

April 30, 1996

The Honorable Robert Pitofsky  
Chairman  
Federal Trade Commission  
Sixth Street & Pennsylvania Avenue, N.W.  
Washington, D.C. 20580

Dear Chairman Pitofsky:

The attached report covers the Office of Inspector General's (OIG) activities for the first half of fiscal year 1996, and is submitted according to Section 5 of the Inspector General Act of 1978, as amended. The Act requires that you submit this report, with your Report of Final Action, to the appropriate Congressional committees on, or before, May 31, 1996.

During this reporting period the OIG: (a) issued two audit reports that reviewed the management of \$47.2 million dollars of consumer redress funds by agency contractors; (b) began a security survey of the agency's automated management activities to identify high risk areas for additional audit follow-up work; (c) completed field work on a compliance audit of employees' use of their American Express charge cards; and (d) closed eight investigations while referring two matters to federal prosecutors.

As in the past, I appreciate management's support during this reporting period, and I look forward to working with you in our ongoing efforts to promote economy and efficiency in agency programs.

Sincerely,

Frederick J. Zirkel  
Inspector General

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## INTRODUCTION

The Federal Trade Commission (FTC) seeks to assure that the nation's markets are competitive, function efficiently, and are free from undue restrictions. The FTC also seeks to improve the operation of the marketplace by ending unfair and deceptive practices, with emphasis on those practices that might unreasonably restrict or inhibit the free exercise of informed choice by consumers. The FTC relies on economic analysis to support its law enforcement efforts and to contribute to the economic policy deliberations of Congress, the Executive Branch and the public.

To aid the FTC in accomplishing its consumer protection and antitrust missions, the Office of Inspector General (OIG) was provided with five (5) FTEs and a budget of \$472,700 in fiscal year 1996.

## AUDIT ACTIVITIES

For this semiannual period, the OIG completed two financial audits of the FTC's redress administration contractors. In a related matter, audit field work was completed on a performance review of the agency's Redress Administration Office (RAO). The OIG also began a review of employee use of the Government-issued American Express charge card. This particular review was requested of a number of IGs by the Chairman of the House Committee on Government Reform and Oversight. Finally, a security-related survey of the agency's computer network systems (LAN/WAN) was also initiated during the period. Each of these reviews is discussed in detail below.

### Completed Audits

<u>Audit Report Number</u>	<u>Subject of Audit</u>
96 - 030	<u>Gilardi &amp; Company Redress Distribution Activities For The Period July 1, 1993 Through July 31, 1995</u>
96 - 031	<u>The Garden City Group Inc. Redress Distribution Activities For the Period July 1, 1994 Through June 30, 1995</u>

## **Summary of Findings for Audit Reports Issued During the Current Period**

During the period, the OIG audited the cash management and claims processing activities performed on behalf of the FTC by two contractors: Gilardi and Company, of Larkspur, CA; and The Garden City Group, Inc. of Garden City, NY. The objectives of the reviews were to: (a) assess the extent to which the contractors complied with the terms and conditions of the contract; (b) test the accuracy of redress account statements provided to the RAO; and (c) review the effectiveness of management controls established by the contractors to safeguard redress funds.

Both contractors received unqualified opinions from the OIG on their cash-based financial statements. Combined, these limited scope statements covered 77 FTC redress cases. They showed that a total of \$47.2 million was under contractor control during the accounting periods reviewed by the OIG. Of the \$47.2 million to enter contractor accounts, \$34.7 million was disbursed during the periods under review. Of the total amounts disbursed, approximately 3.8 percent, or \$1.35 million dollars, was paid to cover contractor expenses. The remaining balance was paid in redress to consumers or returned to the U.S. Treasury in the form of disgorgement.

The financial statements also showed that income earned on judgment funds placed on deposit with the contractors totaled \$1.25 million, or 92 percent of contractor expenses. Consequently, the OIG found that judgment balances are not being depleted by high redress administration expenses.

