



Office of Inspector General

Audit Report

Office of Water's Implementation of the Federal Managers' Financial Integrity Act

E1AME4-07-0024-4100236

March 31, 1994

Inspector General Division
Conducting the Audit:

Central Audit Division
Kansas City, Kansas

Headquarters Office:

Office of Water



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

March 31, 1994

MEMORANDUM

OFFICE OF
THE INSPECTOR GENERAL

SUBJECT: Office of Water's Implementation of the
Federal Managers' Financial Integrity Act
Report No. E1AME4-07-0024-4100236

FROM: Michael Simmons *Michael Simmons*
Associate Assistant Inspector General
for Internal and Performance Audits

TO: Robert Perciasepe
Assistant Administrator
Office of Water

Our report on the Office of Water's (OW) implementation of the Federal Managers' Financial Integrity Act is attached. We conducted the audit as part of a nationwide audit of the Environmental Protection Agency's (EPA) Integrity Act implementation. We discussed our findings with your Policy and Resources Management office and issued a draft report. We summarized your comments to the draft report and exit conference discussions in the report. Your complete response is included as Appendix I to the report.

Our overall audit objective was to determine if OW effectively implemented the Integrity Act to ensure its resources were reasonably protected from fraud, waste, abuse, and mismanagement. Specifically, our objectives were to determine if OW: (1) developed accurate annual management control plans (MCP), (2) evaluated management controls appropriately, (3) reported the evaluation results accurately and implemented timely corrective actions when necessary, and (4) established management control responsibilities in managers' performance standards and trained managers in their responsibilities.

OW emphasized the Integrity Act implementation through increased training and by including Integrity Act requirements in performance agreements. However, to effectively implement the Integrity Act, managers needed to tie the processes for planning, evaluating, and reporting to day-to-day operations.



Recycled/Recyclable
Printed with Soy/Canola Ink on paper that
contains at least 50% recycled fiber

In accordance with our longstanding agreement outlined in EPA Order 2750, we request that you, as the action official, provide us your written response to the audit report within 90 days. Your comments should address all findings and recommendations and include planned corrective actions and milestones for completing the actions.

This audit report contains findings that describe problems the Office of Inspector General (OIG) has identified and corrective actions OIG recommends. This audit report represents the opinion of OIG. Final determinations on matters in this audit report will be made by EPA managers in accordance with established EPA audit resolution procedures. Accordingly, the findings described in this audit report do not necessarily represent the final EPA position. We have no objections to the release of this report to the public.

If your staff has any questions, please have them contact Nikki Tinsley, Divisional Inspector General, at (913) 551-7824 or Bennie Salem, Audit Manager, at (913) 551-7831.

Attachment

EXECUTIVE SUMMARY

PURPOSE

In 1992, the Senate Committee on Governmental Affairs raised questions with the Environmental Protection Agency's (Agency) Inspector General regarding the adequacy of Agency controls to detect significant management and program weaknesses. Also, the Comptroller General stated that management controls are necessary to account properly for resources and to help managers positively achieve program objectives by serving as checks and balances against undesired actions. This audit was part of a nationwide audit of the Agency's Integrity Act implementation.

The overall audit objective was to determine if the Office of Water (OW) effectively implemented the Integrity Act to ensure its resources were reasonably protected from fraud, waste, abuse, and mismanagement. Specifically, our objectives were to determine if OW: (1) developed accurate annual management control plans (MCP), (2) evaluated management controls appropriately, (3) reported the evaluation results accurately and implemented timely corrective actions when necessary, and (4) established management control responsibilities in managers' performance standards and trained managers in their responsibilities.

BACKGROUND

The Federal Managers' Financial Integrity Act of 1982 (Integrity Act), P.L. 97-255, amended the Accounting and Auditing Act of 1950 and required agencies to conduct ongoing evaluations of the adequacy of their accounting and administrative control systems and report annually to the President and Congress. Annual reports must cite material weaknesses in agencies' control systems. To provide reasonable assurance that agencies achieved the Integrity Act objectives, the Integrity Act required agencies to evaluate the control systems annually against General Accounting Office (GAO) standards and Office of Management and Budget guidance.

The Resource Management Division in the Office of Administration and Resources Management, Office of the Comptroller, coordinates the Agency's Integrity Act efforts. The Agency is divided into 22 major organizational components and has designated a primary organization head for each organizational component to administer the Integrity Act process. OW's primary organization head is the Assistant

Administrator. Each primary organization head delegates an individual to coordinate, monitor, and implement Agency internal control guidance within its organization. OW's Assistant Administrator designated a budget analyst in the Budget and Administrative Management Staff in OW's Policy and Resources Management Office as the Management Control Coordinator. The budget analyst has responsibility for OW's compliance with the Integrity Act.

