U.S. ENVIRONMENTAL PROTECTION AGENCY
OFFICE OF INSPECTOR GENERAL

Audit Report

EPA Should Further Connect the National Program Manager Process With Federal Guidance on Internal Control Risks

Report No. 11-P-0067

January 18, 2011

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Abbreviations

EPA	U.S. Environmental Protection Agency
FMFIA	Federal Managers' Financial Integrity Act
FY	Fiscal year
GAO	U.S. Government Accountability Office
GPRA	Government Performance and Results Act of 1993
NPM	National program manager
OCFO	Office of the Chief Financial Officer
OCSPP	Office of Chemical Safety and Pollution Prevention
OMB	Office of Management and Budget
OW	Office of Water
PAR	Performance and Accountability Report

At a Glance

Catalyst for Improving the Environment

Why We Did This Review

We conducted this review to determine how EPA's national program manager (NPM) process relates to the internal control framework under the Federal Managers' Financial Integrity Act (FMFIA). We determined whether the U.S. Environmental Protection Agency (EPA) should improve connections between the two processes and whether NPMs and regions coordinate program management and address risks and vulnerabilities.

Background

FMFIA requires federal agency managers to annually evaluate and indicate whether their agencies' internal controls comply with prescribed standards. NPM guidance sets forth goals and program priorities to support compliance with the Government Performance and Results Act of 1993.

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

To view the full report, click on the following link:
www.epa.gov/oig/reports/2011/20110118-11-P-0067.pdf

EPA Should Further Connect the National Program Manager Process With Federal Guidance on Internal Control Risks

What We Found

EPA has not fully integrated FMFIA and the NPM processes. Activities conducted per the NPM process support internal controls; however, EPA's Office of the Chief Financial Officer did not connect these processes until midway through fiscal year 2009 (in supplemental guidance) and in fiscal year 2010 guidance, and integration efforts are still in their infancy. NPMs already conduct many activities related to internal control, yet national program offices have separate processes and staff responsible for each process. Having national program offices primarily responsible for internal controls over national programs would streamline reporting and lessen confusion among staff involved in both processes.

NPMs have not linked assessing and evaluating relevant risks associated with achieving program objectives to internal control requirements. FMFIA requires managers to define program goals and identify key programs, complete a risk assessment based on their priorities, and then establish controls to mitigate identified program risks. National program offices and regions do not appear to completely understand the risk assessment internal control standard and how to apply it to program operations. Without consistently conducting risk assessments, EPA lacks a sound, documented basis for reasonably assuring that programs implement effective internal controls consistent with federal internal control standards. Additional training on risk assessment, including how to identify weaknesses, determining how to manage risks, and how to conduct necessary internal control reviews, should improve program management.

What We Recommend

We recommend that the Chief Financial Officer assign NPMs primary responsibility for FMFIA reporting on internal controls for national programs and rely on the lead regional coordinator process for input from the regions, and direct regional personnel to report on administrative and financial internal control activities along with unique geographic and programmatic issues in regional assurance letters. We also recommend that the Chief Financial Officer develop a training course on FMFIA and enhance the FMFIA intranet site by providing links to risk assessment guidance and completed products that offices could use as best practices. The Agency agreed with our recommendations and began taking steps to address them.

January 18, 2011

MEMORANDUM

SUBJECT: EPA Should Further Connect the National Program Manager Process
With Federal Guidance on Internal Control Risks
Report No. 11-P-0067

FROM: Arthur A. Elkins, Jr.
Inspector General

TO: Barbara J. Bennett
Chief Financial Officer

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

The estimated cost of this report, calculated by multiplying the project's staff days by the
applicable daily full cost billing rates in effect at the time, is $472,472.

Action Required

On November 22, 2010, your office provided comments to our report, and we discussed your
planned corrective actions and milestone dates on December 15, 2010. We believe your planned
corrective actions address the intent of each of our recommendations. As such, we plan to close
this assignment upon issuance of this final report. We have no objections to the further release of
this report to the public. This report will be available at http://www.epa.gov/oig.

If you or your staff has any questions regarding this report, please contact Melissa Heist,
Assistant Inspector General for Audit, at (202) 566-0899 or heist.melissa@epa.gov; or
Patrick Gilbride, Director for Audit, Risk and Program Performance Issues, at (303) 312-6969
or gilbride.patrick@epa.gov.

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Chapter 1
Introduction

Purpose

The U.S. Environmental Protection Agency's (EPA's) national program managers (NPMs) develop annual guidance documents to define program priorities, strategies, and performance measures in accordance with the Agency's strategic plan, annual plan and budget, and the Administrator's priorities. We conducted this review to determine how the NPM process relates to the internal control framework under the Federal Managers' Financial Integrity Act (FMFIA), and whether the Agency should improve connections between the two processes. We also determined whether NPMs and regional personnel coordinate program management and whether this coordination addresses program risks and vulnerabilities.

Background

EPA annually issues the Performance and Accountability Report (PAR)[1] to describe to the President, Congress, and the public the Agency's environmental program and financial performance during the fiscal year. The PAR also describes progress in addressing management issues and accountability systems and controls. The annual PAR satisfies a number of legislative reporting requirements, including those of the Government Performance and Results Act of 1993 (GPRA) and FMFIA. EPA's Office of the Chief Financial Officer (OCFO) develops, manages, and supports a goals-based management system for the Agency, which includes preparing EPA's strategic plan, annual budget and performance plan, and the PAR. OCFO initiates both the FMFIA and NPM processes by providing annual guidance to EPA managers. OCFO also reports results from each process, such as information from FMFIA assurance statements and NPM performance results, in the Agency's annual PAR.

