



March 28, 2006

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CHIEF FINANCIAL OFFICER AND EXECUTIVE VICE PRESIDENT

SUBJECT: Internal Control Group (Report Number FT-MA-06-001)

This report presents the results of our review of the Internal Control Group (ICG) (Project Number 05BD002FT000). The review was conducted as part of our fiscal year (FY) 2005 Audit Plan.

### **Objectives, Scope, and Methodology**

Our overall objective was to review the ICG's role in the U.S. Postal Service and how it accomplishes that role. Our specific objectives were to determine the scope of ICG work at the headquarters, area, and district levels, and to assess ICG planning, fieldwork, and reporting policies and procedures and the ICG's use of the Internal Control Reporting System (ICRS) to record and track its work. To accomplish our objectives, we interviewed ICG management at headquarters and employees at the judgmentally-selected Capital Metro Area and Richmond District. We also examined information maintained by the ICG on the Postal Service intranet. In addition, we reviewed the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission, for applicability to the ICG. Finally, we relied on computer-generated data maintained in the ICRS.

We conducted this review from January 2005 through March 2006 in accordance with the President's Council on Integrity and Efficiency, *Quality Standards for Inspections*. We discussed our observations and conclusions with management officials and included their comments where appropriate.

### **Prior Audit Coverage**

We did not identify any prior audits or reviews related to the objective of this review.

### **Results**

We acknowledge the Postal Service's efforts to establish the ICG to assist management in proactively improving processes. We performed the review during the developmental phase of the ICG. Therefore, we were able to fully evaluate neither ICG planning,

fieldwork, and reporting policies and procedures, nor the ICRS. Nevertheless, this report provides information on the establishment, mission, structure, methodology, reporting system, and accomplishments of the ICG at the time of our review. Furthermore, we are including observations on the ICG's efforts for reporting on internal controls over financial reporting.

### **Establishment of the ICG**

The need for the ICG was established in the Postal Service's *Transformation Plan* as reported in the *2004 Comprehensive Statement on Postal Operations*. Further impetus for the ICG resulted from the financial reporting reforms proposed by COSO and requirements of the Sarbanes-Oxley Act (SOX) of 2002, and in response to the Government Accountability Office's (GAO) position that the Postal Service needed stronger internal controls.

In FY 2003, under the auspices of the Shared Services/Accounting (SS/A) project, field accounting work was reengineered, residual work was migrated to the three existing accounting service centers, and the 85 district accounting offices were discontinued. Implementation of the SS/A project was intended to streamline accounting processes and operate more efficiently without sacrificing internal controls and service.

Initial staffing for the ICG was drawn from Executive and Administrative Salary Schedule (EAS) employees whose positions were eliminated during the implementation of the SS/A project. EAS employees in positions eliminated (manager, accounting operations; supervisor, financial services; revenue assurance analyst; and postal system coordinator) were the initial selection pool for ICG positions in district offices. The Postal Service reported significant savings from the SS/A project, but these savings did not include positions created in the ICG.

The headquarters ICG operations and program budget for FY 2005 was \$6.8 million.<sup>1</sup> This included headquarters-sponsored events that included field personnel, such as training and conferences. Costs associated with ICG field operations for FY 2005 were approximately \$37 million<sup>2</sup> and were part of the district managers' budgets.

As of April 2005, the ICG had 500 authorized positions at the district level (80 internal control managers and 420 internal control analysts), of which 415 were filled. Because staffing came primarily from the district accounting offices and, to some extent, the former revenue assurance function, internal control analysts continued to assist in the transition to a Shared Services/Accounting structure. Therefore, not all ICG field staff were performing in full-time ICG roles.

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<sup>1</sup> The eRise (Enterprise-wide, Risk Analysis, Internal Control, Sarbanes-Oxley, Excellence) program budget of \$4.1 million is included in this amount. eRise is a key module in the Oracle e-Business suite. It is scheduled to replace ICRS in FY 2006.

<sup>2</sup> This estimate was provided by the headquarters ICG manager and does not include facility costs and other overhead costs.

