



**U.S. Department of Housing and Urban
Development**

OFFICE OF THE CHIEF FINANCIAL OFFICER

Internal Control over Financial Reporting, Appendix A

Financial Policy

April 2018



Special Attention of:

- **Office of the Chief Financial Officer (OCFO) Staff with responsibilities related to Internal Control over Financial Reporting.**
- **Departmental Offices Staff with responsibilities related to Internal Control over Financial Reporting.**

**TRANSMITTAL for Policy Handbook
No. CFO-18-___ issued 4/2018**

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1. This transmits the original policy handbook, OCFO Financial Policy, Internal Control over Financial Reporting, Appendix A, Handbook No. CFO-18-___ issued 4/2018.
 2. Summary: This policy handbook establishes policy for OCFO Internal Control over Financial Reporting Program and outlines performance of the annual internal control assessment in accordance with OMB Circular, A-123, Appendix A.
 3. This policy is to be followed by Department-wide staff with responsibilities relating to Internal Control over Financial Reporting.
 4. This policy is effective April 2018. The policy will be reviewed annually and updated as needed.

Table of Contents

Key Points of Contact

1. Introduction

2. Policy

3. Responsibilities

4. Scope of Assessment

5. Performing A-123, Appendix A Assessment

Evaluate internal control at the entity level

Evaluate internal control at the process, transaction, or application level

Develop an overall assessment of the design and operation of internal control over financial reporting

Assurance statement.

Duplication

Documentation

Subsequent Reviews

6. Management's Assurance Statement on Internal Control Over Financial Reporting

Appendix 1 Glossary of Acronyms

Appendix 2 Legislative and Regulatory Requirements

Key Points of Contact:

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1. Introduction

The Federal Manager's Financial Integrity Act of 1982 (FMFIA) requires agencies to establish and maintain a system of internal control in accordance with standards prescribed by the Comptroller General. Internal control, in the broadest sense, includes the plan of the organization and the methods and procedures adopted by management to meet its goals. Each HUD component, office, or unit is responsible for developing and maintaining internal control activities that encompass (a) Control Environment, (b) Risk Assessment, (c) Control Activities, (d) Information and Communications, and (e) Monitoring categories to meet the above objectives.

According to FMFIA, the GAO's Green Book, and the revised OMB Circular A-123, *Management's Responsibility for Internal Control and Enterprise Risk Management*, the objectives and related risks can be broadly classified into one or more of the following three categories:

- Operations: Effectiveness and efficiency of operations
- Reporting: Reliability of reporting for internal and external use
- Compliance: Compliance with applicable laws and regulations

OMB Circular A-123, as revised July 2016, requires that Executive agencies integrate Enterprise Risk Management (ERM) and Management Evaluation and Internal Control. In compliance with A-123, the Department established a Chief Risk Officer (CRO), located within the Office of Strategic Planning and Management (OSPM) to be responsible for integrating the Department's risk, non-financial internal control, and assurance activities, while the Office of the Chief Financial Officer (OCFO) is responsible for the subset of internal control over financial reporting and related system assurance activities, as follows:

SECTION OF A-123	RESPONSIBLE ORGANIZATION
<p>OMB Circular A-123</p> <ul style="list-style-type: none"> Effectiveness and efficiency of operations 	<p>The Office of Strategic Planning and Management</p> <ul style="list-style-type: none"> Coordinates the Department's assessment of internal controls over operations Consolidates the results and individual agency certification statements over operations Tracks non-financial findings and related corrective actions across the Department Prepares Department-wide Statement of Assurance, incorporating separate statements of assurance required by FMFIA Section 2 and 4, per below
<p>OMB Circular A-123, Appendix A, “Internal Control Over Financial Reporting”</p> <ul style="list-style-type: none"> Reliability of reporting for internal and external use 	<p>The Office of the Assistant CFO for Financial Management</p> <ul style="list-style-type: none"> Coordinates assessment of internal control over financial reporting Tracks findings and corrective actions related to financial reporting across the Department Consolidates the results and individual component certification statements Submits consolidated HUD’s assurance FMFIA section 2 assurance statement to OSPM
<p>OMB Circular A-123, Appendix D, “Financial Management Systems”</p> <ul style="list-style-type: none"> Financial management systems conform to applicable laws, standards, principles, and related requirements 	<p>The Office of the Assistant CFO for Systems</p> <ul style="list-style-type: none"> Coordinates financial systems compliance assessment Tracks findings and corrective actions related to financial systems across the Department Consolidates the results and individual component certification statements Submits FMFIA section 4 assurance statement to OSPM

