

<b>Volume No. 1 – Policies &amp; Procedures</b>	<b>TOPIC NO</b>	<b>10305 – Cardinal</b>
<b>Section No. 10300 – Internal Control Guidance</b>	<b>TOPIC</b>	<b>INTERNAL CONTROL</b>
	<b>DATE</b>	<b>September 2015</b>

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## Overview

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**Introduction** This topic provides guidelines to assist State agencies and institutions in implementing internal control programs under the authority of the *Code of Virginia*, §§ 2.2-800 and 2.2-803.

The definitive source for internal control in the Commonwealth is the *Agency Risk Management and Internal Control Standards* (ARMICS). The initial ARMICS implementation was required through Comptroller’s Directives 1-07 and 1-08. Effective with fiscal year 2010, this CAPP Topic addresses Internal Control requirements for the Commonwealth. No further Comptroller’s Directives on Internal Control are planned.

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**Policy** Each Agency Head is responsible for having agency management document the agency’s assessment of internal control to include:

- Strengths, weaknesses, and risks over the recording of financial transactions in the General Ledger;
- Compliance with the agency’s financial reporting requirements;
- Compliance with laws and regulations; and,
- Stewardship over the Commonwealth’s assets.

The assessment of internal controls and documentation must be conducted in accordance with ARMICS located at [http://www.doa.virginia.gov/Admin\\_Services/ARMICS/ARMICS\\_Main.cfm](http://www.doa.virginia.gov/Admin_Services/ARMICS/ARMICS_Main.cfm)

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**Agency Level Controls** Initially, an agency must document, evaluate, and test agency-level controls across the five components of Internal Control:

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring

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## Overview, Continued

### Agency Level Controls cont'd.

Agency-level controls permeate the agency and have a significant impact on how it achieves its objectives relating to the recording of financial transactions, compliance with financial reporting requirements, compliance with laws and regulations, and stewardship over Commonwealth assets. The agency must demonstrate that they have adequately assessed and tested the five components of internal control on an agency level.

ARMICS include samples of control self-assessment questionnaires that could generally apply to any organization. These questionnaires identify typical, high-level risks for organizations. Agencies are strongly encouraged to adapt these sample questionnaires to best fit their own organization so they may be easily understood by those responding to the questionnaires.

Additionally, there are risk areas unique to each organization at the agency level that should be addressed by additional questions created specifically for each agency.

Once this process has been successfully implemented, the agency does not have to repeat this process each year. However, the agency should refresh and refine the agency-level control evaluation every year considering:

- Any changes to the organization, its management, or functions from prior implementations of ARMICS;
- Enhancements identified internally from prior ARMICS experiences, DOA Quality Assurance Reviews (QARs), APA audits, or other sources;
- Information from the most recent S.W.O.T. (Strengths, Weaknesses, Opportunities, and Threats) analysis; and,
- Best internal control practices from industry, governments, and other agencies.

The agency should implement any of the items above or other enhancements the agency determines it is appropriate to improve the ARMICS process. Additionally, the agency should continue to document, evaluate, assess, and test the internal controls related to agency-level processes and develop a Corrective Action Plan, as needed.

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### Transaction-Level Controls

Transaction-level controls are those applicable to significant fiscal processes for each agency. Initially, an agency must:

- Identify its significant fiscal processes using a documented, consistent, and reasonable process;
- Document the significant fiscal processes using tools such as narratives, flowcharts, data diagrams, etc.;
- Assess the risks associated with the significant fiscal processes using tools such as Risk Maps, Heat Maps, and Control Matrices;
- Identify all internal control points in those processes; and
- Evaluate (test) controls over the agency’s significant fiscal processes to ensure the controls are functioning as intended and document the testing process and results.

### Update and Retest Controls

Once this process has been successfully implemented the agency should update and retest the transaction-level controls every year by completing the following:

- Determine if any organizational changes occurred to require a reevaluation of the fiscal processes determined to be significant for the agency. All new significant fiscal processes should be documented, controls evaluated, and key controls tested;
- Determine if there were any changes to areas identified as significant fiscal processes. Reevaluate the controls for those processes experiencing change, document the process changes, and test the key controls to ensure they function as intended; and,
- For all significant fiscal processes that have not changed since the prior year, retest the key controls to ensure that they are still working.

Processes that were improved as the result of completing corrective actions identified in prior ARMICS reviews should be tested to ensure the new controls have adequately addressed the internal control weakness in the prior year’s corrective action plan.