## **Mission**

The ICG was formed in 2003 to assure compliance with policies and processes in order to confirm integrity in reporting results critical to transition and to the success of a more performance-based culture. Internal control analysts partner with management enterprise-wide to identify, through analysis, risk assessment, and review, those internal controls that are not reliable, effective, or efficient. The ICG and management work to find the root causes for identified deficiencies and make recommendations for improvement, to provide reasonable assurance that desired business objectives are attained.

The ICG operates as an internal consultant by assisting management in proactively improving processes by evaluating the internal controls in those processes. As such, it is not an internal audit function and does not follow professional auditing or other standards.<sup>3</sup> For example, the levels of supervisory review and quality control are not as extensive as those required under professional auditing standards. In addition, the ICG is not considered independent under such standards.

ICG analysts receive 20 hours of training in orientation and methods for performing reviews. In 2003, all field managers and analysts received this training. This training continues to be provided to new ICG personnel. In FY 2005, 94 new analysts received the 20 hours of training.

## **ICG Structure**

The ICG is an integral part of Postal Service management, as shown by its reporting structure. The headquarters' ICG function consists of an ICG manager, the Internal Control Support team, and the Corporate Audit and Response Management (CARM) team. The headquarters function is also supported by area- and district-level personnel. (See Appendix A, ICG Reporting Structure.)

The ICG manager reports to the chief financial officer and executive vice president. The manager is located at Postal Service Headquarters and provides leadership to the ICG function. The manager attends meetings of the Board of Governors Audit and Finance Committee, provides quarterly reports to the Business Review Committee, and meets with the Postal Inspection Service, as needed, on particular topics.

The Internal Control Support team reports to the ICG manager. This team consults with headquarters process owners on process improvements, coordinates national review activities, directs activities to develop new topics for review, and analyzes and reports on summary data from field reviews. In 2004, staffing for this team was completed and consists of a manager, Internal Control Support, eight specialists, and one analyst.

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<sup>3</sup> Professional auditing standards include standards issued by the American Institute of Certified Public Accountants, Institute of Internal Auditors, and GAO.

CARM also reports to the ICG manager. It acts as coordinator and liaison between management and the U.S. Postal Service Office of Inspector General (OIG) and external auditors. Although it does not review Postal Service operations, CARM is expected to benefit the ICG by providing information on risk management and improving its ability to respond to auditors. CARM was formed in 2002 and became a part of the ICG in 2004. CARM is led by a manager and includes eight analysts.

The headquarters ICG function is assisted in each area by the area finance manager and area accounting manager. The area finance manager's primary role is to coordinate activities and act as liaison between the headquarters team and respective districts. The area accounting manager facilitates area-level risk assessment and prioritization, directs reviews of area-selected topics, coordinates training requirements, and advises headquarters ICG on district ICG issues.

The ICG activities at the district level are the heart of the ICG function. Here, the ICG function is led by a district internal control manager who reports to the district finance manager. The district internal control manager oversees a staff of three to nine internal control analysts who perform reviews at field sites using predetermined review steps for a given Postal Service process. Costs associated with the ICG function at this level are funded by the district.

### **ICG Methodology**

An ICG risk assessment<sup>4</sup> is built from the district level through the areas and to headquarters. This method results in national priorities that are generally aligned with district priorities, so that ICG work plans at the districts include national priorities. Work is generally selected based on results of the risk assessment. As time progresses, further data analysis, new information, and events could lead to reprioritizing items in the risk assessment or recognition of potential risks that were not captured. Accordingly, district ICGs continue evaluating risk assessment results against their current environment and adjust work plans based on those assessments. For example, a district manager was concerned about declining mail volume, and the local ICG team responded with a review in the subject area. Also, one ICG manager determined that business mail entry units, a national priority based on risk, was not a top priority at that district. Therefore, the manager assigned reviews in other Postal Service processes that had a higher priority in that district.

The ICG has three programs – financial, performance, and revenue. Each of these has a library of detailed review topics. In conducting a review, analysts evaluate internal controls within a given Postal Service process, such as stamp stock accountability,

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<sup>4</sup> The risk assessment model is a tool used to develop work plans for the ICG. It provides a snapshot of potential risk at a point in time based on (1) inherent risk, the amount of dollar exposure in the process; (2) control risk, the nature of the controls in the process; and (3) prior coverage, the elapsed time since the process was last reviewed by the ICG.

disbursements, asset security, registered mail, automated postal centers, master trust reconciliations, business mail acceptance, business reply mail, and detached mail units.