2. Policy

This document establishes the OCFO policy for reviewing, assessing, and reporting on the effectiveness of Internal Control over Financial Reporting in compliance with the provisions of FMFIA and *OMB Circular A-123, Appendix A*.

3. Responsibilities

- A. Chief Financial Officer (CFO)/Deputy CFO:
- 1) Monitors compliance with this policy
 - 2) Communicates the importance of the Financial Internal Control Program to avoid work disruptions and timeliness of requested responses
 - 3) Provides internal control guidance, as needed, for the financial reporting assessments in accordance with *A-123, Appendix A*
 - 4) Establishes and supports the FM Council to provide oversight and accountability for the Financial Internal Control Program

- 5) Instructs the ACFO–FM to:
 - a) Manage and oversee operations of the Financial Internal Control Program
 - b) Provide guidance, as needed, for proper execution of the Financial Internal Control Program
 - c) Ensure HUD adheres to annual reporting requirements pursuant to *A-123, Appendix A*
 - d) Provide quarterly status reports on all material weaknesses to the FM Council
- B. Office of the Assistant CFO for Financial Management (ACFO–FM):
- 1) Executes the Internal Control over Financial Reporting Program, in accordance with all legislative requirements
 - 2) Coordinates with the individual entities with their own internal control program (Ginnie Mae and the Federal Housing Authority) to obtain their statements of assurance (SoA) for consolidation into Departmental SoA pertaining to *A-123, Appendix A*
 - 3) Prepares the annual statement of assurance pertaining to Internal Control over Financial Reporting
- C. ACFO–FM Assessment Team:
- 1) Assists the ACFO–FM to execute the Internal Control over Financial Reporting Program, in accordance with all legislative requirements, as follows:
 - a) Researches the OMB requirements and directives associated with Internal Control over Financial Reporting, as well as researches and reviews relevant HUD internal control process and program documentation
 - b) Prepares a summary of specific risks of misstatement for each significant line item
 - c) Ranks the identified risk(s) in the risk analysis
 - d) Documents the scope of the annual Internal Control over Financial Reporting assessment and then submits to the ACFO–FM for final approval
 - e) Ensures that the assessment is carried out in a thorough, effective, and timely manner (effective project management)
 - f) Participates in all walkthrough discussions with HUD personnel/key stakeholders
 - g) Documents the key business processes in a step by step narrative along with a process flowchart
 - h) Identifies and confirms key financial reporting controls to be tested with the ACFO–FM and process owner(s)
 - i) Develops internal control matrices
 - j) Defines sampling methodology
 - k) Develops a test plan and evaluates the key entity-level and process-level financial reporting controls
 - l) Documents test results in the test plan and organizes the evidence of the testing
 - m) Prepares an analysis of the findings and recommends reportable conditions
 - n) Submits the analysis of the findings along with the results of the classification of reportable conditions to the process owner for validation
 - 2) Coordinates with the ACFO–FM to submit the analysis of the findings and the results of the classification of reportable conditions to the FM Council for review
 - 3) Reports on the results of the assessment
 - 4) Monitors the progress of implementing corrective actions

4. Scope of Assessment

On an annual basis, the ACFO–FM will execute HUD’s Internal Control over Financial Reporting Program to determine the effectiveness of Internal Control over Financial Reporting, as applicable.