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### Corrective Action Plans

A corrective action plan must be filed when 1) an agency has discovered significant weaknesses in internal control as part of the ARMICS process; 2) an agency is in non-compliance with the ARMICS requirements as a result of a DOA review; or 3) an agency has filed Exhibit 4 stating the agency is not in compliance with ARMICS.

A corrective action plan must include at a minimum the following elements:

- Summary description of the deficiency in internal control;
- When the deficiency was identified;
- A target date for the completion of corrective action. The date of completion should be within the next fiscal year following the date of the assessment;
- Agency personnel responsible for monitoring progress;
- Indicators or statistics used to gauge the resolution progress; and,
- A quantifiable target or qualitative characteristic that will indicate that the deficiency in internal control has been corrected.

Corrective action plans for significant weaknesses must be submitted to the Department of Accounts ([ARMICS@doa.virginia.gov](mailto:ARMICS@doa.virginia.gov)) along with the ARMICS annual certification. Corrective action plans must be updated every 90 days. All corrective actions should be implemented no later than the end of the next fiscal year. The last corrective action plan filed, indicating all deficiencies have been corrected, must be certified by the agency head.

### Certification and Reporting

ARMICS provides guidance for establishing and assessing agency internal controls in order to more effectively manage risk and maintain accountability. As in prior years, agency heads will certify to the Comptroller and Auditor of Public Accounts that they have established, maintained and evaluated their agencies' internal control framework.

**Beginning in fiscal year 2011, the ARMICS annual certification must be submitted to the Department of Accounts by September 30<sup>th</sup> of each year.** In previous fiscal years, agencies were required to submit certifications by June 30<sup>th</sup>. Agencies will continue to certify the effectiveness of internal controls as of June 30, 20XX; however, the revised due date provides agencies additional time to complete the required testing of key internal controls.

**Agencies may not certify unless they have performed ARMICS.** Three sample certification statements are included as exhibits following this CAPP Topic. Each one covers a particular reporting situation for an agency. There is an agency statement provided as Exhibit 4 for agencies that have not performed ARMICS and tested controls annually.

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### Service Provider Agency

An agency (Primary Agency) may use another agency (Service Provider Agency) to perform significant fiscal processes for the primary agency. In these instances, the primary agency must have adequate interaction with the service provider agency to gain an appropriate understanding of the service provider agency’s control environment. For example, the Department of Accounts serves as the service provider agency for several primary agencies.

In order to incorporate these service provider situations into the certification, DOA has created a “Service Provider Agency Clause” in Appendix A following this CAPP Topic.

The primary agency must list the significant fiscal processes performed by a service provider agency on this form. Then, after obtaining assurances from the service provider agency regarding the state of internal control applicable to those processes, the primary agency must select and insert the appropriate control assessment option. This form has three options available based on the control environment of the service provider agency.

**NOTICE:** Primary agencies are cautioned to ensure the agreements with service provider agencies clearly delineate the processes, procedures, and controls assigned to each party of the agreement. Significant interactions between the primary agency and service provider agency should occur to ensure the primary agency is gaining the full value of the service provider agency’s entire control environment for all fiscal processes. The agreements usually take the form of a Memorandum of Understanding (MOU). All service arrangement agreements should be updated at least annually and more frequently in the event a significant change occurs. In all instances, the service agreement must ensure both parties fully understand their respective responsibilities under the MOU.

The certifying agency should submit the service provider agency clause (if applicable) with the applicable certification statement at the end of the fiscal year to DOA.

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### **Third-Party Providers**

Agencies may also use “Third-Party Providers” outside of the state to perform **significant fiscal processes** for the agency. (See page 26 of [ARMICS](#).) In these instances, the agency must have adequate interaction with the service provider to gain an appropriate understanding of the service provider’s control environment. Agencies must maintain oversight over third-party service providers. The Commonwealth must have assurance over outsourced operations.

In order to incorporate these third-party service provider situations into the certification, DOA has created a “Third-Party Provider Clause” in Appendix B following this CAPP Topic.

The agency must list the significant functions or fiscal processes performed by a service provider on this form. Then, after obtaining assurances from the service provider regarding the state of internal control applicable to those processes, the agency must select and insert the appropriate control assessment option. The agency must also state what type of assurance was received from the service provider. This form has three options available based on the control environment of the service provider.

