

Navigating the Revised Green Book Meeting the new internal control standard



Overview

Quietly, the standards governing federal agencies' compliance with the Financial Managers Financial Integrity Act (FMFIA) have undergone a revision. At the end of the 2014 Fiscal Year (FY), as agencies made preparations for year end, the Government Accountability Office (GAO) issued a broad revision to its Standards for Internal Control in the Federal Government, also known as the Green Book. As a result, executive branch agencies must examine their FMFIA programs to assess compliance with these updated internal control standards beginning in FY 2016. Although implementation of the new Standard can pose many challenges, full implementation of the revised Green Book Standards will allow Chief Financial Officers (CFOs) to take a fresh look at their risk and control measures to identify efficiencies, reduce redundant controls and simultaneously make large strides in reducing risk exposure, especially with consideration to fraud risks.

What's Changed?

While the revision's internal control components (i.e., control environment, risk assessment, control activities, information and communication, and monitoring activities) are largely the same as those in the 1999 Standards, the revised Green Book requires entities to demonstrate and assess whether 17 principles (see Figure 1) are present

and functioning in determining whether their system of internal control is effective. This is critical because now the Inspector General, independent auditors, and other related oversight groups will now evaluate an agency's entire system of internal control, not just specific activities or transactions which typically occurred in the past. This could create significant challenges to some agency CFOs to include setting back their auditability goals or introducing new material weaknesses in their agency audit reports. If CFOs properly implement the changes to adopt the Green Book standards, these potential challenges should be considered short-term impediments.

Further, as noted in the Green Book, the 17 principles are supported by attributes, which are critical in demonstrating that the respective principle is in place. These changes will require CFOs to place more scrutiny over their entity level controls as deficiencies in this area can affect the control exception evaluation and reporting process, potentially resulting in new material weaknesses that require remediation. In addition, the revised Green Book now places an even larger emphasis on the risk assessment process, both financial and operational. For example, the Standards now require agencies to take a closer look at fraud risks (principle 8) and identify fraud risk factors and programs with increased susceptibility for fraud.



Additionally, the Green Book considers implications for Federal entities that are consolidating operations for efficiency via shared service operating models. As such, the new Standards spell out management's responsibility to understand the shared service provider's internal controls and how these internal controls impact the entity's system of internal control (i.e., the service provider and the complementary user entity controls).

Finally, the Standards now set minimum documentation requirements to substantiate the effective design, implementation and operating effectiveness of an agency's system of internal control. If management identifies deficiencies in meeting these minimum requirements, it must consider these deficiencies to help determine if the agency has successfully implemented the underlying internal control principle.

Opportunities

While at first glance this may appear to be another compliance burden on already constrained federal resources, this represents an opportunity for Federal CFOs to reevaluate their agency's control and compliance programs to not only validate the effectiveness of their system of internal controls against their risk profiles, but to also more proactively manage the continual changes in laws, regulations and related requirements that affect agencies' control environments – laying the foundation for broader risk management programs and techniques.

To truly unlock the value that can be achieved through adoption of the revised Green Book, CFOs should not just take steps to do the bare minimum to "check-the-box" and comply with its requirements. Instead, CFO's should consider using the Green Book as a catalyst to evaluate how organizational risks are assessed in light of the agency's size, complexity, global reach, and risk appetite; identify gaps in current control and compliance strategies; close these noted gaps; and further expand this approach from managing financial reporting risk to include operations and compliance risks.

Implementation Risks

Today, many agencies do not place enough rigor around assessing the design and operating effectiveness around entity level controls. As such, one of greatest risks to Green Book implementation rests with the increased focus on demonstrating effective design and operating effectiveness over entity level controls. Fourteen of the 17 principles in the Green Book address entity level control considerations and, as a result, are significantly more difficult for agencies to assess, measure and quantify. Combined with the emphasis on supporting control assertions with documentation, this represents an area in which agencies may falter in their implementation. To demonstrate full implementation and compliance, agencies will need complete and comprehensive document support for management's evaluation process. Unfortunately, there are few Federal benchmarks available to management and this may cause uncertainty in meeting full adoption requirements. While mature agencies have established internal control programs, the changes to the Green Book combined with changes in business and mission requirements, may put even established and mature programs at risk. The bottom line, business as usual will likely not meet the mark with regard to the revised Green Book Standards.

