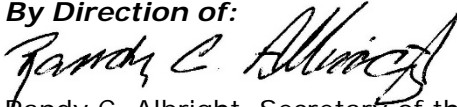


MANAGEMENT DIRECTIVE

Commonwealth of Pennsylvania
Governor's Office

Subject: Standards for Internal Controls in Commonwealth Agencies	Number: 325.12 Amended
Date: May 15, 2018	By Direction of:  Randy C. Albright, Secretary of the Budget
Contact Agency: Office of the Budget, Office of Comptroller Operations, Bureau of Audits, Telephone 717.783.0114	

This directive establishes policy, responsibilities, and procedures for implementing effective internal control systems within commonwealth agencies. This update adjusts language and aligns the directive with *Management Directive 325.13, Service Organization Controls*.

1. **PURPOSE.** To establish policy, responsibilities, and procedures for internal control systems within commonwealth agencies.
2. **SCOPE.**
 - a. This directive applies to all departments, boards, commissions, and councils (hereinafter referred to as "agencies") under the Governor's jurisdiction.
 - b. This directive applies to all aspects of an agency's operations, reporting, and compliance with applicable laws and regulations.
3. **OBJECTIVE.** To adopt and implement the internal control framework outlined in *Standards for Internal Control in the Federal Government* ([Green Book](#)) and ensure agencies use the components, principles, and attributes to design, implement, operate, and assess an effective internal control system.
4. **DEFINITIONS.**
 - a. **Component.** One of five required elements of internal control: control environment; risk assessment; control activities; information and communication; and monitoring.
 - b. **Deficiency.** When the design, implementation, or operation of a control does not allow management or personnel, in the normal course of performing their assigned functions, to achieve control objectives and address related risks.

- c. **Green Book.** The commonly used name for the *Standards for Internal Control in the Federal Government* issued by the United States Government Accountability Office. The Green Book provides managers criteria to design, implement, and operate an effective internal control system. The Green Book defines the standards of internal controls through components and principles of internal control and explains why they are integral to an entity's internal control system. Attributes are used to provide further explanation of the principles and documentation requirements for effective internal control.
- d. **Internal Control.** A process effected by an agency's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity are being achieved.
- e. **Internal Control System.** A continuous built-in component of operations, effected by people, that provide reasonable assurance, not absolute assurance, that an agency's objectives will be achieved.
- f. **Management.** Agency personnel who are directly responsible for the activities of a program or objective, including the design, implementation, and operating effectiveness of the related internal control system.
- g. **Material Weakness.** A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.
- h. **Oversight Body.** The designated members of an agency's senior management team responsible for overseeing management's design, implementation, and operation of the internal control system.
- i. **Principles.** The 17 elements of an effective internal control system, that when adhered to, will support the effective design, implementation and operation of the five components.
- j. **Service Organization.** A party external to commonwealth government that provides a service that is likely to be relevant to an agency's internal control.
- k. **Significant Deficiency.** A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

5. POLICY.

- a. Each agency must design, implement, and operate, for all programs under its jurisdiction, an internal control system that incorporates the five components of internal control; follows the framework established by the Green Book; and documents the internal control responsibilities of the agency.
- b. An assessment of the internal control system's adherence to the 5 components and 17 principles noted in the Green Book must be conducted and documented annually. See the [Internal Control Assessment Template](#).

- c. The Assurance Statement regarding the agency- and program-level effectiveness of the internal control system must be provided to the Office of the Budget by September 30, (for the fiscal year ending June 30, See the sample [Annual Statement of Assurance](#)).
- d. The results of ongoing internal and external monitoring and evaluation of the agency internal control system must be documented. See the [Monitoring Plan Guidance](#) document.
- e. Corrective action plans to address internal control system deficiencies must be documented and implemented timely.
- f. The Office of the Budget shall provide for a technical review of the agency's annual internal control assessment and monitoring plan to ensure compliance with this directive.

6. RESPONSIBILITIES.

a. Agency Heads shall:

- (1) Establish an oversight body to direct the assessment of internal controls.
- (2) Identify the need for policies and procedures for internal control within the agency to ensure the effective design, implementation, and operation of internal controls.
- (3) Provide for an annual assessment of internal control at the agency and program levels.
- (4) Provide an annual statement of assurance regarding the effectiveness of the agency's internal controls.
- (5) Provide for an annual internal and external monitoring plan.
- (6) Annually, by September 30, submit the internal control assessment, the Annual Statement of Assurance on the effectiveness of the agency's internal controls, and the monitoring plan to the Office of the Budget, Office of Comptroller Operations, Bureau of Quality Assurance.

b. Agency Management shall:

- (1) Develop and maintain effective internal controls.
- (2) Continuously monitor and improve the effectiveness of internal controls associated with their operations, financial reporting, and compliance. Continuous monitoring, and other periodic evaluations, should provide the basis for the agency head's annual internal assessment of internal control.
- (3) Identify any deficiencies in internal control based on internal and external information.
- (4) Report any control deficiencies to the oversight body to determine the effect of each deficiency.