RESULTS IN BRIEF

OW instructed managers on the Integrity Act processes and submitted the required reports, but managers did not effectively integrate the Integrity Act concepts into management activities. OW managers exhibited a positive attitude, properly established Integrity Act responsibilities in managers' fiscal 1993 performance agreements, and reported control weaknesses. However, managers implemented the Integrity Act as a process apart from other management activities, and did not fully understand how the Integrity Act process and management controls related to mission accomplishment. Integrity Act training did not improve managers' use of Integrity Act principles. OW managers did not identify all control systems with the related policies and procedures used to operate the systems, and did not evaluate the management processes. As a result, OW's Integrity Act efforts had not contributed to the efficiency and productivity of the organization.

OW's MCP did not provide an adequate strategy for implementing the Integrity Act in accordance with GAO standards. Assessable unit managers had not listed all of their programs and functions with associated risk levels and appropriately scheduled evaluations. In addition, managers did not test controls and perform scheduled control evaluations. OW needed a complete list of programs and functions including new and changing programs and functions to ensure managers identified, documented, and evaluated management controls. As a result, OW did not adequately implement the Integrity Act and ensure that systems worked as intended.

RECOMMENDATIONS

We recommend that the Assistant Administrator for OW improve the administration of the Integrity Act and tie it more closely to daily program management by requiring managers to: (1) identify and list all programs and functions, (2) use risk assessments of programs and functions to prioritize control reviews, and (3) plan and conduct their own reviews

to evaluate and test documented controls. To tie the Integrity Act concepts into their jobs, managers need comprehensive training on incorporating the Integrity Act processes into their daily activities.

AGENCY COMMENTS AND OIG EVALUATION

OW identified two factors it considered when implementing programs and the Integrity Act. First, OW's programs are decentralized and program managers are responsible to Regional Administrators. Second, OW managers meet with Regional counterparts and discuss and identify problems outside the Integrity Act process. OW committed to integrate management integrity concepts into its program and provide training to managers. OW expressed concern about implementing the recommendations prior to EPA implementing its new Integrity Act model and said that improvements in management integrity should be based on the new model.

We added information to the report to acknowledge OW for identifying and discussing problems in managers' meetings. OW's programs may be decentralized, but delegation of program performance does not relieve OW of its responsibility and accountability to use Agency resources to effectively and efficiently achieve program goals and objectives. The policies and procedures that OW and Regional managers discuss and improve need to be documented and periodically tested to assure programs are achieving desired results, to give credence to OW actions and comply with the intent of the Integrity Act. We revised our recommendations to reflect actions necessary for OW to comply with the Integrity Act, GAO standards, and the new Agency model.

TABLE OF CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY	i
CHAPTERS	
1 INTRODUCTION	1
PURPOSE	1
BACKGROUND	2
SCOPE AND METHODOLOGY	3
PRIOR AUDIT COVERAGE	4
2 OW NEEDED TO APPLY INTEGRITY ACT CONCEPTS TO ONGOING OPERATIONS	5
GAO PRESCRIBES INTEGRATING CONTROLS INTO MANAGEMENT SYSTEMS	5
OW NEEDED TO INTEGRATE INTEGRITY ACT PROCESS INTO ONGOING MANAGEMENT ACTIVITIES	6
OW MANAGERS NEEDED TO UNDERSTAND THEIR INTEGRITY ACT RESPONSIBILITIES	7
OW SHOULD EXCHANGE INTEGRITY ACT INFORMATION WITH REGIONAL PROGRAM OFFICES	8
CONCLUSION	8
RECOMMENDATIONS	9
AGENCY COMMENTS AND OIG EVALUATION	9
3 OW NEEDED TO DEVELOP A STRATEGY FOR IMPLEMENTING THE INTEGRITY ACT	10
GAO STANDARDS PROVIDE THE FRAMEWORK FOR IMPLEMENTING THE INTEGRITY ACT	10
OW NEEDED TO IDENTIFY ALL ACTIVITIES WHEN IT DETERMINED WHICH CONTROL SYSTEMS TO REVIEW	11
OW NEEDED TO RATE PROGRAM AND FUNCTION RISK	11
OW NEEDED TO TEST CONTROLS	12
CONCLUSION	14

RECOMMENDATIONS	14
AGENCY COMMENTS AND OIG EVALUATION	14
APPENDIXES	
APPENDIX I: AGENCY COMMENTS	15
APPENDIX II: ABBREVIATIONS	19
APPENDIX III: DISTRIBUTION	20

CHAPTER 1

INTRODUCTION

PURPOSE

The Federal Managers' Financial Integrity Act of 1982 (Integrity Act) required agencies to conduct ongoing evaluations and report annually to the President and Congress on the adequacy of their accounting and administrative control systems. Also, the Comptroller General stated that management controls are necessary to account properly for resources and to help managers positively achieve program objectives by serving as checks and balances against undesired actions. As required by the Integrity Act, the Comptroller General prescribed the management control standards and Office of Management and Budget (OMB) established guidelines for agencies to implement the Integrity Act process.

The Office of Inspector General (OIG) provides technical assistance to improve the Environmental Protection Agency's (Agency) management controls and reports to the Administrator on the Agency management control efforts each year. In 1992, the Senate Committee on Governmental Affairs raised questions regarding the adequacy of Agency controls to detect significant management and program weaknesses. As a result, OIG expanded audit coverage of the Agency's Integrity Act process and performed a nationwide audit of the Agency's Integrity Act implementation. The Office of Water (OW) audit was part of that nationwide effort.