A. Requirements

A-123, Appendix A, places specific requirements on agencies, such as:

- 1) Specifically document the process and methodology for applying the standards when assessing Internal Control over Financial Reporting
- 2) Management to use a separate materiality level when assessing Internal Control over Financial Reporting
- 3) An additional assurance statement on the agency’s effectiveness of Internal Control over Financial Reporting

B. Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and should assure the safeguarding of assets from waste, loss, unauthorized use, or misappropriation as well as assure compliance with laws and regulations.

- 1) All reported transactions actually occurred during the reporting period and all assets and liabilities exist as of the reporting date (existence and occurrence)
- 2) All assets, liabilities, and transactions that should be reported have been included and no unauthorized transactions or balances are included (completeness)
- 3) All assets are legally owned by the agency and all liabilities are legal obligations of the agency (rights and obligations)
- 4) All assets and liabilities have been properly valued, and where applicable, all costs have been properly allocated (valuation)
- 5) The financial report is presented in the proper form and any required disclosures are present (presentation and disclosure)
- 6) The transactions are in compliance with applicable laws and regulations (compliance)
- 7) All assets have been safeguarded against fraud and abuse
- 8) Documentation for internal control, all transactions, and other significant events is readily available for examination

C. Scope of Financial Reports

At the beginning of each fiscal year, the ACFO–FM will perform the risk analysis to determine the scope of financial reports to be included in the assessment over financial reporting and recommend to the CFO or DCFO for final determination.

- 1) Risk Analysis: FM will conduct the risk analysis to identify, analyze, and manage risks relevant to achieving the objectives of reliable financial reporting, as well as evaluate the remediation effort and status of all material weaknesses and significant deficiencies.
 - a. Per OMB guidance, *Frequently Asked Questions Pertaining to OMB Circular A-123...*: “As part of the A-123, Appendix A assessment, management must evaluate the corrective actions taken and should assess whether the previously reported (Financial Statement Audit, FFMIA, or FMFIA) material weaknesses continue to exist.

- b. In cases where previously reported material weaknesses continue to exist, the interim focus should be on adequately executing corrective actions in areas where controls are ineffective and then identifying significant financial reporting areas where assurance can be provided. If previously reported weaknesses have not been corrected, then the agency would not need to test those controls.”
- 2) Service Organizations: Services provided to HUD by service organizations may have a direct or indirect impact on HUD’s Internal Control over Financial Reporting. The ACFO–FM is responsible for determining whether services received from a service provider are material to HUD’s financial reporting. If the services received that are related to HUD’s financial systems are material, the ACFO–FM is responsible for obtaining the service provider’s annual Service Organization Control report that highlights its controls and results of annual testing. The ACFO-FM is also responsible for coordinating the timing of the assessment with the service provider.
- 3) Out of Scope: Ginnie Mae and the Federal Housing Authority may use HUD’s Financial Internal Control Program or their own internal control program. If the entity decides to utilize its own financial internal control program, the ACFO–FM is responsible for coordinating with the entity to obtain their annual departmental statements of assurance pertaining to *A-123, Appendix A*, for the annual HUD statements of assurance over financial reporting.

D. Planning Materiality

Materiality for financial reporting is the risk of error or misstatement that could occur in a financial report that would impact management’s or users’ decisions or conclusions based on such report. The planning materiality for the assessment should be designed as to ensure that items required to be reported will be detected. For determination of materiality for the purposes of conducting our assessment of Internal Control over Financial Reporting, the OACFO – FM has followed the guidance provided by the Government Accountability Office/ President’s Council on Integrity and Efficiency (GAO/PCIE) Financial Audit Manual (FAM). Materiality will be based on the greater of HUD’s total assets or expenses. According to the FAM, planning materiality should generally be three percent of the materiality base, and design materiality should be one-third of the planning materiality. The ACFO-FM will establish materiality level to ensure appropriate testing of all potentially material financial line items.