**NOTICE:** Agencies are cautioned to ensure the agreements with service providers clearly delineate the processes, procedures, and controls assigned to each party of the agreement. Significant interactions between the agency and service provider should occur to ensure the agency is gaining the full value of the service provider’s entire control environment for all fiscal processes and outsourced functions. All service arrangement agreements should be updated at least annually and more frequently in the event a significant change occurs. In all instances, the service agreement must ensure both parties fully understand their respective responsibilities.

The certifying agency must submit the Third-Party Provider Clause (if applicable) with the applicable certification statement at the end of the fiscal year to DOA.

### **Types of Assurance**

Assurance over outsourced operations and processes can come in several forms. Historically, many organizations relied on Statements on Auditing Standards (SAS) 70 reports. However, SAS 70 reports were replaced with Service Organization Control (SOC) reports. In specialized situations, other forms of assurance may be appropriate.

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### Service Organization Control (SOC) Reports

The following is a description of the different types of SOC reports and their use from the AICPA website:

#### **SOC 1 Report – Report on Controls at a Service Organization Relevant to User Entities’ Internal Control over Financial Reporting**

These reports, prepared in accordance with *Statement on Standards for Attestation Engagements (SSAE) No. 16, Reporting on Controls at a Service Organization*, are specifically intended to meet the needs of the entities that use service organizations (user entities) and the CPAs that audit the user entities’ financial statements (user’s auditors), in evaluating the effect of the controls at the service organization on the user entities’ financial statements. There are two types: SOC 1, Type 1 focuses on control design, whereas Type 2 includes operating effectiveness of controls. Use of these reports is restricted to the management of the service organization, user entities, and user auditors.

#### **SOC 2 Report— Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality or Privacy**

These reports are intended to meet the needs of a broad range of users that need information and assurance about the controls at a service organization that affect the security, availability, and processing integrity of the systems the service organization uses to process users’ data and the confidentiality and privacy of the information processed by these systems. These reports can play an important role in: 1) Oversight of the organization; 2) Vendor management programs; 3) Internal corporate governance and risk management processes; and 4) Regulatory oversight. Use of these reports is generally restricted.

#### **SOC 3 Report— Trust Services Report for Service Organizations**

These reports are designed to meet the needs of users who need assurance about the controls at a service organization that affect the security, availability, and processing integrity of the systems used by a service organization to process users’ information, and the confidentiality, or privacy of that information, but do not have the need for or the knowledge necessary to make effective use of an SOC 2 Report. These reports are prepared using the AICPA/Canadian Institute of Chartered Accountants (CICA) *Trust Services Principles, Criteria, and Illustrations for Security, Availability, Processing Integrity, Confidentiality, and Privacy*. Because they are general use reports, SOC 3 reports can be freely distributed.

Most agencies would use an SOC 2 or SOC 3 report. See [AICPA Brochure on SOC](#) for a more detailed description.

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### ARMICS Certification Channels

ARMICS Certifications are accepted at DOA through the following channels.

- **E-Mail**  
[armics@doa.virginia.gov](mailto:armics@doa.virginia.gov)  
 — Convert signed certification to an Acrobat file (.pdf) & attach
- **U.S. Mail**  
 Virginia Department of Accounts  
 Finance and Administration—ARMICS  
 PO Box 1971  
 Richmond, VA 23218 -1971
- **Interagency Mail**  
 Finance and Administration—ARMICS  
 Department of Accounts  
 Agency #151— Monroe Building
- **Hand Delivery**  
 Finance and Administration—ARMICS  
 Monroe Building  
 101 North 14<sup>th</sup> Street  
 2nd Floor

### Additional Information Contact

Further information concerning this CAPP Topic can be obtained from the Assistant Director, Finance and Administration, (804) 225-2542 or [armics@doa.virginia.gov](mailto:armics@doa.virginia.gov).

### Documentation Maintenance

Documentation of the ARMICS assessment processes and performance of the assessments will be maintained at the agency and made available for review by the Department of Accounts or other appropriate parties.

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## Records Retention

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### Records Retention

ARMICS documentation should be maintained on file for three years after successful completion of the corrective action plan for a particular year. For further guidance, see CAPP – Cardinal Topic No. 21005, *Records & Retention*.

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## DOA Contact

### Contact

Assistant Director, Finance and Administration—ARMICS

 (804) 225-2542

 [armics@doa.virginia.gov](mailto:armics@doa.virginia.gov)

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## Appendix A – Certification of Internal Control

### Service Provider Agency Clause

This appendix contains sample certifications for agency signature. If any special circumstances arise, the agency head should modify the certification accordingly. The Agency Head and Chief Fiscal Officer who sign the certification must be the same persons whose names and signatures appear on the *Authorized Signatories* form submitted to DOA.