OW provides Agency-wide program policy, guidance, and direction for the Agency water programs. The Agency charges OW with protecting the environment and human health from hazardous water contamination through the development of environmental and pollution source standards. OW is responsible for evaluating regional activities to ensure enforcement, compliance, and permitting activities minimize water pollution. OW is responsible for providing scientific technical assistance and developing long-term strategic planning and long-term environmental and economic analysis for implementation of pollution prevention strategies nationwide. OW received annual appropriations of about \$189 million and had about 640 full-time equivalents to operate its national program office and oversee water programs administered by the 10 regions in fiscal 1993.

Our overall audit objective was to determine if OW effectively implemented the Integrity Act to ensure OW's resources were reasonably protected from fraud, waste, abuse,

and mismanagement. Specifically, our objectives were to determine if OW:

- developed annual management control plans (MCP) that properly identified organizational components with associated risk levels and provided for necessary management control evaluations,
- evaluated management controls appropriately and determined management control systems' effectiveness,
- reported the evaluation results accurately and implemented timely corrective actions when necessary, and
- established management control responsibilities in managers' performance standards and trained managers in their responsibilities.

BACKGROUND

The Integrity Act amended the Accounting and Auditing Act of 1950. The Integrity Act required agencies' to establish control systems in accordance with General Accounting Office (GAO) standards issued by the Comptroller General (also identified as GAO standards). According to the Integrity Act, agencies' control systems should provide reasonable assurance that agencies protect Government resources against fraud, waste, mismanagement, or misappropriation and effectively and efficiently manage both existing and new program and administrative activities. Further, the Integrity Act requires agencies to evaluate their systems annually against GAO standards following OMB guidance and report the results to the President and Congress.

Standards For Internal Control In The Federal Government, dated June 1, 1983, presents GAO internal control standards and constitutes criteria against which systems should be evaluated. The standards apply to all operations and administrative functions. OMB Circular A-123 (Revised), dated August 4, 1986, requires each agency to establish, maintain, evaluate, improve, and report on its systems of controls. OMB issued guidelines for the process in 1982.

OMB defines management controls to include an entity's organization; written policies and procedures; explicit statements of organizational mission and corresponding standards for mission performance; systems for evaluating performance against existing laws, regulations, policies, and performance standards; system controls; and recognized

accounting controls. Management control weaknesses result when controls are not designed adequately or functioning effectively.

The Resources Management Division (RMD) in the Office of the Comptroller, Office of Administration and Resources Management, coordinates the Agency's Integrity Act efforts. The Agency is divided into 22 major organization components and has designated a primary organization head for each organizational component to administer the Integrity Act process. The primary organization head must annually evaluate Integrity Act compliance and report the results. Each primary organization head delegates an individual to coordinate, monitor, and implement Agency internal control guidance within its organization.

OW's primary organization head is the Assistant Administrator and a budget analyst in the Budget and Administrative Management Staff in OW's Policy and Resources Management Office is the Management Control Coordinator (MCC). OW had 15 assessable units as of fiscal 1993 whose managers are responsible for operating efficient and effective management control systems, evaluating the control systems, and taking timely corrective actions on all identified weaknesses.

Currently, OMB is revising Circular A-123 and RMD is reengineering its management integrity process. RMD envisions an approach that simplifies the process by integrating it into ongoing management activities. Both the OMB guidelines and the Agency's process must incorporate the Comptroller General standards as required by the Act.

SCOPE AND METHODOLOGY

We performed our fieldwork from August 1993 through December 1993 and focused on OW's Integrity Act implementation and reporting in fiscal 1992 and 1993. We evaluated vulnerability assessments and MCPs to determine whether OW identified and properly scheduled reviews of programs and functions. We reviewed event cycles, control objectives, and control techniques to determine whether OW properly documented its management processes and procedures. We reviewed OW's strategic plan and compared it to OW's Integrity Act processes for integration of both processes. Also, we judgmentally selected 10 of OW's 63 fiscal 1992 and 1993 control reviews and evaluated if the reviews met OMB criteria. We selected at least one control review from each division that had completed a review. We reviewed OW's fiscal 1992 and 1993 assurance letters and program offices' sub-assurance letters to determine if OW properly used the Integrity Act process to identify weaknesses. In addition, we evaluated the MCC's oversight and coordination of the

Integrity Act process to determine if it was properly implemented. We judgmentally selected and reviewed fiscal 1992 and 1993 performance agreements, 1993 appraisals, and training records for 20 individuals: the Acting Assistant Administrator, 2 high level policy staff managers, the MCC, the 5 sub-MCCs, 4 office directors, and 7 division directors to determine if OW established management control responsibilities in managers' performance agreements, held managers accountable for Integrity Act implementation, and trained managers in their responsibilities. The sample selection was designed to include a representative sample of the key managers responsible for the Integrity Act process in OW's six divisions. Also, we interviewed managers to determine if they had a general understanding of the Integrity Act process and their responsibilities.