## **Audits in Which Field Work is Complete**

### **Audit Report Number**

### **Subject of Audit**

96-032

**Review of the Redress Administration Office's Oversight of Contractors** The objective of this review was to identify what steps can be taken to improve the efficiency and effectiveness of RAO's oversight activities. This report, along with the two contractor audits detailed above (96-030 and 96-031), complete the OIG's financial review of the FTC's redress administration program. In an audit exit conference held in this reporting period, the OIG informed RAO officials that although both redress contractors received clean opinions, the audit team noticed that a lack of separation of duties by the contractors left selected individuals in these organizations with the means to both perpetrate and conceal disbursement irregularities. Specifically, the audit team noted that a single individual at each contractor is in control of the claims notification,

eligibility determination, claims disbursement, and reporting of redress activity to the RAO. Consequently, these individuals could add claimants or substitute claimant names to any approved FTC consumer redress list. Any fraudulent payments resulting from such actions would be difficult for the FTC to detect if appropriate review of cancelled checks was not routinely undertaken by the RAO. The OIG plans to provide an audit report to management that further details this and other findings discussed at the exit conference.

**Audits in Which Field Work is in Progress**

**Audit Report Number**

**Subject of Audit**

**96-XX**

**Personal Use of Government-Issued American Express Charge Cards by FTC Employees** The objective of this review is to determine the extent to which FTC employees are complying with government regulations when using their agency-provided American Express charge cards. The period selected for this review was the last six months of calendar year 1995.

**96-XX**

**Security Survey of FTC's Automated Management Activities** The objectives of this survey are to identify and evaluate the agency's information management security policies and procedures. Included in this survey is an analysis of: (a) local and wide area network security (LAN/WAN); (b) the adequacy of policies and procedures to address federal laws and regulations in the information management security area; (c) physical security of hardware and equipment; (d) application and systems security; and (e) data availability and recovery. Based on survey results, the OIG will determine what, if any, follow-up audit work needs to be performed. OIG follow-up work will be designed to identify specific automated security vulnerabilities and what can be done to address them.

## INVESTIGATIVE ACTIVITIES

The Inspector General is authorized by the IG Act to receive and investigate matters of fraud, waste and abuse occurring within FTC programs and operations. Matters of possible wrongdoing usually come to the OIG in the form of allegations or complaints from a variety of sources, including FTC employees, other government agencies and the general public.

Reported incidents of possible fraud, waste and abuse might give rise to administrative, civil or criminal investigations. OIG investigations might also be initiated based on wrongdoing by firms or individuals outside the agency when there is an indication that they are or were involved in activities intended to adversely affect the outcome of an agency enforcement action. Because this kind of wrongdoing strikes at the integrity of the FTC's consumer protection and antitrust law enforcement missions, the OIG places a high priority on investigating it.

In conducting investigations over the past several years, the OIG has sought assistance from, and worked jointly with, other law enforcement agencies, including the Federal Bureau of Investigation (FBI), the Postal Inspection Service, the U.S. Secret Service, the Internal Revenue Service (IRS), other OIGs, and state and local police departments.

### Investigative Summary

During this reporting period the OIG received 14 allegations of possible wrongdoing. Four of these 14 allegations involved matters which were the responsibility of agency program components and, therefore, were referred to FTC enforcement staff for appropriate disposition. Of the remaining 10 referrals, five were closed without action. The other five matters resulted in the initiation of OIG investigations.

Following is a summary of the OIG's investigative activities for the six-month period ending March 31, 1996. The OIG opened five new investigations during this reporting period, and closed eight cases:

<b>Cases pending as of September 30, 1995.....</b>	<b>10</b>
<b>Plus: New cases.....</b>	<b>+5</b>
<b>Less: Cases closed.....</b>	<b><u>- 8</u></b>
<b>Cases pending as of March 31, 1996.....</b>	<b><u>7</u></b>

Of the seven investigations remaining open at the end of this reporting period, the OIG has performed field work on three cases. The four remaining cases are awaiting field work consistent with OIG priorities.

The OIG was assisted in conducting criminal investigations during this reporting period by agents of the Postal Inspection Service and the FBI. The OIG also continued to work with the IRS Criminal Investigation Division on a case of joint interest which was opened by the OIG during an earlier reporting period. In addition, the OIG consulted on various other matters with PCIE/ECIE investigators and IG counsels, as well as legal and program experts with the IRS, and the Social Security and Food and Drug Administrations.

### **Investigations Closed During the Current Period**

#### **1. Obstructions and Unauthorized Disclosures (3)**

During this reporting period the OIG closed three cases involving allegations of attempts to obstruct agency enforcement proceedings and/or to disclose nonpublic FTC information.

