



Department of Energy

Washington, DC 20585

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MEMORANDUM FOR DISTRIBUTION

FROM:

JOHN NEWELL *John Newell*
DIRECTOR, OFFICE OF INTERNAL REVIEW

SUBJECT:

**Annual Guidance for Office of Management and Budget
(OMB) Circular A-123, Appendix A, Evaluations**

The purpose of this memorandum is to transmit fiscal year (FY) 2007 annual guidance for implementing the requirements of OMB Circular A-123, Appendix A, *Internal Control Over Financial Reporting*. This guidance expands upon the information in the A-123 FY 2007 Operating Assumptions and Key Changes document that was issued on September 7, 2006, and further defines the Department's expectations for FY 2007. Corresponding detailed execution guidance, in the form of updated *Quick Start Guides*, will be issued in November, 2007.

The A-123 Project Management Team will conduct a conference call in the next few weeks to discuss the annual guidance and answer any questions. Should you have any questions in the meantime, please contact Mindy Bledsoe at 301-903-2553 (Mindy.Bledsoe@hq.doe.gov) or Brian Boos at 301-903-3858 (Brian.Boos@hq.doe.gov).

Attachment

cc: Field Chief Financial Officers
Affected Headquarters Elements



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Distribution

Headquarters OMB Circular A-123 Implementation Team Leads
Field OMB Circular A-123 Implementation Team Leads

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Implementing OMB Circular A-123, Appendix A

Fiscal Year 2007 Annual Guidance



**United States Department of Energy
Office of Internal Review
A-123 Project Management Team**

October 2006

OMB Circular A-123, Appendix A Fiscal Year (FY) 2007 Annual Guidance

Purpose

The purpose of the A-123 *Annual Guidance* is to provide direction on the Department of Energy's (Department or DOE) implementation of Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, Appendix A (Internal Control over Financial Reporting). This guidance facilitates planning for the upcoming fiscal year's implementation of Appendix A by establishing the Department's expectations for that year. Questions regarding the guidance should be directed to the A-123 Help Desk at A-123Helpdesk@hq.doe.gov, or 301-903-3937.

Applicability

The A-123 *Annual Guidance* provides information to Departmental elements, including the National Nuclear Security Administration, Corporate Departments, and the Department's major site and facilities management contractors identified in Attachment 1. (Unless otherwise noted, Departmental elements are generally referred to as "sites" throughout the guidance.)

Operating Assumptions

The operating assumptions described below provide for implementation continuity during the transition to FY 2007.

Key Milestones: The Department has established the following key milestones for its FY 2007 implementation of Appendix A:

- **January 15 / January 30, 2007** – 1st Quarterly Reports due from field elements and Headquarters elements (Lead Program Secretarial Offices (LPSO) and Corporate Departments (CD)), respectively.
- **April 15 / April 30, 2007** – 2nd Quarterly Reports due from field elements and Headquarters elements, respectively.
- **July 15 / July 30, 2007** – 3rd Quarterly Reports due from field elements and Headquarters elements, respectively.
- **July 31, 2007** – Final date for completion of FY 2007 testing.
- **August 15, 2007** – Preliminary FY 2007 assurances due from field elements and Headquarters elements.
- **September 1, 2007** – Final FY 2007 assurances due from field elements.
- **September 15, 2007** – Final FY 2007 assurances due from Headquarters elements.

Assessment Scope: FY 2007 scope will remain consistent with the three-year implementation approach adopted by the Department and approved by OMB.

- Federal sites will complete evaluation and testing of any remaining high-risk activities not completed during FY 2006. (In FY 2006, Federal sites completed assessments of those high-risk activities most critical to supporting the Department's financial statement remediation efforts.) In addition, Federal sites will complete all medium-risk activities. It should be noted, however, that Federal sites are expected to make significant progress against their FY 2008 scope (low-risk activities) in addition to completing the FY 2007 scope. This will position Federal sites to complete their baseline assessments in FY 2008, which will allow for the use a cyclical risk-based testing approach starting in FY 2009.
- Contractor sites will complete evaluation and testing of all medium and low-risk activities. (In FY 2006 contractor sites completed assessments of all high-risk activities.) This will complete the baseline assessment for contractor sites, which will allow for the use of a cyclical risk-based testing approach starting in FY 2008.