National Program Manager Process

GPRA requires the PARs, strategic plans, and annual performance plans to facilitate results-oriented management. GPRA also requires agencies to clarify their missions, set strategic and annual performance goals, and measure and report on performance toward these goals. NPMs for each of EPA's five national

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[1] Effective for the fiscal year 2010 reporting period, EPA now uses an alternate reporting approach to the PAR. The Agency financial report summarizes EPA's financial results and presents its audited financial statements, and the annual performance report presents detailed performance results as measured against targets established in EPA's annual plan and budget. For the purposes of our report, we will refer to the PAR, as it was the reporting approach in place during the time we conducted our audit.

program offices issue annual guidance documents to initiate program planning and establish a relationship among annual operational measures, EPA's annual budget, and long-term strategic goals. NPMs establish national goals for their respective programs and then evaluate and adjust national priorities as new data on emerging environmental issues become available. EPA uses this process that NPMs undertake while developing their guidance documents (hereafter referred to as the "NPM process") to support compliance with GPRA requirements. NPM annual guidance focuses on three areas:

1. Developing NPM priorities, strategies, and associated measures
2. Reporting results for prior year performance commitments
3. Negotiating agreements for performance commitments

NPMs establish these priorities, strategies, measures, and commitments through a process of coordination and negotiation with regional personnel. EPA adopted a methodology in 1984 to provide regions an organized, consistent, and effective role in all major phases of Agency decisionmaking through lead regional coordinators. Lead regional coordinators act as conduits between the regional personnel and the NPMs to ensure ongoing regional input to EPA's national program offices. Lead regional coordinators consolidate information from regional personnel on priorities, emerging issues, weaknesses, and other issues for NPMs to consider during their process and for national program offices' FMFIA assurance letters.

OCFO issues technical guidance for national program offices to follow as they prepare annual NPM guidance on Agency priorities. *OCFO's Technical Guidance on FY 2010 National Program Manager Guidance and Annual Commitment Process in Measures Central* requires managers to establish program priorities and performance measures in support of GPRA requirements and serves as an overall program management tool. This NPM process aims to support Agency program management and decisionmaking by:

- Improving the quality, consistency, and reliability of measures and related data and reporting
- Analyzing progress toward results in midyear reporting to aid in negotiating draft performance commitments
- Engaging with state and tribal partners and stakeholders

EPA's Management Integrity Process

FMFIA requires federal agency managers to establish internal accounting and administrative controls in accordance with standards prescribed by the U.S. Government Accountability Office (GAO) in *Standards for Internal Control in the Federal Government*. FMFIA also requires federal agency managers to annually evaluate their compliance with GAO's standards and issue a statement of full compliance or noncompliance with FMFIA (an "assurance letter"). If the

Administrator determines that the Agency has not fully complied with GAO's standards, the Administrator must report internal weaknesses and a corresponding corrective action plan in the Administrator's assurance statement.

Office of Management and Budget (OMB) Circular A-123 describes federal managers' responsibilities for internal control and provides guidance to meet FMFIA requirements. The circular states that internal control should be "an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing" and "provide continual feedback to management." It also advises agencies to combine their FMFIA reporting efforts with other ongoing efforts to improve effectiveness and accountability.

GAO's *Standards for Internal Control in the Federal Government* provide an overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement (table 1).

Table 1: GAO's *Standards for Internal Control in the Federal Government*

Control environment	This standard establishes and maintains an environment throughout the organization that sets a positive and supporting attitude toward internal control and conscientious management. Internal control and conscientious management includes establishing goals, objectives, and performance measures at both the entity and activity levels.
Risk assessment	A precondition to risk assessment is the establishment of clear, consistent agency objectives. The internal control risk assessment process includes assessing risks the agency faces from both internal and external sources. Management should comprehensively identify risks and should consider all significant interactions between the entity and other parties, as well as internal factors at both the entity and activity levels.
Control activities	Control activities are the policies, procedures, techniques, and mechanisms that implement management's direction to achieving goals. Internal control activities help ensure that management's directives are carried out.
Information and communications	This standard includes data and information (performance and financial) to determine whether the organization meets its goals and objectives and maintains accountability over resources.
Monitoring	Internal control monitoring should assess the quality of performance over time and ensure that audits and other review findings are promptly resolved.

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

According to OMB Circular A-123, risk assessment forms the foundation of any effective system of internal controls. Risk assessment includes identifying and analyzing relevant risks associated with achieving goals and objectives, such as those defined in strategic and annual performance plans developed under GPRA. After an organization identifies significant areas of risk, it should develop control

activities to minimize or eliminate those risks. Risk analysis generally includes estimating the risk's significance, assessing the likelihood of its occurrence, and deciding how to manage the risk and what actions to take.

OCFO initiates the FMFIA reporting process by providing annual guidance to EPA managers. OCFO's FMFIA guidance specifies coordination and communication between NPMs and regional offices. New for fiscal year (FY) 2010, OCFO issued the guidance in two parts: the first part focused on financial activities and the second part focused on program operations. OCFO intended the second part to achieve more systematic and rigorous reviews of internal controls over program operations and establish clear regional and national program roles and responsibilities for reviewing controls and sharing information between offices.

Noteworthy Achievements

OCFO has taken a number of steps to improve EPA's management integrity program. In FY 2010, OCFO issued separate FMFIA guidance for financial and program operations. The program guidance addressed how to conduct internal control reviews over program operations, and also clarified responsibilities between program offices and regions. In addition, OCFO hired a contractor in FY 2009 to conduct FMFIA program compliance reviews in a sample of offices to determine necessary changes to improve FMFIA implementation. OCFO completed additional reviews in FY 2010 in Regions 9 and 10, and will continue these reviews on a rotating basis as part of OCFO's oversight of the management integrity program.