The first investigation closed was based on information provided to the OIG by enforcement staff in the FTC's Bureau of Consumer Protection. Bureau staff had been informed by a state law enforcement official that an attorney representing a company involved in an FTC enforcement matter had, within an hour of a nonpublic Commission vote, learned the results of that vote. The Commission vote had authorized FTC enforcement staff to pursue an ex parte legal action against the attorney's client. Thus, the leak of the vote compromised the element of surprise intended in this legal action, while also providing the company an opportunity to move assets targeted by the FTC. Accordingly, the OIG initiated an investigation to determine if any FTC employee had "leaked" the results of the Commission vote.

The OIG also learned that an FTC investigator had a phone message waiting for him from the head of the company he was investigating upon arriving at his hotel in the state in which the company was located. The investigator's travel plans, including the hotel where he was staying, was believed to be known to only FTC staff working on the matter.

When the principal attorney for the company under agency investigation was questioned by the OIG about the Commission vote, he denied any knowledge of it. When asked about the call to the hotel by the company head, the attorney stated that he makes every effort on behalf of his client to learn the movements of selected federal investigators, to include their airline schedules and what hotels they stay in when on official travel. Thus, he indicated that through these monitoring efforts (routinely calling hotels and airlines) the arrival of the FTC investigator was learned.

The OIG, with FBI assistance, also interviewed a second attorney representing the same company in its home state. This attorney, the OIG learned, had worked for the same state law enforcement agency that was then working with the FTC on its investigation. Further, the OIG found that the attorney maintained a close personal relationship with a then current state enforcement official who had direct knowledge of both the Commission vote (via a phone call by the FTC to the state agency immediately after the vote) and the impending visit by the FTC investigator (as the state official was to assist the FTC in serving legal process on parties in his state). More importantly, the OIG learned that this attorney was representing not only the company under FTC investigation but also the same state official (who was working with the FTC) in an administrative action being pursued against him by the head of the state agency.

While some strong circumstantial evidence was developed to implicate the state official in the leaks, a federal prosecutor, nevertheless, declined prosecution. As the state official was ultimately fired (pursuant to the administrative action), and because criminal investigators developed no evidence to indicate any wrongdoing by any FTC employee, the OIG closed the investigation.

The second investigation closed during this period involved an alleged attempt to obstruct an FTC enforcement action by the head of a debt collection company. This OIG investigation was opened when a regional office enforcement attorney informed the OIG that a witness in the agency's enforcement case had significantly changed his original story to FTC enforcers about law violations by his former boss, the head of the debt collection company. When asked by the FTC attorney why his story had changed, the witness stated that he and his family had been threatened with physical harm by his former employer if he did not change his story to the FTC.

The OIG, with assistance from the FBI in California, interviewed the witness who admitted to criminal investigators that the threats against him and his family, while real, actually related to a large delinquent personal debt that he owed his former boss and not to any dealings he had with the FTC. Based on this finding, the OIG, after consultation with an Assistant United States Attorney (AUSA) in Oakland, decided not to pursue the obstruction matter further. However, evidence was developed during OIG/FBI interviews with the witness as well as another former employee of the company, which indicated the possibility of tax fraud by the head of the company. Consequently, the OIG referred the matter to the IRS Criminal Investigation Division.

The third investigation closed during this period involved the possible disclosure of nonpublic information about an ongoing enforcement case by an FTC attorney. Nonpublic information was allegedly disclosed by an FTC employee to a former FTC attorney now in private law practice during a social gathering. The OIG closed this investigation after conferring with an agency ethics expert and concluding that the information divulged was too generic in nature to constitute a disclosure violation.



## **2. Employee Misconduct and Ethical Violations (1)**

During this reporting period the OIG closed one case involving possible employee misconduct. This investigation was opened when an informant provided the OIG with information indicating that an FTC manager had asserted that pressure from a supervisor accounted for a recommendation to the Commission that a case be settled for a dollar amount of redress which was significantly less than available financial information indicated the proposed defendant would be able to pay.

Based on a review of staff documents, the OIG found no evidence that the Commission was not going to be presented with other than a complete picture of the enforcement matter upon which to make an informed decision, including full details of the proposed defendant's financial condition. The OIG found no evidence of any unethical conduct by any FTC employee involved in this matter and, therefore, closed the investigation.