We conducted the audit in accordance with Government Auditing Standards (1988 Revision) issued by the Comptroller General of the United States. The findings in this report include control weaknesses identified during the audit and our recommendations to correct the weaknesses, when appropriate. No other issues came to our attention which we believed were significant enough to warrant expanding the scope of the audit.

PRIOR AUDIT COVERAGE

OIG and GAO have audited the Agency's Integrity Act process and reported deficiencies since 1983. For example, the OIG audit of the Agency's 1989 Integrity Act process reported control reviews did not properly test controls and not all major activities had been identified. Based on recent audits of Regions 1, 7, and 8 Integrity Act implementation, we determined that further audit of the administration and implementation of the Integrity Act process at the Agency Headquarters level was warranted. Regional audits disclosed a general lack of understanding of the Integrity Act process. Managers had not developed proper MCPs, scheduled control evaluations, and evaluated existing controls. Managers were not adequately trained on the Integrity Act and held accountable for implementing effective management control systems. Regional personnel stated they did not understand that the Integrity Act was a necessary mechanism to ensure mission accomplishment.

CHAPTER 2

OW NEEDED TO APPLY THE INTEGRITY ACT CONCEPTS TO ONGOING OPERATIONS

OW instructed managers on the Integrity Act processes and submitted the required reports, but managers did not effectively integrate the Integrity Act concepts into management activities. OW managers exhibited a positive attitude, properly established Integrity Act responsibilities in managers' fiscal 1993 performance agreements, and reported control weaknesses. However, managers did not understand the link between their management processes and Integrity Act requirements and stated they did not fully understand how the Integrity Act related to mission accomplishment. Integrity Act training was insufficient. As a result, OW managers did not identify and assess risk for all control systems, and properly evaluate management controls. OW's Integrity Act efforts had not contributed to the program efficiency and effectiveness nor to mission accomplishment.

GAO PRESCRIBES INTEGRATING CONTROLS INTO MANAGEMENT SYSTEMS

GAO identifies internal (now called management) controls as an integral part of the systems managers use to regulate and guide their operations. The Comptroller General Standards define the minimum level of quality acceptable for management control systems and constitute the criteria against which systems are to be evaluated. They apply to all operations and administrative functions. The standards include the following requirements:

- Managers and employees should have clear lines of authority and responsibility. Duties, responsibilities, and accountabilities should be clearly communicated to staff members. Performance appraisals should be based on an assessment of implementation and maintenance of effective management controls.
- Managers and employees are to maintain a level of competence that allows them to accomplish their assigned duties, as well as understand the importance of developing and implementing good management controls. Individuals should be given the necessary formal and on-the-job training.

GAO recognized that management controls facilitate the achievement of management objectives by serving as checks and balances against undesired actions. In preventing negative

consequences from occurring, management controls help achieve the positive aims of program managers.

The Integrity Act process begins at the point at which a program or function has been authorized by the policy-level official having authority to do so, and focuses on the steps involved in program operation. Management controls include the plan of organization, methods, and procedures adopted by management to ensure that it meets its goals and objectives. The Integrity Act process should be incorporated into the routine of daily management activities.

OW NEEDED TO INTEGRATE INTEGRITY ACT PROCESS INTO ONGOING MANAGEMENT ACTIVITIES

Managers did not integrate the Integrity Act process into ongoing management activities as envisioned by the Act and GAO standards. OW managers identified and discussed programs and problems in management meetings, but did not link the meetings to Integrity Act requirements. As a result, OW managers prepared documents that they did not use and that did not improve controls or benefit their organizations.

Managers implemented the Integrity Act as a process apart from other management activities. They prepared time consuming paperwork that addressed Integrity Act requirements for planning, documenting, and evaluating controls and met RMD milestones, but they did not increase efficiency and productivity of OW's operations as a result of applying the process.

As part of the strategic planning process, OW managers appropriately identified the need for environmental risk indicators to prioritize work and direct resources. At the time of our review, OW's strategic plan had not been completed and did not address why and how the water quality goals and objectives would be met. Likewise, OW's control documentation did not identify how its managers would achieve the goals of the strategic plan.

After identifying priorities, managers should have identified obstacles to accomplishing strategic plan objectives and program goals (e.g., outdated written guidance). They should have then documented controls necessary to produce the desired results (e.g., written policies and procedures).

OW advised us that it reviewed program performance outside the Integrity Act process through meetings and discussions. For example, Office Directors, the Deputy Assistant Administrator, and the Assistant Administrator had quarterly meetings with Water Division Directors during which they identified and discussed key problems, established follow-up

actions as needed, and shared regional experiences. Program offices met with their program counterparts at least annually where program-specific problems were identified and discussed in greater detail. As a result of the meetings, OW issued guidance and direction. To integrate these management meetings with the Integrity Act requirements and GAO standards, OW could have based problem discussions on documented reviews of policies and procedures and later tested revised policies and procedures to ensure they produced desired results.