Prior Year High-Risk Activities: In FY 2007, Federal and contractor sites will need to review all high-risk areas evaluated during FY 2006 to determine if significant process changes occurred since the time of the evaluation that would cause them to question whether prior year results are still valid (e.g. if the process for validating invoices changed from a completely automated to manual process, etc.). Field element A-123 leads are responsible for ensuring this review takes place for the sites under their cognizance. LPSO/CD A-123 leads are responsible for performing their own reviews and, with respect to LPSOs, for also ensuring that field elements under their cognizance have conducted their respective reviews. It should be noted that sites are NOT required to re-evaluate and test all high-risk activities in FY 2007.

Material Accounts: FY 2007 material accounts will remain consistent with those used during the FY 2006 assessment. The Department's three-year implementation approach requires the material accounts to remain fairly constant so that progress against the Department's commitments to OMB can be adequately tracked. The A-123 Project Management Team (PMT) has determined that no new material accounts have been identified at the Departmental level.

Federal sites, however, will need to determine whether significant changes have occurred in the operating environment at their location—and at contractor locations over which they have cognizance—which might change their material accounts. Operational changes that might drive a change in material accounts include, but are not necessarily limited to, the following:

- Changes in allottee
- Changes in organizational cognizance
- Changes resulting from reorganizations

- Changes resulting from a contractor merger or split
- Changes resulting from a new contract award

Any proposed change to material accounts must be approved by the A-123 PMT. Once approved, sites will immediately flag the account(s) in the A-123 Assessment and Reporting Tool (AART) as being applicable and update its Appendix A documents accordingly (e.g., *Implementation Plan*, process documentation, etc.).

Implementation Changes

The implementation changes described below provide for advance notice of planned FY 2007 changes to the corporate Appendix A methodology, tools or other elements of support. These changes are being made based on lessons learned, best practices and feedback received from Headquarters and field A-123 implementers. Sites should use this information to prepare for the changes or to eliminate steps that will be unnecessary once the changes are implemented. A revised AART will be issued in the November timeframe to accommodate those changes that identify an impact on the tool.

Organizational and Process Changes: Organizational and process changes at any level may have impacts on the corporate implementation of Appendix A. Sites should be aware of any such changes on an on-going basis and highlight those changes in updates to their *Implementation Plans*. Such changes could include, but are not necessarily limited to, the following:

- Changes in composition of the A-123 assessment team or senior management personnel (e.g., change in CFO, field element manager, etc.)
- Changes in implementation approach, contracting strategy or contractors
- Changes in allottee status, organizational structure or reporting chain of command

Sites should immediately notify the A-123 PMT if they determine that a change to their AART is needed. The A-123 PMT will make any changes to the AART, as necessary.

Categorizing Controls: Effective for the FY 2007 evaluation, sites will categorize controls as either preventive, detective or both. This information, along with the currently required identification of automated/manual controls, will better support control design effectiveness ratings and risk analysis. The AART tool will be modified to accommodate this activity.

Control Design Effectiveness Ratings: Effective in FY 2007, control design effectiveness ratings will be evaluated on a scale of 3 to 6. The following table provides the rating categories and definitions.

**New Control Design Effectiveness Ratings
(ECS/PCS-Assess Worksheets)**

3	4	5
<p align="center">Significant Design Deficiency</p> <p><u>Significant deficiency(ies)</u> in the control set design exist such that there is a HIGH probability of the risk occurring. This may adversely affect the organization's ability to meet its internal control objectives for the specified risk.</p>	<p align="center">Design Deficiency</p> <p><u>Deficiency(ies)</u> in the control set design exist such that there is MORE than a remote possibility of the risk occurring. This may adversely affect the organization's ability to meet its internal control objectives for the specified risk.</p>	<p align="center">Minor Design Deficiency</p> <p><u>Deficiency(ies)</u> in the control set design exist such that there is ONLY a REMOTE possibility of the risk occurring. This may not adversely affect the organization's ability to meet its internal control objectives for the specified risk.</p>
6	7	
<p align="center">Design Effective</p> <p>Control set design is <u>effective</u> such that there is LESS than a REMOTE possibility of the risk occurring. This should not adversely affect the organization's ability to meet its internal control objectives for the specified risk.</p>	N/A	

The AART tool will be modified to accommodate this activity.