**Service Provider Agency Clause**

The (Primary Agency Name) utilizes (Service Provider Agency Name) as a service provider for the following fiscal processes that are significant to (Primary Agency Name):

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We have received assurance from (Service Provider Agency Name) that they have adequately assessed the effectiveness of their internal control in accordance with the *Agency Risk Management and Internal Control Standards* issued by the Office of the Comptroller as applicable to the processes used to provide services to (Primary Agency Name). Insert the appropriate paragraph from the following:

Based on the results of (Service Provider Agency’s Name) internal control assessment in accordance with ARMICS,

no significant weakness was found in the design or operation of the internal controls applicable to the processes or services conducted on behalf of (Primary Agency Name).

OR

no significant weakness was found in the design or operation of the internal controls applicable to the processes or services conducted on behalf of (Primary Agency Name). However, other (non-significant) internal control weaknesses were identified and (Service Provider Agency’s Name) has provided assurance to us that they will address these minor weaknesses.

OR

significant weakness was found in the design or operation of the internal controls applicable to the processes or services conducted on behalf of (Primary Agency Name). (Service Provider Agency’s Name) has provided us with a list of these weaknesses and a copy of their Corrective Action Plan.

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## Appendix B – Certification of Internal Control

### Third-Party Provider Clause

This appendix contains sample certifications for agency signature. If any special circumstances arise, the agency head should modify the certification accordingly. The Agency Head and Chief Fiscal Officer who sign the certification must be the same persons whose names and signatures appear on the *Authorized Signatories* form submitted to DOA.

#### **Third-Party Provider Clause**

The (Agency Name) utilizes (Third-Party Provider Name) as a service provider for the following processes that are significant to (Agency Name):

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

We have received assurance from (Third-Party Provider Name) that they have adequately assessed the effectiveness of their internal control in accordance with the AICPA/Canadian Institute of Chartered Accountants (CICA) *Trust Services Principles, Criteria, and Illustrations for Security, Availability, Processing Integrity, Confidentiality, and Privacy* or *SSAE No. 16* as applicable to the processes used to provide services to (Agency Name). Insert the appropriate paragraph from the following:

Based on the results of (Third-Party Provider Name) internal control assessment contained in the Service Organization Control (SOC) report, [Insert type of SOC report]

no significant weakness was found in the design or operation of the internal controls applicable to the processes or services conducted on behalf of (Agency Name).

**OR**

no significant weakness was found in the design or operation of the internal controls applicable to the processes or services conducted on behalf of (Agency Name). However, other (non-significant) internal control weaknesses were identified and (Third-Party Provider Name) has provided assurance to us that they will address these minor weaknesses.

**OR**

significant weakness was found in the design or operation of the internal controls applicable to the processes or services conducted on behalf of (Agency Name). (Third-Party Provider Name) has provided us with a list of these weaknesses and a copy of their Corrective Action Plan.

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## Exhibit 1: Certification Statement – No Significant Weaknesses in Internal Control

The [Agency’s] management is responsible for establishing and maintaining an effective system of internal control. The [Agency] has completed its control assessment of the agency level risks and significant fiscal processes at the transaction level.

(Agency) management is responsible for the integrity and objectivity of the financial transactions and other information provided to the State Comptroller. We believe the data provided for inclusion in the Commonwealth’s Comprehensive Financial Report (CAFR) are accurate in all material respects and that all disclosures necessary to obtain a thorough understanding of the (Agency’s) financial activities have been included.

The basis for these conclusions relates to our assessment of the internal controls operating within the (Agency). The [Agency] conducted its assessment of the effectiveness of the [Agency’s] internal control in accordance with the *Agency Risk Management and Internal Control Standards* issued by the Office of the Comptroller. Based on the results of this evaluation, the [Agency] can provide reasonable assurance that internal control over the recording of financial transactions in the General Ledger, compliance with the agency’s financial reporting requirements, compliance with applicable laws and regulations, and stewardship over the Commonwealth’s assets as of June 30, 20XX, was operating effectively and no significant weaknesses were found in the design or operation of the internal controls at the agency and transaction levels.

Agency Name	Agency Number
Agency Head Name	Chief Fiscal Officer Name
Agency Head Signature	Chief Fiscal Officer Signature
Date	Date

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## Exhibit 2: Certification Statement –

### Internal Control Weaknesses Noted But None Significant

The [Agency’s] management is responsible for establishing and maintaining an effective system of internal control. The [Agency] has completed its control assessment of the agency level risks and significant fiscal processes at the transaction level.