OW's mission states that it is responsible for developing and implementing a nationwide policy for water quality programs. If OW managers had integrated the Integrity Act's documentation requirements with the strategic planning process, they would have identified and reviewed controls to ensure the strategic plan achieved short-term goals. Also, they would have identified and tested controls to ensure that accomplishing short-term goals would lead to achieving the long-term goals of the strategic plan.

OW MANAGERS NEEDED TO UNDERSTAND THEIR INTEGRITY ACT RESPONSIBILITIES

OW appropriately established Integrity Act responsibilities in fiscal 1993 performance agreements we reviewed, but OW managers acknowledged they needed a better understanding to perform their Integrity Act responsibilities. OW emphasized the Integrity Act by developing and presenting Integrity Act training to several OW groups, but managers stated they still did not know how to relate the Integrity Act processes to their jobs. To improve their understanding of the Integrity Act process, OW management volunteered to pilot the new RMD Integrity Act model.

We could not determine the degree to which managers were held accountable for implementing Integrity Act requirements. OW appropriately included Integrity Act responsibilities in managers' performance agreements, but appraisals contained only numerical ratings and did not discuss specifics of managers' Integrity Act performance. For fiscal 1992, 13 of the 19 performance agreements reviewed (68 percent) contained Integrity Act responsibilities. In 1992, the MCC reminded managers that their performance agreements had to include Integrity Act responsibilities. For fiscal 1993, 19 of 20 managers' performance agreements (95 percent) contained Integrity Act responsibilities.

Nineteen of the 20 managers received some form of Integrity Act training, but the training did not significantly improve managers' use of Integrity Act principles to evaluate their controls. Six managers received formal classroom training

and 13 received some informal training. Although managers received training, they did not understand how to integrate into their jobs the Integrity Act concepts of identifying program risk, planning and performing control reviews, and strengthening controls. The MCC and sub-MCCs stated that the biggest obstacle in implementing the Integrity Act was helping managers understand the correlation between risk assessments, MCPs, and control evaluations. Managers associated the Integrity Act with paperwork, not with accomplishing the water program mission.

OW SHOULD EXCHANGE INTEGRITY ACT INFORMATION WITH REGIONAL PROGRAM OFFICES

Audits of the Integrity Act process in three regions disclosed that regions had not developed adequate program controls because regional program managers did not understand what constituted a control. OW could better ensure program offices accomplish the overall water program goals and objectives by collaborating with regional program offices to identify controls, evaluate risk, and review program accomplishments in order to improve controls. OW could use weaknesses identified by regions as early warnings of potential program-wide problems, indicators that weaknesses exist that affect the successful accomplishment of OW's overall program goals and objectives and could disseminate information on improved controls developed by regions. In appropriate instances, OW could develop standardized water program controls to ensure that regions support and fulfill the Agency and program goals, since part of OW's mission is to evaluate regional programs. OW advised us that the Headquarters program oversight role is being reduced; this makes its collaborative efforts to strengthen regional capabilities more important.

CONCLUSION

OW managers followed annual Agency Integrity Act guidance but did not properly apply the processes to achieve the intent of the Integrity Act. Managers needed to tailor Integrity Act guidance to their specific programs and functions to benefit from using the Integrity Act process. Managers attempted to interpret and understand Agency Integrity Act guidance, but were not successful because they did not understand the intent of Integrity Act requirements and RMD's guidance needed improvement. OW managers need to understand the Integrity Act concepts and apply the processes to their jobs for management integrity to be successful.

RECOMMENDATIONS

We recommend that the Assistant Administrator:

1. Establish procedures to ensure that all managers integrate Integrity Act requirements into management activities and instruct managers on the correlation between the processes. Direct controls toward effective and efficient implementation of OW's strategic plan.
2. Develop model management principles to share with regional program offices to build core integrity concepts into existing program guidance and reviews. Collaborate with regional program offices to identify controls, evaluate risk, and review program accomplishments to improve controls.
3. Obtain results of regional control evaluations to identify potential Agency-wide weaknesses and advise the regions and other media when appropriate. Exchange identified weaknesses with all regions and Headquarters program and administrative offices, when appropriate. For potential Agency-wide weaknesses identified by regions, strengthen controls in written policies and procedures.

AGENCY COMMENTS AND OIG EVALUATION

OW agreed that the Integrity Act process was not fully integrated into daily operations, but stated that it implemented management controls and identified weaknesses and priorities outside the process. OW stated the Agency's current direction is to reduce regional and State oversight, and that regional oversight is only one of its many activities and not its primary function. OW also stated its resources for regional and state oversight were severely limited.

It stated that oversight was not a primary function and resources for regional and State oversight were severely limited.

Integrity Act implementation can be successful when OW managers understand and apply basic management control principles as part of their daily operations. Existing management processes and mechanisms such as management meetings that anticipate, identify, and resolve mission critical issues should be recognized as management controls and should be linked with the Integrity Act. Integrity is more important when oversight is limited because increasing empowerment places greater dependence on sound management controls.