Test Ratings: Effective in FY 2007, test results will be scored on a scale of 3 to 7. The following table provides the rating categories and definitions.

**New Test Ratings
(ECS/PCS-Test Worksheets)**

3	4	5
<p align="center">Significant Operational Deficiency</p> <p><u>Significant deficiency(ies)</u> in the control set operation exist such that there is a HIGH probability of the risk occurring. This may adversely affect the organization's ability to meet its internal control objectives for the specified risk.</p>	<p align="center">Operational Deficiency</p> <p><u>Deficiency(ies)</u> in the control set operation exist such that there is MORE than a REMOTE possibility of the risk occurring. This may adversely affect the organization's ability to meet its internal control objectives for the specified risk.</p>	<p align="center">Minor Operational Deficiency</p> <p><u>Deficiency(ies)</u> in the control set operation exist such that there is ONLY a REMOTE possibility of the risk occurring. This may not adversely affect the organization's ability to meet its internal control objectives for the specified risk.</p>
6	7	
N/A	<p align="center">Operating Effectively</p> <p>Control set is operating <u>effectively</u> such that there is LESS than a REMOTE possibility of the risk occurring. This should not adversely affect the organization's ability to meet its internal control objectives for the specified risk.</p>	

The AART tool will be modified to accommodate this activity.

Process/Entity Summary Ratings: Effective in FY 2007, Process and Entity ratings at the summary level will be scored on a scale of 3 to 7. The following table provides the categories and definitions for both Process and Entity control summary ratings.

**New Process/Entity Summary Ratings
(PCS/ECS-Assess Worksheets)**

3	4	5
Significant Deficiency	Deficiency	Minor Deficiency
Control deficiency(ies) (design and/or operational) exist that create a HIGH probability of not detecting or preventing fraudulent and/or erroneous transactions WITH a <u>significant exposure</u> to unreliable, inaccurate and/or untimely financial reporting.	Control deficiency(ies) (design and/or operational) exist that create a MODERATE probability of not detecting or preventing fraudulent and/or erroneous transactions WITH a <u>significant exposure</u> to unreliable, inaccurate and/or untimely financial reporting.	Control deficiency(ies) (design and/or operational) exist that create a LOW probability of not detecting or preventing fraudulent and/or erroneous transactions OR an <u>insignificant exposure</u> to unreliable, inaccurate and/or untimely financial reporting.
6	7	
Designed Effectively	Operating Effectively	
Controls are designed <u>effectively</u> to detect and/or prevent fraudulent and erroneous transactions AND ensure reliable, accurate and timely financial reporting.	Controls are operating <u>effectively</u> to detect and/or prevent fraudulent and erroneous transactions AND ensure reliable, accurate and timely financial reporting.	

The AART tool will be modified to accommodate this activity.

All the new ratings should be used in conjunction with the following definitions:

- **Probable** – the future event or events are likely to occur
- **Possible** – the chance of the future event or events occurring is more than remote but less than likely
- **Remote** – the chance of the future event or events occurring is slight

Oversight: In FY 2007, LPSOs and field elements will continue to oversee Appendix A implementation activities for any sites under their cognizance. Oversight is multifaceted, but some of the key aspects of oversight for which both LPSOs and field elements are responsible include:

- Ensuring that A-123 Assessment Teams comprise the appropriate mix of skills and resources
- Ensuring that professional judgment decisions are reasonable
- Ensuring the consistency, completeness and accuracy of data resulting from implementation activities

- Identifying and sharing possible best practices and identifying and resolving problems, challenges and barriers
- Coordinating with other Departmental elements as needed

The AART tool will be modified to allow LPSOs and field elements to document their completion of key oversight activities.