OCFO has also made efforts to show the relationship between the NPM process and FMFIA by cross-referencing them in each guidance document. The FY 2010 FMFIA program guidance mentions the NPM process, while the FY 2011 *Technical Guidance on the NPM Guidance* mentions the FMFIA process for the first time. OCFO's *Technical Guidance on FY 2012 National Program Manager Guidance and Annual Commitment Process* notes that annual NPM guidance documents serve as an important internal control for Agency programmatic operations because the documents set forth program priorities and key actions for the upcoming year. OCFO also encouraged NPMs to discuss their annual program guidance as a key internal control in preparing FY 2011 annual letters of assurance to the Administrator. National program offices and regions in our scope acknowledged connections between the two processes and have taken initial steps to integrate them.

Finally, we observed strong communication and coordination between national program offices and regions. They establish national program priorities through an inclusive process involving states, tribes, and other stakeholders.

Scope and Methodology

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our review objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objectives.

We focused our review on FMFIA and NPM process implementation by the Office of Water (OW), Office of Chemical Safety and Pollution Prevention (OCSPP), and Regions 5 and 9; we also reviewed Regions 3 and 6 because they house, respectively, the OW and OCSPP lead regional coordinators. We also focused our review on guidance provided by OCFO to EPA managers.

We reviewed OCFO's FMFIA guidance for FYs 2008, 2009, and 2010, and OCFO's *Technical Guidance on the National Program Manager Guidance and Annual Commitment Process in Measures Central* for FYs 2010, 2011, and 2012. We also reviewed FMFIA assurance letters for FYs 2008 and 2009 for OW, OCSPP, and Regions 3, 5, 6, and 9; NPM guidance documents for FYs 2008, 2009, and 2010; and program review strategies for FY 2010.

We interviewed OCFO, OW, OCSPP, regional, and other EPA personnel to understand, document, and analyze EPA's FMFIA and NPM processes and coordination between national program offices and regions.

We are issuing this report to bring to the Agency's attention findings that could influence FMFIA and NPM reporting in FY 2011.

Appendix A provides additional information on our scope and methodology.

Chapter 2
FMFIA and NPM Processes Not Integrated

The Agency has not fully integrated FMFIA into the NPM process. FMFIA requires federal agency managers to assess financial and programmatic operations, establish controls, and ensure those controls are effective. NPM guidance sets forth goals and program priorities to support compliance with GPRA and align Agency long-term strategic goals and annual budgetary decisions with detailed implementation instructions. Activities conducted per the NPM process support internal controls. EPA has made efforts to improve management integrity implementation for program operations and is currently working to clarify links between the two processes. However, OCFO has segregated information that offices should use in both processes and integration efforts are in their infancy. Having national program offices primarily responsible for internal controls over national programs would streamline reporting and lessen confusion among staff involved in both processes.

FMFIA and NPM Processes Have Common Elements

OMB Circular A-123 provides guidance to federal managers on implementing FMFIA to improve the accountability and effectiveness of federal programs and operations by establishing, assessing, and reporting on internal control. The circular states, "the requirements of FMFIA serve as an umbrella under which other reviews, evaluations and audits should be coordinated and considered to support management's assertion about the effectiveness of internal control." The circular lists a number of statutory requirements and government-wide initiatives, including GPRA, which should be considered as part of an agency's internal control framework and should be integrated to meet the requirements of FMFIA. Internal control is a major part of successful agency management and comprises the plans, methods, and procedures used by an agency to meet its mission, goals, and objectives. OMB Circular A-123 states that by incorporating internal control into its planning and implementation activities, an agency fulfills federal expectations for performance-based management.

EPA establishes and communicates goals and priorities through the NPM process to support GPRA compliance. Functional statements note how national program offices have responsibility for EPA's program integrity and performance:

- **OW:** The Assistant Administrator for Water serves as principal advisor to the Administrator and provides Agency-wide policy, guidance, and direction for the Agency's water programs. Primary responsibilities include evaluating regional activities.

- **OCSPP:** The Assistant Administrator for Chemical Safety and Pollution Prevention is responsible for establishing Agency strategies and developing and operating Agency programs and policies for assessment and control of pesticides and toxic substances. Responsibilities include monitoring, evaluating, and assessing program operations in EPA headquarters and regional offices.

While organizationally regional personnel report to Regional Administrators, regional personnel are accountable to national program offices for negotiating performance commitments and reporting performance results. Regional personnel raise emerging issues to national program offices at periodic NPM planning meetings. Regional personnel also provide FMFIA input to national program offices through the lead regional coordinator process. Thus, NPMs manage national programs and oversee regional programs through these existing mechanisms.

Our review found that NPMs already conduct many of the steps outlined in OCFO's FY 2010 FMFIA guidance as shown in bold text and checkmarks in table 2. Table 2 also notes internal control standards to which OCFO's guidance steps pertain.