CHAPTER 3

OW NEEDED TO DEVELOP A STRATEGY FOR IMPLEMENTING THE INTEGRITY ACT

OW's MCP did not provide an adequate strategy for implementing the Integrity Act. Assessable unit managers had not identified risk for all of their programs and functions and appropriately scheduled control reviews. In addition, managers did not perform scheduled control reviews or always test controls when they performed a control review. As a result, OW did not adequately implement the Integrity Act and determine that control systems were working to ensure water program mission accomplishment.

GAO STANDARDS PROVIDE THE FRAMEWORK FOR IMPLEMENTING THE INTEGRITY ACT

The Integrity Act focuses on the need for Agencies to strengthen control systems, periodically evaluate the systems, and report significant system weaknesses. As discussed in Chapter 2, GAO established the standards for Agencies to follow when developing and reviewing management control systems. In addition to the items identified in Chapter 2, the standards require that:

- Management control systems document in writing items including an Agency's organization, plans, policies, and procedures for accomplishing management, financial, program (mission) and administrative (program support) goals.
- Systems documentation be readily available and easily accessible for examination.
- Agencies identify risks inherent in agency operations and develop control systems for each agency activity and test controls for effectiveness and efficiency.

OMB Circular A-123 requires agencies to identify their control systems, assess the risk of controls not working to achieve expected goals, schedule control reviews based on risk assessments (high risk systems should be reviewed first), perform control reviews, implement actions to correct problems identified during control reviews, and accurately report the results of control reviews. Managers use the MCP to list all control systems, then to identify levels of risk that controls won't achieve goals, and finally to schedule control reviews.

OW NEEDED TO IDENTIFY ALL ACTIVITIES WHEN IT
DETERMINED WHICH CONTROL SYSTEMS TO REVIEW

For fiscal 1992 and 1993, the OW MCP did not include all programs and functions (administrative activities such as contracts, grants, resource management activities). OW managers stated they followed RMD's written guidance which recommends segmenting an office according to the organizational structure to identify control systems, although OMB Circular A-123 recommends identifying all programs and functions. Managers appeared to be confused by Integrity Act terminology as illustrated by items they identified as programs and functions.

OW appropriately identified assessable units, but unit managers did not identify all programs and functions. OW designated each division and major program office an assessable unit. Assessable unit managers had not identified all major programs and functions on the MCP and thus did not consider all control systems when assessing risk and deciding what programs to review. Managers had developed a more complete list of programs and functions in their control documentation but did not use the list to determine which controls to review.

Managers used different approaches to segment their assessable units in the MCP, and included terms which did not represent programs, functions, or major activities. For example, the Permits Division improperly listed the term "office director" as a subunit on the fiscal 1992 and 1993 MCPs rather than listing programs or functions. The Ground Water Protection Division improperly listed the terms "office director" and "division director" as two subunits rather than programs or functions. The Oceans and Coastal Protection Division and the Wetlands Division did not identify any component inventory on the MCPs. In addition, managers generally did not list any administrative functions in the MCP inventory, although some managers identified functions such as budgeting in their control documentation.

OW NEEDED TO RATE PROGRAM AND FUNCTION RISK

OW managers did not plan control evaluations based on risk as required by the GAO standards and the risk assessments managers performed were not meaningful. Consequently, risk assessments did not provide a basis to identify which programs and functions should be reviewed immediately so that managers could identify problems impeding mission accomplishment and take appropriate corrective action.

Thirteen of OW's 14 fiscal 1992 vulnerability assessments did not identify specific areas of vulnerability and were so

broad that managers could not identify individual program and function risk ratings. Managers assessed risk based on their impressions of overall controls rather than specific program and function controls. Only the Municipal Support Division's fiscal 1992 risk assessment appropriately identified specific areas of vulnerability and identified functions needing more effective controls.

The Wetlands Division risk assessments were too general to identify controls needing review. In fact, Wetlands managers did not schedule any control reviews for the 5-year period covered by the MCP, even though OIG's report, "Wetlands: EPA's Implementation and Management of the Section 404 Wetlands Program" (E1HWE0-04-0291-1100434), issued September 30, 1991, identified significant program weaknesses. Wetlands managers should have assessed controls over activities reported as problems as high risk and reviewed controls during the year following the audit. OW needed a complete list of programs and functions to ensure managers assessed risk in all areas.

Also, OW managers should have performed vulnerability assessments when significant program and organizational changes occurred. For example, OW reorganized in fiscal 1991, and OW significantly changed functions in the Office of Wastewater, Enforcement and Compliance. The Office of Watersheds, Oceans, and Wetlands changed from three separate offices to one office with three divisions. OW managers did not assess the risks associated with the reorganizations to determine if the existing control structure was adequate to ensure program goals would be effectively and efficiently accomplished.

OW NEEDED TO TEST CONTROLS

OW managers did not test controls as required by the Integrity Act. Managers generally did not plan and schedule control reviews, because they had not learned exactly what a control review entailed. Managers misunderstood the purpose of the reviews and stated that their involvement in day-to-day operations was enough control. Some managers' comments reflected that they did not understand the difference between control systems and control reviews. As a result, managers relied on external audit groups to test controls or identified control weaknesses without testing or improving control systems documentation.