## **3. Crimes Against the Government (2)**

During this reporting period the OIG closed two cases involving crimes against the government. The first of these cases involved theft of government property while the second case dealt with bribery.

The theft investigation was opened when management informed the OIG about a suspected loss of approximately 175 Metrocheks. An OIG analysis of agency purchase and distribution records for calendar year 1995 confirmed that Metrochek losses had occurred. In fact, the analysis established that losses had been ongoing for six months and that over \$10,000 worth of Metrocheks were unaccounted for.

The OIG, working with a Postal inspector, obtained a confession from a former temporary FTC employee when she came to a Washington Metropolitan Area Transit Authority (WMATA) office to claim reimbursement for 100 Metrocheks which she had stolen from the FTC. The individual confessed to stealing over 450 Metrocheks during her FTC employment and laundering them through WMATA for cash using a fictitious van service that she created. She also implicated a current employee in the fraud scheme. Accordingly, the OIG performed additional investigative work to determine if her allegations against this employee were supportable.

The OIG developed evidence that supported not only the allegations of wrongdoing by the current employee, but that also suggested some culpability by a third employee (who had also recently left the agency) in the concealment of Metrochek losses. Consequently, the OIG referred its findings on all three individuals to a federal prosecutor. In addition, the OIG provided FTC management with a report of investigation on the current employee and, thereafter, closed its investigation.

The second investigation of crimes against the government closed during this period culminated in the arrest and pending prosecution of an individual who impersonated an FTC employee while extorting bribes of hundreds of dollars from numerous used car dealers in the Tampa/St. Petersburg, Florida area.

This investigation was opened when the OIG was called by a Florida Department of Motor Vehicles (DMV) enforcement official. The DMV official told the OIG that a local used car dealer had just alerted him to the fact that a person with an FTC badge, business card and other credentials had attempted to extort money from him in return for not citing his dealership for violations of the FTC's Used Car Rule (UCR).

The OIG was also informed by the DMV official that this used car dealer had made no payoff to the FTC "special agent" but, instead, told him that he would give him a few hundred dollars the next day when he returned. Accordingly, the OIG requested that the DMV official instruct the dealer (as well as any other used car dealer he might hear from) to develop as much information as possible about the individual, including a description of his car and its license plate number and, if possible, to take a photograph of him with the dealership's security camera.

Further, the OIG instructed the DMV official to tell the dealer to make the payoff (as he would be reimbursed), but to make no attempt to apprehend the subject. Finally, the DMV official was informed that the OIG would attempt to get an FBI agent on the scene to make an arrest.

The dealer was able to obtain a detailed description of the subject and his car. He also obtained a photograph of the individual. Within three days, the individual was arrested by the FBI while in the midst of extorting a bribe from yet another used car dealer.

The subject was not an FTC employee. Rather, he was a former used car dealer who admitted to the OIG and a federal prosecutor during an interview in Tampa that he had devised the scam as a means of making money, and that he had created bogus credentials, along with a UCR questionnaire similar to the one used by agency staff when enforcing the UCR. He also stated that he had contacted some 60-plus dealerships in the Tampa/St. Petersburg area, while claiming to have asked for payoffs in only 10 percent of these contacts.

Finally, to assist FTC staff in their enforcement of the UCR, the OIG has requested relevant details relating to the subject's 60-plus contacts along with all his payoffs.

#### **4. Other Cases (2)**

The first "other" case closed this period related to a missing headquarters building interior master key which was removed from the key ring of an agency employee and replaced with a partially cut key made from the same type of official key blank used to make the master key.

While unable to conclusively identify who stole the master key, the OIG was able to develop sufficient evidence to turn suspicion away from an agency employee who appeared to be the prime suspect because of some questionable events leading up to the theft of the key. A closing letter, when completed, will be shared with management so they might consider some internal control changes relating to the operations of the agency's physical security program.

The last "other" matter closed in this reporting period grew out of a complaint the OIG received from an employee about how the agency was administering its headquarters building parking program. Following a number of interviews, and after consultation with the IRS, the OIG advised management of the need to clarify its existing parking policies and to inform all concerned parties of the new policies. As a result of these efforts, new policies were issued and distributed by management to all employees who routinely park in the headquarters building. In addition, a new market survey was performed and, as appropriate, reserved parking signs were posted.