Table 2: FY 2010 FMFIA guidance outline and related internal control standards

Step	Internal control standard	Task	NPM activities
I. ESTABLISH A FOUNDATION FOR INTERNAL CONTROL REVIEWS			
1	Control environment	**Identify key programs and operations.**	✔
2	All GAO standards	Develop a Program Review Strategy for each key program and operation. Among other things, the strategy will **identify potential risks associated with the program; rank the risks; and outline the internal controls (e.g. policies, procedures, or measures) in place to mitigate the risks**.	✔
3	Control activities	Prepare a Multiyear Plan for **reviewing internal controls over program operations**. Based on risk levels assigned, prepare a Multiyear Plan that establishes priorities for assessing the internal controls over programmatic operations.	✔
II. CONDUCT FY 2010 REVIEWS			
1	Control activities and monitoring	**Conduct reviews, testing, or monitoring activities** planned for FY 2010.	✔
2	Control activities	Determine corrective actions.	
3	Information and communication	Document your findings.	
III. REPORT FY 2010 FINDINGS			
1	Monitoring and information and communication	Provide **status updates** for midyear Management Integrity Report and the Agency "Update" meeting.	✔
2	Information and communication	Develop FY 2010 assurance letter to the Administrator.	
3	Information and communication	Prepare for end-of-year "Decision Meeting."	

Source: OIG analysis of an outline provided by OCFO's associate staff director for accountability within the Office of Planning, Analysis, and Accountability, on June 30, 2010.

Table 2 illustrates how the NPM process relates to the FMFIA process, and how information from one process can inform the other. However, EPA has not fully integrated FMFIA into the NPM process. OCFO's guidance documents only recently referenced each process. OCFO has reoriented its FMFIA process to include program operations, and OCFO, national program offices, and regional personnel considered FY 2010 a building year in which to clarify links between the two processes.

Program Office Interpretations Vary on Degree of Integration

While NPMs, management integrity advisors, regional personnel and planners, and OCFO acknowledged links between the two processes, we found variations in the extent to which regions and offices understand the relationship between the FMFIA and NPM processes and confusion as to what to report. OW managers have different views as to the linkages between the two processes—one saw no link, and the other had fully integrated each process. However, most regional program personnel continue to struggle with how FMFIA relates to the NPM process. OCFO said this confusion derives largely from an acknowledged lack of familiarity with FMFIA terms and framework, and OCFO is striving to improve understanding.

Staff stated they had not considered the NPM guidance as a tool to identify program vulnerabilities. However, OCFO believes the NPM process is the primary control for program management. We agree and note the following elements of the NPM process relevant to FMFIA:

- Final NPM guidance from the national program offices contains information that could be included in the FMFIA *Midyear Status Report to the Administrator*.
- Information published in national program offices' midyear reports on commitments could be considered for input from the lead regional coordinators to NPMs for FMFIA assurance letters.
- Managers' discussions of program priorities, vulnerabilities, and other issues during the NPM process include issues that offices should assess for internal control deficiencies and, if necessary, report in FMFIA assurance letters. We noted two such examples: (1) a national water division directors meeting in October 2009 addressed water quality monitoring, new administration priorities, the Urban Waters Initiative, and surface mining operations; and (2) OCSPP division directors discussed with us significant management issues such as the Toxic Substances Control Act and requirements for polychlorinated biphenyls in caulk.

Regional Personnel Unclear on Assurance Letter Content

By not linking the FMFIA and NPM processes, regional personnel remain unclear as to how to report certain issues in assurance letters. For example, our review of FY 2009 regional FMFIA assurance letters found inconsistencies in how regional personnel reported geographic initiatives. Geographic initiatives are programs or activities unique to a particular EPA region (e.g., the Chesapeake Bay and the Great Lakes programs are tasked with protecting and restoring large aquatic ecosystems). OCFO said that reporting responsibilities on geographic initiatives varies by NPM. Of the four regions' assurance letters we reviewed, we found that:

- Region 3 briefly mentioned the Chesapeake Bay.
- The Great Lakes National Program Office issued its own assurance letter through Region 5's annual FMFIA process.
- Regions 6 and 9 did not mention initiatives within their purview: the Gulf of Mexico, United States-Mexico Border Water Quality, or the Pacific Islands Waters.

As we reported in 2009,[2] because OCFO previously focused FMFIA primarily on financial and administrative activities, staff were confused about FMFIA roles and reporting. Beginning in FY 2009, OCFO expanded EPA's FMFIA reporting from strictly financial and administrative activities to include program operations and, in FY 2010, clarified regional and national program roles and responsibilities. During this transition, regional offices remain confused as to what to report on and how. Regional comptrollers noted improvements in this year's OCFO guidance, but said that program personnel remain unclear on their FMFIA responsibilities.

OCFO should require NPMs to summarize national program issues in their assurance letters, including information NPMs obtain on regional program implementation and performance. Regional FMFIA assurance letters would then focus on administrative and financial internal control activities. OCFO has also historically administered the FMFIA and NPM processes separately and has only recently viewed the two as complementary. Program offices and regional personnel have considered the NPM process a separate task distinct from FMFIA, even though many NPM process activities support FMFIA.

Both the Administrator and Chief Financial Officer have issued statements on how EPA should view the management integrity process as a year-long process instead of a once-yearly exercise to complete assurance letters. In her February 2, 2010, memorandum, the Administrator stated that to improve management integrity for FY 2010, everyone involved should view it as a year-long process—a

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[2] We issued two reports on the administrative focus of FMFIA guidance and the confusion regional and program office personnel had with FMFIA requirements: *EPA Should Use FMFIA to Improve Programmatic Operations,* Report No. 09-P-0203, August 6, 2009; and *EPA's Office of Research and Development Could Better Use the Federal Managers' Financial Integrity Act to Improve Operations,* Report No. 09-P-0232, September 15, 2009.

significant departure from how EPA has traditionally carried out management integrity activities. Lastly, the Agency has committed to adopting a "OneEPA" approach to accomplishing its environmental protection mission.[3] By making NPMs responsible for internal controls and FMFIA reporting for national programs (working through Lead Regional Coordinators to do so), the Agency would support OneEPA and foster more communication between regional personnel and NPMs.