Another key aspect of oversight includes ensuring the timely completion of Appendix A implementation activities to meet Departmental milestones and commitments to OMB. In FY 2007, LPSOs and field elements will accomplish this oversight responsibility by continuing to monitor and track the progress in documenting, evaluating, testing and remediating controls.

The AART tool will be modified with a self-assessment capability that will allow A-123 leads across the Department to assess the progress of implementation. The self-assessment will include key elements of progress—such as the number and percentage of rated/unrated risks and the number of activities in remediation—that were previously captured and reported as part of the Continuous Quality Improvement initiative.

Corrective Actions: In FY 2007, sites will continue to remediate controls identified as not designed or operating effectively, document corrective actions taken, and report on the status of those actions as appropriate. To that end, the AART tool will be modified to integrate the current stand-alone Corrective Action Plan (CAP) Tracking Tool.

Risk Assessment: In FY 2007, risk assessments will continue to be performed based on inherent risk. This risk assessment will factor in the inherent likelihood that a risk *may* occur, and the inherent impact if the risk *does* occur, considering the general environment (not the control environment) in which the control functions. To clarify the requirements for conducting an inherent assessment of risk, the Quick Start Guides will be updated to incorporate related guidance that was issued by the A-123 PMT in May, 2006.

Financial Statement Assertions: Effective in FY 2007, sites will identify which financial statement assertions are impacted/addressed by each risk and control set. The alignment of risks and controls with the financial statement assertions provides a number of benefits, such as:

- Assisting in the assessment of risk (i.e., allows for a better understanding of potential material misstatements in the financial statements)
- Assisting in the differentiation between financial statement and business process risk (i.e., allows for a better focus of resources on internal controls over financial reporting)
- Allowing for an improved analysis of remediation issues and an understanding of the potential impact of deficiencies
- Identifying gaps in risk definitions

To facilitate this requirement, the Quick Start Guides will be updated to specifically define the five financial statement assertions as follows:

- ***Presentation and disclosure (P)*** – the particular components of the financial statements are properly classified, described and disclosed.
- ***Existence or occurrence (E)*** – an entity's assets or liabilities exist at a given date and recorded transactions have occurred during a given period.
- ***Rights and obligations (R)*** – assets are the rights of the entity and liabilities are the obligations of the entity at a given date.
- ***Completeness and accuracy (C)*** – all transactions and accounts that should be presented in the financial statements are so included.
- ***Valuation or allocation (V)*** – asset, liability, revenue and expense components have been included in the financial statements at appropriate amounts.

Also, the AART tool will be modified to capture this alignment of risks and controls with the financial statement assertions.

Testing: In FY 2007, sites will use a "dual-purpose" testing approach to evaluating the operating effectiveness of controls. There are two steps to using dual-purpose testing:

1. Determining *whether a control failure occurred* (control operation); and,
2. Determining *whether the risk actually occurred* (impact) as a result of the control failure, where reasonable and appropriate.

Sites should perform additional procedures, as necessary, to implement the use of dual-purpose testing. The Quick Start Guides will be updated accordingly.

**Departmental Elements, Corporate Departments,
and Major Site and Facilities Management Contractors
Subject to OMB Circular A-123, Appendix A**