Many controls evaluated are the same or similar to those examined by the OIG in conducting field financial audits. For example, both ICG and OIG programs determine whether retail floor stock exceeds authorized amounts, and if cash counts are performed at the required frequencies. The OIG, however, completes work as part of an overall audit in accordance with professional auditing standards. Although the ICG does not complete work as part of an overall audit, approximately 80 percent of its work is directed at evaluating controls and making recommendations for improvements for risks identified in the annual risk assessment and prioritization. This work may include areas that are also covered by the OIG.

The ICG has 527 authorized positions<sup>5</sup> and an operating budget of approximately \$39.6 million<sup>6</sup> that it uses to accomplish its program work. Approximately 15 percent of its work and \$5.5 million of its operating budget are directed to cyclical topics<sup>7</sup> covering the same or similar areas covered by the OIG. The OIG dedicated 84 authorized positions and \$8.9 million of its operating budget to accomplish its audits in the same or similar program areas.

While the ICG and OIG may conduct work on the same or similar topics, the objectives are different. The ICG performs the monitoring function of the internal control structure<sup>8</sup> by selecting data-driven reviews to evaluate internal controls, determine root causes for control weaknesses, and make recommendations to improve control effectiveness and efficiency. On the contrary, the OIG performs statistically-selected audits in support of the annual financial statement opinion in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. (See Appendix B for a comparative analysis of ICG and OIG program work.)

### **Reporting Results and Accomplishments**

The ICG uses the ICRS, a web-based system, to track work in progress and maintain a record of completed work. The ICRS is a database that serves as the internal control analysts' workpapers. It enables the analysts to record their work, and supervisors and others in authority to oversee the work done. The system also maintains recommendations by site and reviews<sup>9</sup> issued. The system provides ICG statistical data, such as the most frequent reportable conditions, including weaknesses in internal

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<sup>5</sup> As of September 30, 2005.

<sup>6</sup> FY 2005 headquarters and field budget information, not including the eRise program budget and overhead costs such as facilities.

<sup>7</sup> Cyclical reviews represent items that, in general, have adequate controls to mitigate risk. However, periodic reviews are needed to ensure that controls continue to work as designed.

<sup>8</sup> Monitoring is one of five interrelated components of internal control, as identified by COSO's *Internal Control – Integrated Framework*.

<sup>9</sup> Generally, a report consists of one review.

controls, and statistics by area and district. The system also provides statistical data by types of reviews – for example, money orders, business reply mail, and payroll.

Although each topic is generally a separate review, it may be combined with the results of another topic at the same site, if conducive, and tracked in the system as a single review. For example, if the analyst performs some or all of the steps in review topic 2000, Stamp Stock Accountability, SIA Office, that work is considered one review. If the analyst then performs steps in topic 3000, Money Orders, at the same location, it is considered a second review. For reporting purposes, the analyst, however, may combine the results from 2000 and 3000 into a single review. As of May 11, 2005, the ICG had performed 16,586 reviews, and 2,703 reviews were in progress.<sup>10</sup>

When analysts complete their reviews, they prepare written reports for the district finance or internal control manager's review and signature using a standardized format. Postal Service management is expected to respond within 30 days of receiving the report. When a recommendation for a policy or standard procedure change is not within the authority of the unit or district manager, area managers consider whether the recommendation should be forwarded to ICG headquarters for further action. For example, the field ICG in the Pacific Area developed recommendations for improvements in controls for media mail that included changes in nationally established procedures. The recommendations were submitted through the Pacific Area to headquarters ICG, and resulted in establishing national procedures for periodic management inspections of media mail.

The ICG expects to transition from ICRS to the internal controls manager application in FY 2006, but ICRS data will be available through FY 2007. Internal control programs, approach, and methodologies will not change, and data from ICRS will be accessible for tracking and analysis.