Conclusion

EPA would increase its ability to maximize its resources, achieve its commitments, and meet its goals by clarifying links between the NPM and FMFIA processes. Separate activities and reporting related to the FMFIA and NPM processes potentially result in duplicative activities under each. NPMs already conduct many of the activities related to FMFIA in the NPM process, yet national program offices have separate processes and staff responsible for each process. Having NPMs primarily responsible for reporting on internal controls over national programs would streamline reporting and lessen confusion among staff involved in both the NPM and FMFIA processes.

Recommendations

We recommend that the Chief Financial Officer:

2-1   Assign NPMs primary responsibility for FMFIA reporting on internal controls for national programs and rely on the lead regional coordinator process for input from the regions.

2-2   Direct regional personnel to report on administrative and financial internal control activities along with unique geographic and programmatic issues in regional assurance letters.

Agency Comments and OIG Evaluation

In recommendation 2-1 of our draft report, we stated that OCFO should "Use existing activities under the NPM guidance process to require that NPMs in National Program Offices complete FMFIA reporting on program performance, risks, and emerging issues (including those related to regional program performance and/or feedback NPMs receive from regional program implementers)." In its response, OCFO suggested that we revise the recommendation to "require NPMs to address in their NPM Guidance, as appropriate, the vulnerabilities and weaknesses identified through their FMFIA responsibilities." We disagreed with OCFO's suggested revision to recommendation 2-1 because it did not incorporate using the

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[3] As described in EPA's Open Government Plan, the "OneEPA" tool is in place to promote transparency by initiating discussion, capturing suggestions, and collecting reactions both within the Agency and from the public.

NPM framework along with the lead regional coordinator process. National program offices should integrate evaluating internal controls into all program management activities using these processes. After reviewing OCFO's response, we clarified our report to focus on the entire NPM framework (i.e., developing program priorities, strategies, and performance commitments linked to strategic and budget planning), rather than specific annual NPM guidance documents. We met with OCFO on December 15, 2010, and agreed upon the current recommendation. We also discussed OCFO's planned corrective actions and milestone dates, such as connecting FMFIA and the NPM processes in its FY 2012 NPM guidance and upcoming FY 2011 FMFIA guidance. OCFO's planned FY 2011 FMFIA guidance will reinforce the role of NPMs and the lead regional coordinator process.

On recommendation 2-2, OCFO responded that it should continue to direct regions to address regional aspects of key national programs to ensure Regional Administrator-level accountability. We agree and discussed this with OCFO on December 15, 2010, and added text to recommendation 2-2.

We believe our recommendations will provide national program offices a more unified perspective and a means to gauge program priorities, weaknesses, and emerging areas across all regions. This approach will also ensure regional accountability on unique geographic and programmatic issues. OCFO will verify its planned corrective actions to address recommendations 2-1 and 2-2 in FY 2011 program compliance reviews. We believe OCFO's planned corrective actions address the intent of our recommendations. Appendix B includes OCFO's full response.

NPMs assess and evaluate relevant risks associated with achieving their program objectives through communication within the national program offices and with regional personnel and other stakeholders. However, offices have not linked these activities to internal control requirements. FMFIA requires managers to define program goals and identify key programs, complete a risk assessment based on their priorities, and then establish controls to mitigate identified program risks. National program offices and regional personnel do not appear to completely understand the risk assessment internal control standard and how to apply it to program operations. Additional training on risk assessment, including how to identify weaknesses, determining how to manage risks, and how to conduct necessary internal control reviews, should improve program management.

Risk Assessments Not Informing Program Reviews

Risk assessment—a fundamental element in internal control—identifies and analyzes risks that might impede the achievement of organizational goals, such as goals defined in strategic and annual performance plans developed under GPRA. Agencies should analyze identified risks for their potential effect or impact and implement controls to minimize or eliminate the risks to achieve the internal control objectives of efficient and effective operations.

OCFO's FY 2010 FMFIA guidance requires all EPA programs to identify key programs and develop program review strategies that list and rank potential risks and related internal controls. The guidance also requires that all EPA programs prepare schedules, or multiyear plans, describing when offices plan to review internal controls for program operations. OCFO's FY 2009 FMFIA guidance required all EPA programs to develop a multiyear review strategy (similar to the FY 2010 multiyear plan) and complete a checklist based on GAO's *Standards for Internal Control in the Federal Government* that includes risk assessment.

We found that not all national program offices and regions within our scope conduct risk assessments in accordance with GAO's standards. Of the six FY 2009 assurance letters we reviewed, only OW reported that it conducted a risk assessment and used it to determine program reviews. Our interviews confirmed that in the course of program management activities and coordinating with regional personnel and other stakeholders, offices perform elements of risk assessments. Offices we reviewed do not, however, analyze risks for potential effects or impacts on the Agency, do not consider those assessments in the context of internal controls, and do not incorporate activities into FMFIA. While OCFO has taken steps to include programmatic operations in FMFIA reporting, Agency

personnel need training on internal control standards and terminology, and ways to connect FMFIA to their program-level tasks and accomplishments. OCFO is developing training but does not expect it to be ready until the FY 2011 management integrity reporting period.

OCFO's FY 2010 FMFIA program guidance instructs offices to prepare program review strategies that list and rank risks and vulnerabilities. OCFO assumes that offices conducted risk assessments prior to completing program review strategies so that risk information could be included. Offices have begun submitting FY 2010 program review strategies, but our analysis of eight strategies indicates that completing a strategy itself does not meet the intent of GAO's standards. The Agency cannot ensure that offices assess and analyze internal and external risks simply because they submitted program review strategies, as shown in table 3.