5. Performing the A-123, Appendix A Assessment

A. Evaluate Internal Control at the Entity Level

Internal control at the entity level refers to those elements of the five components of internal control that have an overarching or pervasive effect on the agency. Specific elements of internal control that should be evaluated at this level are:

- 1) Control Environment: The assessment should include obtaining a sufficient knowledge of the control environment to understand management's attitude, awareness, and actions concerning the control environment. The assessment should consider the collective effect

on the control environment, since management's strengths and weaknesses can have a pervasive effect on internal control.

- 2) Risk assessment: The assessment should include obtaining sufficient knowledge of the agency's process regarding how management considers risks relevant to financial reporting objectives and make decisions on how to address those risks. The assessment should determine how management identifies risks, estimates the significance of risks, assesses the existence of risks in the current environment, and relates them to financial reporting.
- 3) Control activities: Control activities are the policies and procedures that help ensure management directives are carried out and that management's assertions in its financial reporting are valid. The assessment should include obtaining an understanding of the control activities applicable at the entity level.
- 4) Information and communication: The assessment should include obtaining an understanding of the information system(s) relevant to financial reporting.
- 5) Monitoring: The assessment should include obtaining an understanding of the major types of activities the agency uses to monitor Internal Control over Financial Reporting, including the source of the information related to those activities, and how those activities are used to initiate corrective actions.

B. Evaluate Internal Control at the Process, Transaction, or Application Level This should involve:

- 1) Determining significant accounts or groups of accounts
- 2) Identifying and evaluating the major classes of transactions
- 3) Understanding the financial reporting process
- 4) Gaining an understanding of control design to achieve management's assertions
- 5) Identifying controls that are not adequately designed
- 6) Testing controls and assessing compliance to support management's assertions

C. Develop an Overall Assessment of the Design and Operation of Internal Control over Financial Reporting

The final step in the assessment is an overall conclusion as to the design and operation of the internal controls over financial reporting, based on the assessments at the entity level and the process, transaction, or application level.

D. Assurance Statement

The overall assessment should conclude whether the internal controls over financial reporting are operating effectively or whether material weaknesses exist in the design or operation.

E. Duplication

The assessment of internal control over financial reporting should be coordinated with other activities to avoid duplication of efforts with similar activities.

F. Documentation

The documentation will be maintained by the OACFO-FM and be readily available for review. Documentation should include appropriate representations from officials and personnel responsible for monitoring, improving, and assessing internal controls, to cover the following:

- 1) Documenting internal control over financial reporting: The assessment team should document its understanding of the agency's internal control over financial reporting. Documentation may be electronic, hard copy format, or both, and be readily available for examination. Documentation could include organizational charts, flow charts, questionnaires, decision tables, or memoranda.
- 2) Documenting the assessment process: The assessment team must document the assessment process of internal control over financial reporting, including:
 - a) The establishment of the assessment team, its authority, and members
 - b) Contracting actions if contractors are used to perform or assist in the assessment
 - c) Communications with agency management and employees regarding the assessment
 - d) Key decisions of the assessment team
 - e) The assessment methodology and guide
 - f) The assessment of internal control at the entity level
 - g) The assessment of internal control at the process, transaction, or application level
 - h) The testing of controls and related results
 - i) Identified deficiencies and suggestions for improvement

G. Subsequent Reviews

- 1) The requirement for documentation will be lessened in subsequent years, as internal control activities focus on testing once the internal control process has been fully documented in the initial year.
- 2) The establishment of continuous monitoring systems as a sustainable process will lessen the burden of testing over time.