Eight of the 10 control reviews we evaluated did not test controls. Instead managers identified recurring activities such as program status reports and briefings and controls themselves as control reviews. For example, the Permits Division reviewed and updated its permits backlog list and

reported this activity as a control evaluation. The Health and Ecological Criteria Division counted a cost tracking system as a control review. The Engineering and Analysis Division counted periodic briefings to the division director as a control review.

OW managers did not accurately test written management policies and procedures to see if they were working to accomplish program goals. Control tests should evaluate whether management policies and procedures operate as intended. For example, managers using the cost tracking system in the Health and Ecological Criteria Division should establish a goal to assure data accuracy and periodically test the accuracy of data recorded in the system as a quality assurance measure. To evaluate the accuracy, managers could compare a small quantity of recorded data to the actual documents. Then, as a control review, managers could check to see that the data accuracy tests were actually being performed and corrective measures were taken when test results disclosed deficiencies, or managers could perform an independent test to compare to the data accuracy tests performed during the period.

Managers appropriately tested controls during two control reviews but did not document control improvements made as a result of the reviews. Managers conducting the two evaluations stated they found controls were inadequate or missing and changed the way they performed their work, but did not document the change in their written policies and procedures. Since documentation of the new control did not exist, managers could not ensure the new control was working as intended through validation tests. In addition, managers could not fully or adequately correct weaknesses identified through management discussion and judgment, because they could not identify the extent of the control weakness without testing the procedures.

Managers relied on external audit groups such as OIG and GAO to test controls. External audits of programs and functions can be adequate substitutes for planned reviews, but OW cannot project when outside audit groups will make reviews or what areas will be included in the review. OW managers should plan their own reviews of programs and functions and cancel them if an audit or other acceptable substitute review occurs.

OW managers identified more than half of their reportable weaknesses outside the Integrity Act process. External audit groups identified 14 of 26 weaknesses reported in fiscal 1992 and 1993. OW managers identified the other weaknesses through meetings and judgment. If managers had reviewed their controls, weaknesses might have been identified and corrected before problems became serious. For example, OW

managers identified and appropriately reported Confidential Business Information (CBI) as a weakness after several boxes of CBI were lost. Managers appropriately improved CBI protection procedures. However, if managers had reviewed CBI controls in accordance with the Integrity Act, the control weakness could have been identified and corrected before OW lost CBI.

CONCLUSION

OW managers prepared the majority of the required Integrity Act paperwork without knowing or anticipating how each piece fit together. OW managers prepared MCPs with no consistent method of segmenting assessable units by programs and functions, so risk assessments were too broad to provide a basis to schedule control reviews. Also, OW did not identify weaknesses through control evaluations. As a result, managers did not use the Integrity Act process to evaluate and report on their control systems or to improve controls.

RECOMMENDATIONS

We recommend that the Assistant Administrator:

1. Advise managers to consider all programs and functions when assessing risk. Require managers to assess risk as a basis for control reviews and to review controls in high risk areas. Encourage managers to use completed audits and other reviews as part of this assessment.
2. Require control reviews to include documented tests of management policies and procedures and require managers to document improvements or changes.

AGENCY COMMENTS AND OIG EVALUATION

OW expressed concern that our recommendations might not be consistent with EPA's reengineered Integrity Act process and said it would respond to the recommendations based on EPA's revised Integrity Act implementation guidance.

We revised our recommendations to reflect actions necessary for OW to comply with the Integrity Act and GAO standards, and to implement the proposed Agency model.



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

OFFICE OF
WATER

MEMORANDUM

SUBJECT: Office of Water's Implementation of the Federal
Managers' Financial Integrity Act
Draft Report No E1SFE3-07-0101-XXXX

FROM: Robert Perciasepe *[Signature]* 3/29/94
Assistant Administrator

TO: *[Signature]* Michael Simmons
Associate Assistant Inspector General
for Internal and Performance Audits

The Office of Water has reviewed the Draft Report on OW's Implementation of the Federal Managers' Financial Integrity Act. We appreciate the recognition that OW managers exhibited a positive attitude and OW has emphasized the Integrity Act requirements through developing and presenting training, including Integrity Act requirements in performance agreements, and submitting the required reports.

Before addressing the specific findings and recommendations in the Draft Report, I call to your attention two factors which we in OW must consider when implementing our programs and FMFIA activities.

First, we need to respect the heavily delegated status of our programs. Water programs are the most delegated within the Agency whose policy is to provide States, as well as our Regional Offices, with increasing autonomy and flexibility to deal with site-specific problems and develop site-specific solutions. We in OW can and do set general priorities and directions, and provide guidance in implementing program requirements. However, within this framework, Regions and States are being given increasing freedom to administer their programs as they determine. Moreover, as I trust you are aware, we can and do provide guidance to the Regions, although Regional program managers are responsible to their Regional Administrators.

-2-

Second, OW identifies problems and provides management direction and oversight to the Regions in many ways outside of the FMFIA process which, I believe, meet the intent of FMFIA. Many of these practices recognize the heavy delegation of our programs. The Office Directors, Deputy Assistant Administrator, and I have quarterly meetings with the Water Management Division Directors during which we identify and discuss key problems, establish follow-up actions as needed, and share Regional experiences. Our program offices hold meetings with their program counterparts at least annually where program-specific problems are identified and discussed in greater detail. As a result of these meetings, OW issues appropriate guidance and direction.