Program Name	PGM Code	Federal Field Element Name	FO Code	CSO	Site Name	Site Code	Contractor Name		
National Nuclear Security Administration	NNSA	National Nuclear Security Administration (Service Center) -- Federal Activity --	NAFO	(None)	Kansas City	KC	Honeywell FM&T		
					Lawrence Livermore National Lab	LLNL	University of California		
					Los Alamos National Lab	LANL	Los Alamos National Security, LLC		
					Nevada Test Site	NTS	National Security Technologies, LLC		
					Pantex	PX	BWXT Pantex		
					Y12	Y12	BWXT Y-12		
				Sandia National Lab	SNL	Lockheed Martin Sandia			
				RW	Yucca Mountain Project (YMP)	YMP	Bechtel SAIC Company, LLC		
				Pittsburgh -- Federal Activity --	PFO	(None)	Bettis Atomic Power Lab	BAPL	Bechtel Bettis
				Schenectady -- Federal Activity --	SNFO	(None)	Knolls Atomic Power Lab	KAPL	Knolls Atomic Power Lab
Science	SC	Oak Ridge -- Federal Activity --	OR	EM	East Tennessee Technology Park	ETTP	Bechtel Jacobs Company LLC		
					Oak Ridge National Lab	ORNL	UT-Battelle, LLC		
					Pacific Northwest National Lab	PNNL	Battelle Memorial Institute		
					Oak Ridge Inst. For Sci & Educ.	ORISE	Oak Ridge Assoc. Univ.		
					Thomas Jefferson National Acc. Fac.	TJNAF	Jefferson Science Associates		
				Chicago -- Federal Activity --	CH	(None)	Argonne National Lab	ANL	University of Chicago Argonne, LLC
				Brookhaven National Lab	BNL	Brookhaven Science Assoc. (Battelle)			

					Fermi National Accelerator Lab	FNL	TBD (new contract to be awarded in 10/06)
					Lawrence Berkeley National Lab	LBNL	University of California
					Princeton Plasma Physics Lab	PPPL	Princeton University
					Stanford Linear Acc. Center	SLAC	Stanford University
Fossil Energy	FE	Strategic Petroleum Reserve Office -- <i>Federal Activity</i> --	SPRO	(None)	Strategic Petroleum Reserve	SPR	DynMcDermott Petroleum Oper. Co.
		National Energy Technology Lab -- <i>Federal Activity</i> --	NETL	EE	National Renewable Energy Lab (reports under NETL for purposes of A-123)	NREL	Midwest Research Institute & Battelle
					Golden Field Office (reports under NETL for purposes of A-123)	GFO	-- <i>Federal Activity</i> --
Nuclear Energy	NE	Idaho -- <i>Federal Activity</i> --	ID	NE	Idaho National Lab	INL	Batelle Energy Alliance
					Advanced Mixed Waste Treatment Plant	AMWTP	Bechtel BWXT Idaho
Environmental Management	EM	EM Consolidated Business Center (EMCBC) -- <i>Federal Activity</i> --	EMCBC	(None)	Fernald	FER	Fluor Fernald
					West Valley	WV	West Valley Nuclear Services
					Waste Isolation Pilot Plant	WIPP	Washington TRU Solutions
			Portsmouth Paducah Project Office (PPPO) -- <i>Federal Activity</i> -- (Reports under EMCBC)	(None)	Portsmouth	POR	LATA/Paralax
						UPOR	UDS Portsmouth
					Paducah	PAD	Paducah Remediation Services
						UPAD	UDS Paducah

		Savannah River -- Federal Activity --	SRFO	(None)	Savannah River Site	SRS	Washington Savannah River Company
		Richland -- Federal Activity --	RLFO	(None)	(None for purposes of A-123)		-- Federal Activity --
Power Marketing Administrations	PMA	Southeast Power Administration -- Federal Activity --	SEPA	(None)	(None)		-- Federal Activity --
		Southwest Power Administration -- Federal Activity --	SWPA	(None)	(None)		-- Federal Activity --
		Western Area Power Administration -- Federal Activity --	WAPA	(None)	(None)		-- Federal Activity --
		Bonneville Power Administration -- Federal Activity --	BPA	(None)	(None)		-- Federal Activity --
HQ CFO Organization	CFO	HQ CFO Organization -- Federal Activity --	CFO	(None)	(None)		-- Federal Activity --
Energy Efficiency and Renewable Energy	EE	(NREL & GFO report under NETL for purposes of A-123)					
Radioactive Waste	RW	(Yucca Mtn. reports under NNSA for purposes of A- 123)					
Legacy Management	LM	(None)					-- Federal Activity --
HQ Procurement	HPROC	(None)					-- Federal Activity --
Office of Engineering & Construction Management	HOECM	(None)					-- Federal Activity --
HQ CIO	HCIO	(None)					-- Federal Activity --