- (5) Develop a corrective action plan for significant deficiencies and material weaknesses and monitor the progress to ensure timely and effective results.
- (6) Follow the policy and procedures in [Management Directive 325.13, Service Organization Controls](#) when using service organizations that support agency processes.

c. Agency Oversight Body shall:

- (1) Coordinate or perform evaluations of agency assessments, Office of the Budget technical review comments or reports, and service organization reports to enhance or maintain effective internal controls.
- (2) Monitor corrective action initiatives to confirm corrective action has been implemented.

d. Office of the Budget, Office of Comptroller Operations shall:

- (1) Develop guidance necessary for agencies to complete their annual internal assessment of internal control. See the Internal Control Assessment Template.
- (2) Develop guidance necessary for agencies to implement an annual plan for ongoing monitoring. See the Monitoring Plan Guidance document.

7. PROCEDURES. All agencies must observe the following minimum procedural steps to ensure adequate management controls, accountability, and uniformity in creating and implementing a system of internal controls.

a. Action by Agency Head.

- (1) Designates senior management to the oversight body.
- (2) Coordinates or confers with the oversight body to administer management's design, implementation, and operation of the internal control system.
- (3) Assigns agency management to develop and update the annual assessment of internal control and the internal and external monitoring plans.

b. Action by Agency Management.

- (1) Identifies deficiencies in internal control using the following sources of information:
 - (a) Management knowledge gained from the daily operation of agency programs and systems.
 - (b) Management reviews conducted (i) expressly for assessing internal control, or (ii) for other purposes with an assessment of internal controls as a by-product of the review.

- (c) Reports, including audits, inspections, reviews, investigations, or other products of the Department of the Auditor General, Office of Inspector General, Office of the Budget, and federal agencies.
 - (d) Program evaluations.
 - (e) Control self-assessments.
 - (f) Audits of financial statements, including information revealed in preparing the financial statements; the auditor's reports on the financial statements, internal control, and compliance with laws and regulations.
 - (g) Single audit reports.
 - (h) Reviews of financial systems, including service organization controls reports.
- (2) Completes an annual internal control assessment by entering required information into the designated Online Assessment Tool. The Internal Control Assessment Template can be used as a guide.
 - (3) Identifies and reports any internal control deficiencies to the oversight body.
 - (4) Develops and implements a corrective action plan for any significant deficiencies and material weaknesses.
- c. Action by Office of the Budget, Office of Comptroller Operations, Bureau of Quality Assurance.** Provides guidance to agencies in establishing their monitoring plans. See the Monitoring Plan Guidance document.
- d. Action by Agency Head.**
- (1) Evaluates internal control assessments and corrective action plans in conjunction with the oversight body to determine significant deficiencies and material weaknesses and prepare the agency internal control assessment.
 - (2) By September 30, submits the internal control assessment, the Annual Statement of Assurance on the effectiveness of the agency's internal controls and the monitoring plan to the Office of the Budget, Office of Comptroller Operations, Bureau of Quality Assurance.
- e. Action by Office of the Budget, Office of Comptroller Operations, Bureau of Quality Assurance.**
- (1) Monitors the receipt of the agencies' assurance statements, the assessments of internal controls, and the monitoring plans.
 - (2) Performs a technical review of the internal assessment of internal control and the monitoring plan to ensure compliance with the requirements of this directive.
 - (3) Notifies the Commonwealth Audit Committee of significant deficiencies and material weaknesses.

- (4) Reports to the Commonwealth Audit Committee at least semi-annually the progress of the agencies' corrective action plans.
 - (5) Notifies the Commonwealth Audit Committee of agencies that fail to provide the required assurance statement, the internal assessment, or a monitoring plan.
- f. **Action by Agency Head.** Incorporates the Office of the Budget, Office of Comptroller Operations, Bureau of Quality Assurance best practice comments or recommendations into the agency monitoring plan and the assessment process.
- g. **Action by Commonwealth Audit Committee.**
- (1) Compels agency compliance with this directive.
 - (2) Assesses significant deficiencies and material weaknesses to determine the effect on enterprise wide risk.
 - (3) Recommends agencies obtain formal evaluations of internal control systems as appropriate or initiates control self-assessment in accordance with [Management Directive 325.11, Evaluating Agency Internal Controls and Financial Risk through Self-Assessment.](#)
- h. **Action by Office of the Budget, Office of Comptroller Operations, Bureau of Audits.** Upon request of the Commonwealth Audit Committee, provides formal evaluations of agency internal control systems or facilitate a Control Self Assessments in accordance with *Management Directive 325.11, Evaluating Agency Internal Controls and Financial Risk through Self-Assessment.*

This directive replaces, in its entirety, *Management Directive 325.12, dated December 17, 2014.*