Table 3: Program review strategy limitations in addressing risk assessment

OCFO's FY 2010 FMFIA guidance requires that program review strategies list and rank potential risks and related internal controls.	
OIG comment	All eight OW and OCSPP strategies that were available by August 2010 identified and ranked at least one risk, but did not include any risk analysis. For example, in OW's biosolids strategy, the risk of "insufficient monitoring data" does not have attendant control activities, monitoring, and information/communication relative to that specific risk. Instead, the strategy includes a random collection of material (e.g., one information/communication entry is to make its website more user friendly, but it is not clear what risk that addresses). OW's biosolids strategy also includes a potential major risk related to the lack of exposure and toxicity data, but no apparent control activity to address that risk.
Risk analysis generally includes estimating the risk's significance, assessing the likelihood of its occurrence, and deciding how to manage the risk and what actions to take.	
OIG comment	OCSPP has not completed a risk assessment. Instead, OCSPP senior managers met to discuss and prioritize key risks to include in their program review strategies, half of which were administrative. OCSPP did not include backlogged chemical assessments under the Toxic Substances Control Act even though GAO[a] and our office[b] identified the backlog as a major management challenge for EPA. OW completed and included a risk assessment in its FY 2009 assurance letter, and its FY 2010 program review strategy included reviews that were already planned as a result of its risk assessment (i.e., ongoing reviews). One regional management integrity advisor said that regional water managers did not understand why OW selected the areas included in its strategy.

Source: OIG analysis of a sample of submitted FY 2010 program review strategies.

[a] GAO, *Environmental Protection Agency Major Management Challenges,* GAO 09-434, March 4, 2009.
[b] EPA OIG, *EPA's Fiscal Year 2010 Key Management Challenges*, May 11, 2010.

These examples indicate that national program offices and regional personnel do not fully understand FMFIA and risk assessment. This confusion stems from how to apply internal control risk assessment to program management. Many EPA personnel understand risk assessment as a scientific term used to assess risks to human health and the environment. For example, one program office's review

strategy identified as a program risk that "human health and the environment may no longer be protective"—a risk in a scientific sense. However, GAO's *Standards for Internal Control in the Federal Government* defines internal control risk as barriers that might inhibit a program from achieving its objectives. In this case, protecting human health and the environment is the program objective, and the office did not identify internal control risks that prevent the program from achieving this objective. Offices also appear to not understand how to apply risk assessment to program operations because they have not connected internal control risk assessment and the NPM process. OCFO said it is providing more guidance and training on risk.

Managers and staff we spoke with described a "language barrier" between what program staff understands about FMFIA and what management integrity staff understands about programmatic operations. While OCFO has taken steps to include programmatic operations in FMFIA guidance, Agency personnel need training on internal control standards and terminology, and ways to connect FMFIA to their program-level tasks and accomplishments. OCFO believes that offices conduct risk assessments and establish controls but do not identify them in FMFIA terms, and OCFO said it is working to address this language barrier. Offices could benefit from OCFO posting on its intranet tools such as the five-page overview of risk assessment (including step-by-step instructions and definitions) included in the contractor's report on program compliance reviews (dated January 15, 2010) and highlighting on its intranet completed products (such as OW's risk assessment) that other offices could use as examples. OCFO is developing training on GAO's standards and how to incorporate FMFIA into daily program operations, and expects it to be ready for the FY 2011 management integrity reporting period.

In a February 5, 2010, memorandum to all EPA Assistant and Regional Administrators, EPA's Chief Financial Officer said that without adequate and effective internal controls integral to day-to-day activities, the Agency jeopardizes its mission by placing at risk the resources and authority entrusted to it to protect the nation's environment and health.

Conclusion

Without conducting risk assessments consistent with GAO's *Standards for Internal Control in the Federal Government*, EPA cannot ensure it has appropriate internal controls in place or that programs operate effectively and efficiently. Additionally, EPA has not incorporated FMFIA into day-to-day activities, which limits how well offices identify and address program risks. Moreover, without adequate training, the learning curve for program staff on FMFIA and, conversely, for management integrity staff on environmental programs, could take time and resources from other Agency priorities.

Recommendations

We recommend that the Chief Financial Officer:

3-1   Develop a training course on FMFIA that describes:
   a. what internal control standards are, including definitions and terminology;
   b. how management integrity relates to program operations; and
   c. how to conduct risk assessments.

3-2   Enhance its management integrity intranet site by providing links to risk assessment guidance and completed products (such as risk assessments and program review strategies) that offices could use as best practices or examples when completing their own products.

Agency Comments and OIG Evaluation

OCFO concurred with recommendations 3-1 and 3-2 and expects to complete activities to address each recommendation in FY 2011. For example, OCFO sought and applied our feedback on FMFIA training (per recommendation 3-1) for management integrity advisors in June 2010. We concur with OCFO's planned actions to address these recommendations. Appendix B includes OCFO's full response.