### **Reporting on Internal Controls Over Financial Reporting**

The ICG, in coordination with Finance, participates in management actions to voluntarily comply with portions of Section 404 of SOX.<sup>11</sup> Under Section 404, businesses must acknowledge management's responsibility for maintaining adequate internal control mechanisms for financial reporting and evaluate the efficacy of such mechanisms.

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<sup>10</sup> We attempted to ascertain the number of recommendations since the inception of the ICG, but ICRS could not readily provide the information.

<sup>11</sup> SOX provisions do not apply to the Postal Service. However, Postal Service management stated that it remains committed to a continuing effort to achieve voluntary compliance with Section 404 of SOX.

To achieve compliance, the ICG and the controller's function have been working to map eight major processes:

- Cash
- Payroll
- Transportation
- Meter revenue
- Money orders
- Real estate transactions
- Contract payments
- Accruals – month- and year-end closing process

More than 300 processes and subprocesses have been documented, and three teams have been reviewing end-to-end processes for cash, money orders, and meter allocations.<sup>12</sup>

In its report on internal control and other matters to the Audit and Finance Committee and Postal Service management, the independent public accountants, Ernst & Young, LLP, supported management's initiative begun in FY 2004 towards voluntary compliance with portions of Section 404 of SOX. They also recommended that management continue the momentum it has started and set a goal to review its overall strategic plan and timetable for this initiative. In addition, they recommended management continue to communicate its path to the Audit and Finance Committee.

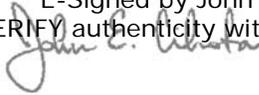
Management views SOX compliance as a viable plan for documenting, testing, and monitoring controls over financial reporting. Priority business initiatives for improvement and limited resources have affected the timeline for meeting management targets for voluntary compliance with portions of SOX, but the Postal Service's efforts and commitment are expected to continue.

We discussed the results of this review with Postal Service management on March 14, 2006. No recommendations were made, and management chose not to respond to this report. No action by management was required.

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<sup>12</sup> Process documentations are in the draft phase and not available for release at this time.

We appreciate the opportunity and courtesies provided by your staff during the review. If you have any questions or need additional information, please contact Lorie Siewert, director, Financial Statements, or me at (703) 248-2300.

E-Signed by John Cihota   
VERIFY authenticity with Approve!  


John E. Cihota  
Deputy Assistant Inspector General  
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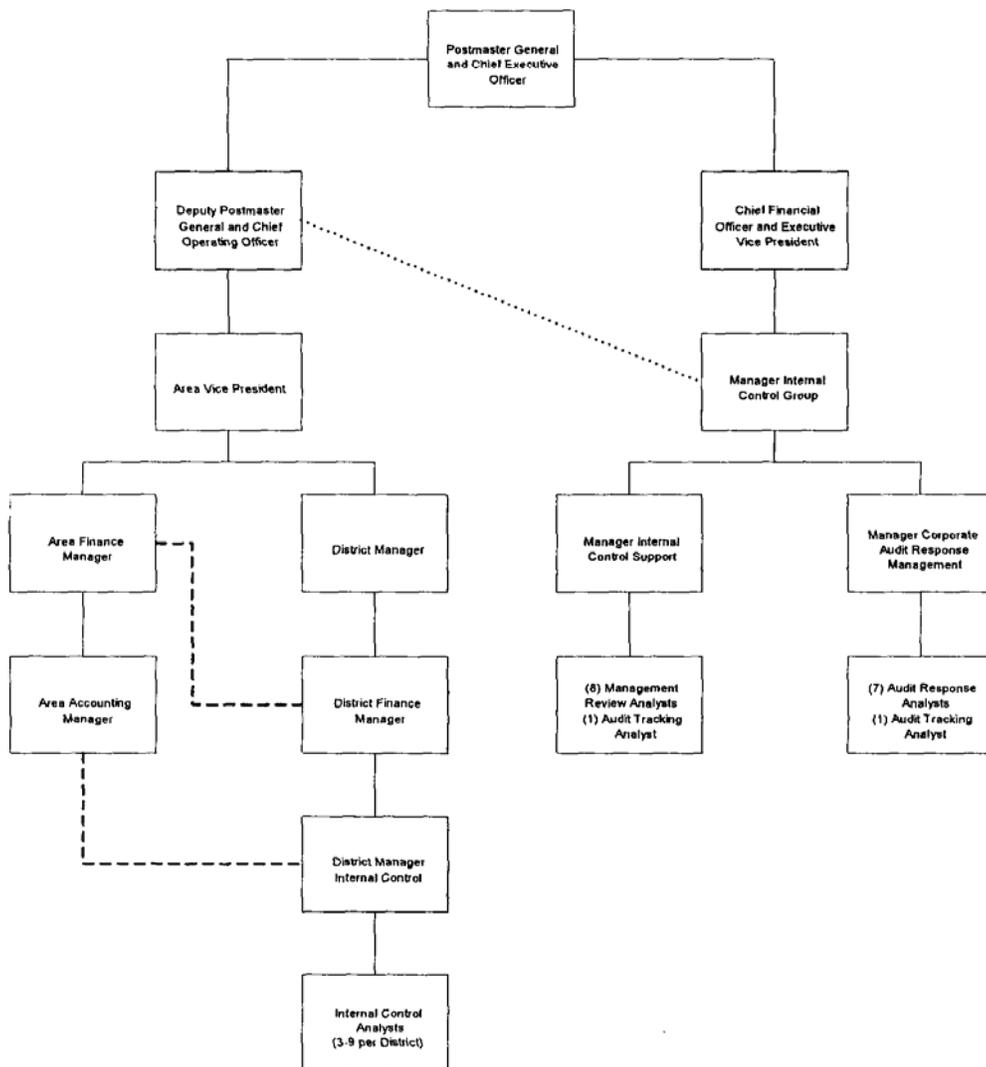
Attachments