To help accommodate for some these implementation risks, CFOs should consider documenting an inventory of evidential matter and related items that can help substantiate evidence of the effective design and operating effectiveness of the entity level controls across the Green Book's 17 principles. For example, principle 1 of the Green Book requires agencies to demonstrate a commitment to integrity and ethical values. To demonstrate that principle 1 is met, agencies could inventory and routinely review their policies that support ethics such as anti-fraud policy. It should also inventory the evidence of points of contact to report unethical behavior, such as management contacts and the Inspector General (IG) hotlines.

Control environment	Risk assessment	Control activities	Information and communication	Monitoring activities
<ol style="list-style-type: none"> 1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibilities 3. Establishes structure, authority, and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability 	<ol style="list-style-type: none"> 6. Define objectives and risk tolerances 7. Identifies, analyzes, and responds risk 8. Assesses fraud risk 9. Identifies and analyzes and responds to change 	<ol style="list-style-type: none"> 10. Designs control activities 11. Selects and develops general controls for the system 12. Deploys and implements control activities 	<ol style="list-style-type: none"> 13. Uses relevant, quality information 14. Communicates internally 15. Communicates externally 	<ol style="list-style-type: none"> 16. Performs ongoing monitoring activities 17. Evaluates issues and remediates deficiencies

Figure 1 - GAO Green Book's 17 Principles

As agencies continue defining and refining their control and compliance programs around the revised Green Book, we've highlighted a few principles in the Green Book that, although they may not seem significant, should not be neglected by CFOs as they are critical to an agency's system of internal control:

Assessing Fraud Risk (Principle 8)

As agencies evolve and change, their ethics programs may become stale or inadequate while compliance with them may become a "check-the-box" exercise. Moreover, while many agencies have established ethics programs, they do not always address the relevant types of fraud and may not consider the ways that fraudulent activities could occur. Most commonly, we see that agencies do not periodically reevaluate fraud risk as significant changes occur within the agency or its external environment. Often times this is a result of agency management not adequately briefing senior stakeholders on fraud risk areas, or senior stakeholders not challenging management's assessment of fraud risk.

To effectively demonstrate compliance, CFOs should consider reviewing and updating their risk assessment at least annually. The relevant fraud risks should be discussed, reviewed and revised as necessary with input from key functional and component management. For high risk areas, CFOs should consider the potential need to include outside fraud experts. Finally, agencies should select well designed and implemented controls to mitigate identified inherent fraud risks.

Identifying Changes and Appropriately Factoring Them into the Risk-Assessment Process (Principle 9)



Change creates risk; therefore, CFOs should implement processes that enable identification and evaluation of changes affecting their agencies on a timely basis. All too often, agency risk assessment processes become routine and are typically rolled over from year to year with little consideration for changes in business operations. Not only does this expose an agency to significant financial and operational risks, it also makes it difficult for agencies to demonstrate their compliance with Principle 9. To both comply with the revised Standards and execute federal programs with the appropriate level of oversight and demonstrated stewardship, CFOs should focus on completing comprehensive risk assessments on an annual basis. Moreover, agencies will need a repeatable and consistent framework for assessing risks and incorporating new and evolving risks related to changes in agency

operations. As agency operations change, management must demonstrate that it understands the impact to its risk profile and in response, implement new or adapt existing controls to manage risk exposure.

Outsourced Service Providers (Multiple Principles)

Given the significant increase in outsourcing relationships for information, business processes, and IT, internal controls related to shared service providers have become critical. While most agencies have processes in place for evaluating Statement on Standards for Attestation Engagements No. 16 (SSAE 16) reports obtained from service organizations, most user organizations have not integrated service provider activities into their agency's system of internal control (i.e., assessing service provider activity across all five components on internal control). In addition, agencies may rely too heavily on service provider controls and not establish effective user-side controls to manage risk. For example, agencies may record significant journal entries based on reports received from service providers without adequately reviewing these reports and their contents for accuracy and reasonableness. It is important for CFOs to establish robust monitoring controls over shared services. Without such controls, there could be unfortunate surprises late in the year when SSAE 16 reports are delivered, such as unexpected report qualifications.

The Path Forward

While adopting the revised Green Book will likely pose some challenges in the short-term, the more robust requirements and control environment considerations will enable a more effective and efficient government that can more readily demonstrate its stewardship of tax payer dollars. As CFOs design their programs in response to the Green Book revisions, they should consider the intent and purpose behind each principle to unlock the full value as envisioned by GAO. In response to the revision, CFOs should reevaluate their chosen control and risk mitigation strategies to identify areas of redundancy and showcase the internal control program's ability to increase efficiency, while simultaneously increasing oversight. Adoption represents a unique opportunity to take a fresh look and set the tone for agency risk management well into the next decade.

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