Status of Recommendations and Potential Monetary Benefits

		RECOMMENDATIONS				POTENTIAL MONETARY BENEFITS (in $000s)	
Rec. No.	Page No.	Subject	Status[1]	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
2-1	10	Assign NPMs primary responsibility for FMFIA reporting on internal controls for national programs and rely on the lead regional coordinator process for input from the regions.	O	Chief Financial Officer			
2-2	10	Direct regional personnel to report on administrative and financial internal control activities along with unique geographic and programmatic issues in regional assurance letters.	O	Chief Financial Officer			

3-1	15	Develop a training course on FMFIA that describes:
		  a. what internal control standards are, including definitions and terminology;
		  b. how management integrity relates to program operations; and
		  c. how to conduct risk assessments.
			O	Chief Financial Officer	09/30/11		

3-2	15	Enhance its management integrity intranet site by providing links to risk assessment guidance and completed products (such as risk assessments and program review strategies) that offices could use as best practices or examples when completing their own products.	O	Chief Financial Officer	09/30/11		

[1] O = recommendation is open with agreed-to corrective actions pending
   C = recommendation is closed with all agreed-to actions completed
   U = recommendation is undecided with resolution efforts in progress

Details on Scope and Methodology

We conducted our review to determine whether EPA links the FMFIA process with the NPM process. We also reviewed whether NPMs and regional personnel coordinate program management to address program risks and vulnerabilities. We chose two program offices for our review: OW and OCSPP. OW is one of EPA's largest program offices, has the largest budget, and interacts extensively with regional personnel. OCSPP represents a contrast to OW as it is a smaller office with a smaller budget. Further, because OCSPP is more headquarters focused, it interacts differently with the regional personnel. We also selected two regions for review: Regions 5 and 9. Region 5 is EPA's largest regional office and has the largest budget. Region 9 is a midsized office with a midsized budget, and its staff played a significant role in the development of EPA's management integrity policy. Regions 5 and 9 both include states that have significant water and pollution concerns. We also reviewed Regions 3 and 6 because they house, respectively, the OW and OCSPP lead regional coordinators.

To address our objectives, we did the following:

- Reviewed and summarized relevant laws, regulations, policies, and guidance on the management integrity (FMFIA) and the NPM processes.

- Flowcharted the FMFIA and NPM process timelines to identify potential linkage points and areas of efficiency.

- Analyzed information from the Office of Regional Operations (which oversees the lead regional coordinator process), OCFO, OW, OCSPP, Regions 5 and 9, and management integrity advisors for all offices in our scope

- Gathered and analyzed information from lead regional coordinators for OW and OCSPP, located in Regions 3 and 6 respectively, to understand the lead region process and its role in management integrity reporting.

- Conducted a literature search to review previous related audits and reports.

- Reviewed OCFO's FMFIA guidance for FYs 2008, 2009, and 2010.

- Participated in OCFO conference calls and interviewed OCFO staff to discuss the FMFIA process and the FY 2010 requirement on program review strategies.

- Reviewed assurance letters for OW, OCSPP, and Regions 5 and 9 for FYs 2008 and 2009, and compared reporting between the headquarters program offices and regions. We also reviewed assurance letters for Regions 3 and 6. Our assurance letter reviews

focused on program operations, as well as whether letters included evidence of completed internal control risk assessments.

- Reviewed OW and OCSPP program review strategies, which OCFO required as part of the FY 2010 FMFIA process.

- Reviewed OCFO's *Technical Guidance on FY 2010 National Program Manager Guidance and Annual Commitment Process in Measures Central,* as well as OW and OCSPP NPM guidance for FYs 2008, 2009, and 2010.

- Conducted interviews with NPM and regional planners, regional comptrollers, office directors, and other program and regional staff to understand, document, and analyze the FMFIA process, the NPM process, and coordination between national program offices and regional personnel. These interviews included briefings with NPMs from OW and OCSPP, who explained processes they use to develop annual NPM guidance documents and stakeholders with whom they coordinate on performance targets.

In FY 2009, OCFO hired Industrial Economics, Inc., to assess the effectiveness of EPA's management integrity program and to identify how EPA program and regional offices can improve FMFIA implementation. We reviewed Industrial Economics, Inc.'s, final report, dated January 15, 2010, as it included offices in our project scope as well as recommendations to OCFO that were similar to those resulting from our own interviews with Agency personnel.

Prior Audit Coverage

The OIG reviewed the Agency's FMFIA implementation in two reports issued in 2009:

- In *EPA Should Use FMFIA to Improve Programmatic Operations,* Report No. 09-P-0203, issued August 6, 2009, we determined whether EPA offices integrated internal control standards under FMFIA into their programmatic operations. We also determined whether EPA offices use available GAO guidance to develop and monitor their internal controls. We found that because OCFO did not require—and program and regional offices did not evaluate and report on— compliance with GAO's standards in FY 2008, EPA risked not fully complying with FMFIA. We also observed that the FMFIA process emphasized administrative and financial reporting over programmatic performance. We made five recommendations and are monitoring corrective actions OCFO has undertaken to address all recommendations.

- In *EPA's Office of Research and Development Could Better Use the Federal Managers' Financial Integrity Act to Improve Operations,* Report No. 09-P-0232, issued September 15, 2009, we determined whether the Office of Research and Development had a systematic strategy to establish, review, and monitor internal controls. We also determined what the Office of Research and Development's internal control strategy should contain to account for risks in meeting program goals. We found that the Office of Research and Development has several opportunities for

improving the accountability and effectiveness of federal programs and operations to better accomplish FMFIA as intended. We made three recommendations and are monitoring corrective actions the Office of Research and Development has undertaken to address all recommendations.