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# APPENDIX A

## INTERNAL CONTROL GROUP REPORTING STRUCTURE

ICG Reporting Structure



## APPENDIX B

### COMPARATIVE ANALYSIS OF ICG AND OIG PROGRAM WORK

Comparison of Effort Postal Service Programs Reviewed by:			
<u>Internal Control Group</u> 80% Risk Priority Topics 15% Cyclical Topics 5% other		ICG and OIG work conducted in same or similar areas	<u>Office of Inspector General</u> Financial Operations Core Operations Headquarters Operations
ICG Other	ICG Risk Priority Topics  Identified through Risk Assessment and Prioritization  NOTE: May include parts of ICG cyclical topics if particular controls are evaluated as risk priorities.	<u>ICG Cyclical Topics</u> Stamp Stock Accountability Disbursements Asset Security Business Mail Acceptance Business Reply Mail Detached Mail Units  <u>OIG Financial Program</u> Financial Statements Field Financial	Other OIG Programs  Identified in fiscal year audit plans  NOTE: Audit plans are updated throughout the fiscal year

**Note:** The diagram shows where ICG and OIG conduct work in the same or similar areas. There are other ICG activities not related to OIG work, and OIG work not related to ICG work, as illustrated by the non-intersecting portions of the diagram.

### ICG

### OIG

#### Authorized Positions as of September 2005

	Cyclical	Total		Field Financial	Field Financial	Total Audit
Headquarters		21	Field Financial	84		
Field	80	506	Total Audit			356
Total	80	527				

**Note:** ICG Cyclical is estimate based upon 15% of work assigned to cyclical topics.

#### Funding of Operations (\$Millions) for FY 2005

	Cyclical	Total		Field Financial	Total Audit
Headquarters		2.6	Field Financial	8.9	
Field	5.5	37.0	Total Audit	8.9	27.3
Total	5.5	39.6			

**Note:** ICG Cyclical is estimate based upon 15% of work assigned to cyclical topics.

#### Professional Standards Followed

None—Certification program under consideration  
 ICG Analysts receive 20 hours training in review methods at time of appointment

Government Auditing Standards  
 PCIE Quality Standards for Inspections  
 AICPA—Auditing Standards Generally Accepted in the U.S.

#### Purpose of Work

Provide recommendations to management regarding internal control weaknesses.

Provide support for the annual financial statement opinion by the independent public accountant.