We have two formal public advisory committees representing a full range of our customers who are quick to point out to us areas where EPA needs to pay more attention. Similarly, the Office Directors and I meet regularly with the regulated community and environmentalists who examine our activities carefully. OW also created an OW/Regional SES-level IRM Steering Committee to deal with information management problems and issues when they were identified after this area was identified as an Agency material weakness. These are just a few examples of our management activities outside of the FMFIA arena. Some examples of these activities are represented in the attached documentation.

Our specific comments regarding the findings and revised recommendations are presented below.

Chapter 2 Findings and Recommendations

Findings. OW NEEDS TO APPLY THE INTEGRITY ACT CONCEPTS TO DAILY OPERATIONS. OW managers need to integrate the Integrity Act processes into their daily operations. OW managers need Integrity Act training to understand their responsibilities and the Resource Management Division (RMD) guidance.

OW COMMENT. The OIG is correct in that the paperwork associated with the FMFIA process is not fully integrated in day-to-day operations. However, the OIG did not take into consideration that there are management controls outside of the formal FMFIA process that are being implemented effectively. In OW for example, FMFIA concepts are being implemented by managers, even though everything does not get or reported through the formal FMFIA process. In addition, we have identified the front-end priorities which Agency management should be paying attention to in our Material and Agency weaknesses.

-3-

1. Establish procedures to ensure that all managers integrate the Integrity Act process into management activities and provide managers instructions on the correlation between the processes. **SEE CLOSING REMARKS.**

2. Share model management principles with regional program offices for their use in developing program controls consistent with OW's mission and goals.

3. Obtain results of regional control evaluations to identify potential Agency-wide weaknesses and advise the regions and other media when appropriate. Exchange identified weaknesses with all regions and Headquarters programs and administrative offices, when appropriate. For potential Agency-wide weaknesses identified by regions, strengthen controls in written policies and procedures.

OW COMMENT ON 2 AND 3. OW sets policy and program direction through regulations, guidance and technical assistance. We also have developed a strategic plan that responds to our evolving programs. Although OW conducts Regional reviews as part of program implementation activities, Regional oversight is only one of the many activities carried out vis-a-vis the Regions and is not our primary function. The Agency's current direction is to reduce Regional and State oversight and we have taken cuts in our FY 1995 budget that significantly limit our resources for performing oversight.

Chapter 3 Findings and Recommendations

Findings. OW NEEDS TO DEVELOP A STRATEGY FOR IMPLEMENTING THE INTEGRITY ACT. OW needed to identify its programs and functions, rate programs and function risks, and schedule appropriate control evaluations.

1. Require managers to assess annually the effectiveness of their management controls for each control system and document the results to help ensure OW's strategic plans and goals are achieved effectively and efficiently. Advise managers to consider all programs and functions when assessing controls. Encourage managers to use completed audits and other reviews as part of this assessment. **SEE CLOSING REMARKS.**

2. Require control evaluations to include documented tests of management policies and procedures and require managers to document improvements or changes. **SEE CLOSING REMARKS.**

3. Require managers to schedule and conduct tests of controls on all programs and functions within a 5-year period based on results of vulnerability assessments and document results. **SEE CLOSING REMARKS.**

-4-

As I am sure you are aware, the Agency is in the process of streamlining the management integrity process. It is anticipated that the new integrity model will make it easy for managers to assess and strengthen Agency programs as part of everyday operations and decision-making. This audit process was started while the old FMFIA process was still in place. Although your recommendations have been revised from the original February 25, 1994 memorandum, it seems inappropriate to make further changes in processes, procedures, documentation and other (FMFIA) controls prior to implementation of the new process. Our response to your final report will depend on the new Agency guidance.

OW will continue to integrate management integrity concepts into our programs and provide training information to our managers. If you should have any questions, please contact Juanita Smith, Management Control Coordinator, on 260-6226.

Attachments

Note: Because the attachments to this letter were provided solely as supporting documentation, we have not included them with this report.

ABBREVIATIONS

Agency	Environmental Protection Agency
CBI	Confidential Business Information
GAO	General Accounting Office
Integrity Act	Federal Managers' Financial Integrity Act
MCC	Management Control Coordinator
MCP	Management Control Plan
OIG	Office of Inspector General
OMB	Office of Management and Budget
OW	Office of Water
RMD	Resource Management Division

DISTRIBUTION

Headquarters Office

Inspector General (2410)
Assistant Administrator for Administration and
Resources Management (3101)
Chief, Communications and Resources Staff (4102)
Management Control Coordinator (4102)
Audit Liaison (4102)
Director, Resource Management Division (3304)
Headquarters Audit Followup Coordinator (3304)
Associate Administrator for Regional Operations and
State/Local Relations (1501)
Headquarters Library (3404)

Regional Offices

Regional Administrator, Regions 1 -10