#### **Matters Referred for Prosecution**

The OIG referred one case to a federal prosecutor during this reporting period based on evidence developed by the OIG, with FBI assistance, that indicated a violation of 18 U.S.C. 912, impersonating a federal officer, and also 18 U.S.C. 872, extortion while impersonating a federal officer. The subject of this referral has, to date, cooperated with the OIG/FBI and the prosecutor following his arrest in Florida. Prosecution is pending.

The Metrochek matter was referred to an AUSA during this reporting period. The referral was based on violations of 18 U.S.C. 641, theft of government property, and 18 U.S.C. 1505 and/or 1512, obstructing an OIG investigation. Prosecution decisions are pending.

Finally, a sentence was handed down in a case referred earlier by the OIG to the United States Attorney's Office for the District of Columbia based on a guilty plea for embezzlement from a federal credit union. The defendant in the case, who had used the names of both real and fictitious FTC employees to commit loan fraud, pleaded guilty to a one-count information which charged that she had intentionally defrauded the federal credit union. In March 1996, the subject was sentenced to four years probation with home monitoring for six months, to perform community service, and to make restitution of over \$6,400.

## **OTHER ACTIVITIES**

During this reporting period the OIG also allocated resources to activities other than conducting audits and investigations. These activities involved participation in Executive Council on Integrity and Efficiency (ECIE) activities, which included work on council committees and responding to Congressional and OMB requests for information.

### **Significant Management Decisions**

Section 5(a)(12) of the IG Act requires that if the IG disagrees with any significant management decision, such disagreement must be reported in the semiannual report. Further, Section 5(a)(11) of the Act requires that any decision by management to change a significant, resolved audit finding must also be disclosed in the semiannual report. For this reporting period there were no significant final management decisions made on which the IG has disagreed, and management has not revised any earlier decisions on any OIG audit recommendation.

### **Access to Information**

The IG is to be provided with ready access to all agency records, information or assistance when conducting an investigation or audit. Section 6(b)(2) of the IG Act requires the IG to report to the agency head, without delay, if the IG believes that access to required information, records or assistance has been unreasonably refused, or otherwise has not been provided. A summary of each report submitted to the agency head in compliance with Section 6(b)(2) must be provided in the semiannual report in accordance with Section 5(a)(5) of the Act.

During this reporting period, the OIG did not encounter any problems in obtaining assistance or access to agency records. Consequently, no report was issued by the IG to the agency head in accordance with Section 6(b)(2) of the IG Act.

### **Internet Access**

The OIG has established a home page at the FTC Web Site. The OIG internet address is **<http://www.ftc.gov/oig/oighome.htm>**. A visitor to the OIG home page can download some of the OIG's more recent semiannual reports to Congress, and can also browse through a list of audit reports, identifying those of interest and ordering them via an E-mail link to the OIG. In addition to these capabilities for information about our office, visitors are also provided a link to other federal organizations and offices of inspector general. The OIG also plans to broaden access to its audit and semiannual reports through an additional Web Site at the IG Net during the next reporting period.

### **Audit Resolution**

As of the end of this reporting period, all OIG audit recommendations for reports issued in prior periods have been resolved. That is, management and the OIG have reached agreement on what actions need to be taken. With two exceptions, management has informed the OIG that all recommendations have been implemented.

The two exceptions concern the implementation of a new key card security system. In AR 95-029, "***Review of FTC's Control Over the Use of Key Cards***," the OIG recommended that management "*take immediate action to ensure that only currently authorized FTC employees have activated key cards. To clean out the existing system, management should issue an agency-wide memorandum asking each employee to provide, within two weeks, his/her name and key card number to the General Services Branch to ensure activation. All other key cards should then be deactivated.*" This recommendation was in response to management's inability to provide assurances that only authorized individuals possess activated key cards. The OIG also recommended that "*custody of deactivated key cards be maintained in the Division of Personnel*" to insure separation of duties between key card custody and activation.

On May 13, 1996, the agency will implement a new key card system, closing out the first recommendation noted above. Regarding the second recommendation, management told the OIG that it has not developed written policies and procedures to formally transfer custody of the deactivated key cards to the Division of Personnel. However, management said that this task is now a top priority given that the new key card security system will be operational in May.