Agency Response to Draft Report

November 19, 2010

<u>MEMORANDUM</u>

SUBJECT: Response to draft Audit Report *EPA Should Further Integrate National Program Manager Guidance with Federal Guidance on Internal Control Risks* (Project No. OA-FY09-1003)

FROM: Barbara J. Bennett //s//
                        Chief Financial Officer

TO: Melissa M. Heist
                 Assistant Inspector General for Audit

        We appreciate the opportunity to respond to the draft Audit Report cited above. Throughout this review OIG has kept OCFO involved and informed, and we believe this has been very constructive. In particular, thank you for taking time to discuss this report with OPAA managers on November 17. I would like to provide several general comments on the conclusions and recommendations presented in this draft audit report. In addition, I have asked Kathy O'Brien to send you a copy of the report annotated with our more detailed comments on specific statements. We appreciate your consideration of our comments and suggestions.

<u>Overall Comments – Link Between NPM Guidance and FMFIA</u>

        As you know, OCFO has taken a number of steps over the past year to clarify and strengthen the Agency's internal controls over programmatic activities, including highlighting the connections between Management Integrity (FMFIA) and processes such as the annual NPM guidance. In our technical guidance for both FMFIA and NPM Guidance, we call attention to the importance of identifying program risks and vulnerabilities, including obtaining input through the Lead Region process.

        Our primary concern with this draft audit is the confusion regarding the purpose of NPM Guidance and the link between FMFIA and NPM Guidance -- a critical concept central to the audit. The primary purpose of NPM Guidance is to operationalize the program priority decisions made in developing the Agency's Strategic Plan and Annual Plan and Budget, thereby *supporting* the Agency's compliance with GPRA. On the other hand, Annual Management Integrity guidance is the primary means to facilitate communication between NPMs and regions for identifying program risks, vulnerabilities, and controls. In this report, you urge OCFO to more fully "integrate FMFIA into the NPM Guidance." We believe that FMFIA and the NPM Guidance, while related, are separate, complementary processes. We do not view FMFIA as something to be incorporated into the Guidance; on the contrary, we view the NPM Guidance process as one control or mechanism by which the Agency implements FMFIA.

We agree with the observation that some staff and managers at the national and regional levels still struggle with relating their day-to-day activities to complying with FMFIA. There are a number of reasons for this, including lack of familiarity with FMFIA terminology and the historical view of FMFIA as a financial administrative process. We have made progress and will continue to address these gaps in understanding through on-site reviews, meetings with staff and managers, and technical guidance to implement both Management Integrity and the NPM process. Also, our online Management Integrity Training, to be released in FY 2011, will help increase this understanding.

<u>Comments on Recommendations</u>

<u>Recommendation 2-1</u>. *Use existing activities under the NPM guidance process to require that NPMs in National Program Offices complete FMFIA reporting on program performance, risks, and emerging issues (including those related to regional program performance and/or feedback NPMs receive from regional program implementers).*

Based on the November 17 discussion, we are suggesting revised language to clarify this recommendation:

Require NPMs to address in their NPM Guidance, as appropriate, the vulnerabilities and weaknesses identified through their FMFIA responsibilities.

We believe we have fulfilled the intent of this recommendation. OCFO's Management Integrity Guidance currently requires that NPMs "complete FMFIA reporting on program performance, risks, and emerging issues." Further, OCFO's guidance to NPMs for developing their FY 2011 and FY 2012 annual program guidance instructs the NPMs to seek input from regions, through the Lead Region process, on program risks, vulnerabilities, and actions to mitigate program risks, and to incorporate these, as appropriate, in their annual letters of assurance. We believe these steps make the appropriate connection between the two processes and, therefore, address this recommendation.

<u>Recommendation 2-2</u> *Direct regional personnel to report on administrative and financial internal control activities in regional assurance letters.*

OCFO requires this reporting now, and also requires that regions discuss their internal controls as implementers of national programs.

We agree that NPMs have responsibility for identifying and mitigating risks that threaten programs at *a national* level. Through the Lead Region process, NPMs receive regions' perspectives on national program risks. We continue to maintain, however, that regions have clear roles for implementing national programs in their regions and, in certain cases, implementation responsibilities specific to a region (e.g., a number of geographical initiatives). OCFO believes we should continue to direct regions to address regional aspects of key national programs in their internal control assessments, in addition to administrative and financial controls. All relevant activities should be addressed in regions' assurance letters.

<u>Recommendation 3-1</u> *Develop a training course on FMFIA that describes (a) what internal control standards are, including definitions and terminology; (b) how management integrity relates to program operations; and (c) how to conduct risk assessments.*

<u>Recommendation 3-2</u> *Enhance its management integrity intranet site by providing links to risk assessment guidance and completed products (such as risk assessments and program review strategies) that offices could use as best practices or examples when completing their own products.*

We agree in general that risk is a subject needing further clarification for Agency staff unfamiliar with its application in FMFIA.

OCFO's online training for management integrity advisors and Agency managers (currently in development) will address the topics enumerated in the recommendation, including risk. These courses will be available to MIAs, managers, and all Agency employees in FY 2011. We may determine that supplemental training in some areas, such as risk assessment, may be warranted after an evaluation of the initial training offerings.

OCFO is in the process of reorganizing, updating, and enhancing its Management Integrity website with links to guidance, policy, and tools on risk assessment. This work will be completed in FY 2011. In addition, some of these aids/links are embedded in OCFO's online training for the convenience of MIAs and managers.

In summary, I believe that OCFO is already taking actions to address the intent of these four recommendations to strengthen the Agency's FMFIA program and to integrate the NPM Guidance with FMFIA, and I would like to close this audit as expeditiously as possible. I appreciate your consideration of our comments on the draft Audit Report. Please contact Debbie Rutherford (202-564-1913), Director of OCFO's Accountability Staff, to discuss these comments further.

cc: Patrick Gilbride, OIG
        Maryann Froehlich
        Joshua Baylson
        Kathy O'Brien
        Stefan Silzer

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