(Agency) management is responsible for the integrity and objectivity of the financial transactions and other information provided to the State Comptroller. We believe the data provided for inclusion in the Commonwealth’s Comprehensive Financial Report (CAFR) are accurate in all material respects and that all disclosures necessary to obtain a thorough understanding of the (Agency’s) financial activities have been included.

The basis for these conclusions relates to our assessment of the internal controls operating within the (Agency). The [Agency] conducted its assessment of the effectiveness of the [Agency’s] internal control in accordance with the *Agency Risk Management and Internal Control Standards* issued by the Office of the Comptroller. Based on the results of this evaluation, the [Agency] can provide reasonable assurance that internal control over the recording of financial transactions in the General Ledger, compliance with the agency’s financial reporting requirements, compliance with applicable laws and regulations, and stewardship over the Commonwealth’s assets as of June 30, 20XX, was operating effectively and no significant weaknesses were found in the design or operation of the internal controls on the agency and transaction levels.

Although no significant weaknesses were identified as a result of the ARMICS process, a list of other Internal Control weaknesses were identified and are attached to this certification. No formal corrective action plan is required for these weaknesses in accordance with ARMICS. The [Agency] will / will not correct these deficiencies by June 30, 20XX +1.

\_\_\_\_\_

Agency Name

\_\_\_\_\_

Agency Number

\_\_\_\_\_

Agency Head Name

\_\_\_\_\_

Chief Fiscal Officer Name

\_\_\_\_\_

Agency Head Signature

Date

\_\_\_\_\_

Chief Fiscal Officer Signature

Date

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**Exhibit 3: Certification Statement – Significant Deficiencies or Material Weaknesses Identified – Corrective Action Plan Required**

The [Agency’s] management is responsible for establishing and maintaining an effective system of internal control. The [Agency] has completed its control assessment of the agency level risks and significant fiscal processes at the transaction level in accordance with the *Agency Risk Management and Internal Control Standards* issued by the Office of the Comptroller. Based on the results of this evaluation, the [Agency] identified [number] of significant weakness(es) in its internal control as of June 30, 20XX.

(Agency) management is responsible for the integrity and objectivity of the financial transactions and other information provided to the State Comptroller. We cannot provide assurance that the data provided for inclusion in the Commonwealth’s Comprehensive Financial Report is accurate in all material respects or that all disclosures necessary to obtain a thorough understanding of the (Agency’s) financial activities have been included. Our basis for this conclusion is due to the extent of the significant weaknesses in internal control identified in Exhibit [xx].

Other than the exceptions noted in Exhibit [xx], the internal controls were operating effectively and no other significant weaknesses were found in the design or operation of the internal controls. A plan of the actions the [Agency] will take to comply with the *Agency Risk Management and Internal Control Standards* is included in Exhibit [xx].

**If insignificant weakness(es) are also noted** - Also, other Internal Control weaknesses were noted and attached to this certification. No formal corrective action plan is required for these weaknesses in accordance with ARMICS. The [Agency] will / will not correct these deficiencies by June 30, 20XX +1.

\_\_\_\_\_ Agency Name Agency Number

\_\_\_\_\_ Agency Head Name Chief Fiscal Officer Name

\_\_\_\_\_ Agency Head Signature Date Chief Fiscal Officer Signature Date

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## Exhibit 4: Agency Statement – ARMICS Not Completed

The [Agency's] management is responsible for establishing and maintaining an effective system of internal control.

The [Agency] has **not** conducted its assessment of the effectiveness of the [Agency's] internal control in accordance with the *Agency Risk Management and Internal Control Standards (ARMICS)* issued by the Office of the Comptroller.

The [Agency's] management expects to complete the assessment of the effectiveness of the [Agency's] internal control in accordance with ARMICS by \_\_\_\_\_, 20XX

The [Agency's] management understands that the [Agency] is noncompliant, and will be considered noncompliant until the [Agency] completes the required assessment and related certification of the effectiveness of the [Agency's] internal control in accordance with ARMICS. The [Agency's] management will submit a Corrective Action Plan (CAP) with this statement, and a follow-up CAP will be required every 90 days until complete.

\_\_\_\_\_  
 Agency Name Agency Number

\_\_\_\_\_  
 Agency Head Name Chief Fiscal Officer Name

\_\_\_\_\_  
 Agency Head Signature Date Chief Fiscal Officer Signature Date