### **Review of Legislation**

Section 4(a)(2) of the IG Act authorizes the IG to review and comment on any proposed legislation or regulations relating to the agency or affecting the operations of the OIG. During this reporting period, the OIG responded to requests from OMB, PCIE and ECIE.

### **Contacting the Office of Inspector General**

Employees and the public are encouraged to contact the OIG regarding any incidents of possible fraud, waste or abuse occurring within FTC programs and operations. The main OIG telephone number is **(202) 326-2800**. To report suspected wrongdoing, employees and the public should call the OIG's chief investigator directly on **(202) 326-2581**. A confidential or anonymous message can be left 24 hours a day.

The OIG is located in room 494 of the FTC Headquarters Building at Sixth Street and Pennsylvania Avenue, N.W., Washington, D.C. 20580. Office hours are from 8:30 a.m. to 5:30 p.m., Monday through Friday, except federal holidays.

**TABLE I**  
**SUMMARY OF INSPECTOR GENERAL**  
**REPORTING REQUIREMENTS**

<u>IG Act Reference Page(s)</u>	<u>Reporting Requirement</u>	<u>Page(s)</u>
Section 4(a)(2)	Review of legislation and regulations	11
Section 5(a)(1)	Significant problems, abuses and deficiencies	1
Section 5(a)(2)	Recommendations with respect to significant problems, abuses and deficiencies	2
Section 5(a)(3)	Prior significant recommendations on which corrective actions have not been made	11
Section 5(a)(4)	Matters referred to prosecutive authorities	9
Section 5(a)(5)	Summary of instances where information was refused	10
Section 5(a)(6)	List of audit reports by subject matter, showing dollar value of questioned costs and funds put to better use	1
Section 5(a)(7)	Summary of each particularly significant report	2
Section 5(a)(8)	Statistical tables showing number of reports and dollar value of questioned costs	13
Section 5(a)(9)	Statistical tables showing number of reports and dollar value of recommendations that funds be put to better use	14
Section 5(a)(10)	Summary of each audit issued before this reporting period for which no management decision was made by the end of the reporting period	11
Section 5(a)(11)	Significant revised management decisions	10
Section 5(a)(12)	Significant management decisions with which the Inspector General disagrees	10

**TABLE II**

**INSPECTOR GENERAL ISSUED REPORTS  
WITH QUESTIONED COSTS**

	<u>Number</u>	<u>Dollar Value</u> (in thousands)	
		<u>Questioned Costs</u>	<u>Unsupported Costs</u>
A. For which no management decision has been made by the commencement of the reporting period	<u>0</u>	<u>0</u>	[ <u>0</u> ]
B. Which were issued during the reporting period	<u>0</u>	<u>0</u>	[ <u>0</u> ]
<b>Subtotals (A + B)</b>	<u>0</u>	<u>0</u>	[ <u>0</u> ]
C. For which a management decision was made during the reporting period	<u>0</u>	<u>0</u>	[ <u>0</u> ]
<b>(i) dollar value of disallowed costs</b>	<u>0</u>	<u>0</u>	[ <u>0</u> ]
<b>(ii) dollar value of cost not disallowed</b>	<u>0</u>	<u>0</u>	[ <u>0</u> ]
D. For which no management decision was made by the end of the reporting period	<u>0</u>	<u>0</u>	[ <u>0</u> ]
Reports for which no management decision was made within six months of issuance	<u>0</u>	<u>0</u>	[ <u>0</u> ]

**TABLE III**

**INSPECTOR GENERAL ISSUED REPORTS  
WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE**

	<u>Number</u>	<u>Dollar Value (in thousands)</u>
A. For which no management decision has been made by the commencement of the reporting period	0	0
B. Which were issued during this reporting period	0	0
C. For which a management decision was made during the reporting period	0	0
<b>(i) dollar value of recommendations that were agreed to by management</b>	0	0
- based on proposed management action	0	0
- based on proposed legislative action	0	0
<b>(ii) dollar value of recommendations that were not agreed to by management</b>	0	0
D. For which no management decision has been made by the end of the reporting period	0	0
Reports for which no management decision was made within six months of issuance	0	0