6. Management's Assurance Statement on Internal Control Over Financial Reporting

A. Requirements

Each Federal agency is required to provide a separate assurance statement on internal control over financial reporting. This statement is a subset of the overall FMFIA assurance statement and is based on the results of management's assessment conducted in accordance with the requirements in *A-123, Appendix A*. This assurance statement is required each year and must include the following:

- 1) A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the agency
- 2) A statement identifying the OMB Circular A-123, Management's Responsibility for Internal Control, as the framework used by management to conduct the assessment of the effectiveness of the agency's internal control over financial reporting
- 3) An assessment of the effectiveness of the agency's internal control over financial reporting as of June 30th each year, including an explicit conclusion as to whether the internal controls over financial reporting are effective
- 4) If a material weakness is discovered by June 30th, but corrected by September 30th, a statement identifying the material weakness, the corrective action taken, and that it has been resolved by September 30th
- 5) If a material weakness is discovered after June 30th, but prior to September 30th, the statement of assurance should be updated to include the subsequently identified material weakness

B. Assurance Statement Conclusion

Management is required to state a direct conclusion about whether the agency's internal controls over financial reporting are effective. The statement must take one of the following forms, per the latest OMB Circular A-136, as revised August 2017:

- Unmodified - The system of internal controls currently in place ensures that major program objectives are being met and control techniques are working properly, and that the objectives of the FMFIA are being achieved.
- Modified - The system of internal controls currently in place ensures that major program objectives are being met and control techniques are working properly, with exceptions noted. Provide a brief explanation for the qualification contained in the statement.
- No assurance - The system of internal controls does not ensure that major program objectives are being met and control techniques are working properly, and the objectives of the FMFIA are not being achieved.

C. Material Weaknesses

- 1) Management is precluded from concluding that the agency's internal control over financial reporting is effective if there is one or more material weakness. Management must make the final determination regarding what constitutes a material weakness. Management is required to disclose all material weaknesses that exist as of June 30th of the current fiscal year.
- 2) Management may be able to accurately represent that internal control over financial reporting, as of June 30th of the agency's current fiscal year, is effective, even if one or more material weaknesses existed during the period. To make this representation, management must have implemented improvements in internal control over financial reporting to mitigate the material weaknesses, and have satisfactorily tested the effectiveness over a period of time that is adequate for it to determine whether, as of June 30th of the current fiscal year, the design and operation of the internal controls over financial reporting are effective.

D. Correcting Material Weaknesses in Internal Control over Financial Reporting

The ACFO–FM Assessment Team is responsible for tracking material weaknesses and findings to ensure the prompt and proper resolution and implementation of corrective action on identified material weaknesses. The ACFO–FM Assessment Team is also responsible for reviewing the progress against the corrective action plans periodically, and then communicating the status of the corrective action plan to the FM Council via the ACFO–FM on a regular basis.

Appendix 1: Glossary of Acronyms

The table below contains a list of acronyms and full names found in this policy.

Acronym / Term	Definition
ACFO	Assistant Chief Financial Officer
AFR	Agency Financial Report
CFO	Chief Financial Officer
FM	Financial Management
FMFIA	Federal Managers' Financial Integrity Act
GAO	U.S. Government Accountability Office
HUD	U.S. Department of Housing and Urban Development
OMB	Office of Management and Budget

Appendix 2: Legislative and Regulatory Requirements

This policy is developed based on the following federal regulations and guidance:

- A. *Title 31, Section 3512, United States Code, "Executive agency accounting and other financial management reports and plans"* (Requires Federal Agency Head to establish and maintain systems of accounting and internal controls)
- B. *OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control*, July 15, 2016
- C. *Implementation Guide for Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Internal Control, Appendix A, Internal Control over Financial Reporting*, dated July 2005
- D. *Government Accountability Office (GAO), "Standards for Internal Control in the Federal Government,"* September 2014 (Refers to "Green Book" and sets the standards for an effective internal control system for federal agencies and provides the overall framework for designing, implementing, and operating an effective internal control system)
- E. *GAO/President's Council on Integrity and Efficiency Financial Audit Manual, Section 390.05*, July 2008 (Governs the requirements of Process Cycle Memorandum and Flowcharts)
- F. *The Federal Managers Financial Integrity Act of 1982* (Requires the establishment of "internal accounting and administrative controls")