enterprise.

This break down in governance often results in the bifurcated risk management methodologies and processes that many agencies often apply today. Further, this break down frequently inhibits management from making the decisions that help better meet their strategic objectives, which may result in lost value to an agency.

To effectively sustain compliance with the GAO Green Book and lay the foundation for broader ERM implementation and full A-123 compliance, agencies should consider their current governance structure and determine the appropriate stakeholders and senior-level sponsorship needed to help the agency achieve its operations, compliance, and report objectives – which often times reside outside of the Chief Financial Officer's (CFO) domain.

### Considerations for service organizations

As part of demonstrating an effective system of internal control and demonstrating compliance with the GAO Green Book, A-123 provides additional details for federal managers to consider when managing the operations, compliance and reporting risks inherent in user/service provider relationship. Specifically, A-123 (and the GAO Green Book) discusses:

- Management's responsibility for the activities performed by third-party services organizations;
- Considerations for the level of oversight needed for service organizations based on the terms of service level agreements and the level of risk a service organization poses to an agency meeting its objectives;
- Management's responsibility for establishing "user" controls to help mitigate the potential third-party risks to the "user" agency that could arise from service provider activities; and

- Service organizations' responsibilities to provide assurances to their customers and assistance to their customers in understanding the relationships between existing service provider- and user-side controls.

#### **Considerations for mitigating fraud risk**

The revised Circular requires agencies to establish internal controls to help mitigate fraud risk. These controls are to also be included in the agency's risk profile. In addition, A-123 requires agencies to establish financial and administrative controls, through the agency risk profile, which include:

- Controls to address identified fraud risks around payroll, beneficiary payments, grants, large contracts, information technology and security, asset safeguards, purchase, travel and fleet cards; and
- Collecting and analyzing data from reporting mechanisms to help detect and monitor fraud trends as well as using data to continually improve fraud prevention controls and fraud response.

#### **Considerations for internal control documentation**

The revised Circular and the GAO Green Book provide documentation requirements needed to help substantiate an effective system of internal control. Although OMB and GAO allow for management to apply judgement in determining the extent of documentation needed, minimum documentation requirements include:

- Management's assessment that was used to determine if a GAO Green Book principle is not relevant to the respective agency's system of internal control;
- Internal control responsibilities for the organization via policy;
- Evaluation results and related documentation illustrating the results of ongoing monitoring and separate evaluations to identify internal control issues; and
- Corrective actions plans and corrective action status.

#### **The path forward**

While adopting the revised OMB Circular A-123's requirements may pose some challenges in the short term, this bigger-picture focus on ERM and the overall system of internal controls should position agencies to better balance strategy and operations with risk, which supports more value-added decision-making, further demonstrating stewardship of tax payer dollars. As agencies revise their A-123 programs in response to the revised Circular, they should thoroughly evaluate their current system of internal controls, identify areas needed to improve the design and strengthen the operating effectiveness of their current ELCs, and integrate ERM with current internal control programs to effectively manage risks across an agency.

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