

FEDERAL TRADE COMMISSION
OFFICE OF INSPECTOR GENERAL



SEMIANNUAL REPORT TO CONGRESS

October 1, 2003 - March 31, 2004

Report #30



OFFICE OF
INSPECTOR GENERAL

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

The Honorable Timothy J. Muris
Chairman
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Dear Chairman Muris:

The attached report covers the Office of Inspector General's (OIG) activities for the first half of fiscal year 2004 and is submitted according to Section 5 of the Inspector General Act of 1978, as amended.

During this six-month reporting period ending March 31, 2004, the OIG completed an audit of the FTC's FY 2003 financial statements, issued a companion report to management containing financial-related findings and recommendations resulting from the audit and circulated for management comment, a draft audit report of the FTC's transit subsidy program. The OIG also began working on two legislatively required reviews. The first effort deals with the need to perform an IT security evaluation for fiscal year 2004 in compliance with the Federal Information Security Management Act. The second review concerns the management of selected fiscal year 2003 funds provided the FTC by the U.S. Agency for International Development.

In addition, the OIG opened two investigations into wrongdoing during the period, and closed two other investigations. The results of these closed investigations were reported to management for ultimate disposition.

As in the past, management has been responsive in attempting to implement all OIG recommendations. I appreciate management's support and I look forward to working with you in our ongoing efforts to promote economy and efficiency in agency programs.

Sincerely,

A handwritten signature in cursive script that reads "Frederick J. Zirkel".

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, efficient, and 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 five work years and a budget of \$931,100 for fiscal year 2004.

AUDIT ACTIVITIES

During this semiannual period, the OIG issued an audit of the FTC's FY 2003 financial statements and a companion report to management containing financial-related findings and recommendations resulting from the audit. The OIG also issued a review of the agency's policies and procedures concerning the participation of contractor employees in agency-sponsored social events, such as holiday and retirement parties, and completed a draft audit report of the FTC's transit subsidy program. The OIG also began audits of the FTC's implementation of the Federal Information Security Management Act for Fiscal Year 2004 and the agency's technical assistance activities funded by the U.S. Agency for International Development. Detailed information regarding these audits and reviews is provided below.

Completed Audits

Audit Report Number

AR 04-057

AR 04-057A

AR 04-058

Subject of Audit

**Audit of the Federal Trade Commission's
Financial Statements for the Fiscal Year Ending
September 30, 2003**

**Management Letter to the FY 2003 Financial
Statements**

**Policy Review: Contractor Participation at
Agency-Sponsored Social Events**

Summary of Findings for Reviews Issued During the Current Period

In AR 04-055, *Audit of the Federal Trade Commission's Financial Statements for the Fiscal Year Ending September 30, 2003*, the objective was to determine whether the agency's financial statements present fairly the financial position of the agency. The statements audited were the Balance Sheets as of September 30, 2003 and 2002, and the related Statements of Net Cost, Statements of Changes in Net Position, Statements of Budgetary Resources, Statements of Financing, and Statements of Custodial Activity for the years then ended. This was the seventh consecutive year that the FTC has undertaken a financial statement audit. The agency received an unqualified opinion, the highest opinion given by independent auditors.

The FY 2003 audited statements provide insight into the mission and operations of the Federal Trade Commission. The FTC had total assets of \$399.9 million and \$237.4 million as of September 30, 2003 and 2002, respectively. Approximately \$304.6 million and \$155.9 million of the 2003 and 2002 assets, respectively, were funds collected or to be collected and distributed under the consumer redress program, under the agency's Consumer Protection mission. In addition, \$41.2 million in fiscal year 2003 and \$41.0 million in fiscal year 2002 was held in a divestiture fund and will be subsequently disbursed per the terms of the divestiture agreement under the agency's Maintaining Competition mission. Another \$1.6 million in fiscal year 2003 and \$1.7 million in fiscal year 2002 represent undisbursed Hart-Scott-Rodino (HSR) premerger fees to be transferred to the Department of Justice (DOJ) in a future period.

Revenue and financing sources received in fiscal years 2003 and 2002 totaled \$184.4 and \$160.9 million, respectively. Exchange revenue, classified as earned revenue on the financial statements, was received from three sources: the collection of premerger notification filing fees, Do-Not-Call (DNC) user fees and reimbursements received for services from other government agencies. Financing sources were received through direct appropriations, appropriation transfers and imputed for costs absorbed by others.

Exchange revenue was \$62.4 million and \$69.2 million for fiscal years 2003 and 2002, respectively. The primary source of exchange revenue collected, \$56.0 million in fiscal year 2003 and \$67.9 million in fiscal year 2002, was premerger filing fees. The FTC collects a filing fee from each business entity that files a *Notification and Report Form* as required by the Hart-Scott-Rodino (HSR) Anti-Trust Improvement Act. Qualifying mergers with a transaction amount over \$50 million in total assets are charged a filing fee. The fee is based on a three-tiered structure: \$45,000, \$125,000, and \$280,000, depending upon the combined total of assets of the merger transaction. The fee is divided equally between the FTC and the Antitrust Division of the DOJ. The disposition of amounts collected for DOJ is reported on the Statements of Custodial Activity. Due to the combination of changing economic conditions and the restructuring of the filing fee reporting threshold in fiscal year 2001, merger activity over the past 3 years has slowed. In fiscal year 2003, the FTC processed 968 reportable filings, 174 less than in 2002. Earned revenue from HSR filing fees dropped \$11.9 million from fiscal year 2002. As a percentage of total financing sources, HSR fees dropped from 42.2 percent of total revenue in fiscal year 2002 to 30.4 percent in fiscal year in 2003.

The second source of exchange revenue was Do-Not-Call fees. In September 2003, the

FTC began collecting fees associated with the implementation and enforcement of the National Do-Not-Call Registry. This registry operates under Section 5 of the FTC Act, which enforces the Telemarketing Sales Rule (TSR). Telemarketers under FTC's jurisdiction are required to pay a user fee and download from the DNC database a list of consumers' telephone numbers who do not wish to receive calls from telemarketers. Fees are based on the number of area codes downloaded. The fees range from \$25 for one area code to \$7,375 for all area codes within the United States. The agency earned \$5.2 million in fees in fiscal year 2003, representing 2.9 percent of the total financing sources for the year.

The third source of exchange revenue was earned through reimbursable agreements with other federal agencies. Total earnings were \$1.2 million and \$1.3 million, representing 0.6 percent and 0.8 percent of total financing sources for fiscal years 2003 and 2002, respectively.

Financing sources were received from direct appropriations from the General Fund of the Treasury and transfers in the amount of \$115.6 million in fiscal year 2003 and \$86.6 million in fiscal year 2002. The budgetary authority appropriated from the General Fund was reduced by the amount of offsetting collections (HSR and DNC fees) received during the year to arrive at the final amount of resources appropriated from the General Fund. In fiscal years 2003 and 2002, the amount of direct appropriations and transfers that were recorded as a net financing source was 62.7 percent and 53.8 percent of total funding sources received.

The gross cost of operations during the 2003 fiscal year was approximately \$174.7 million, an 8.8 percent increase over fiscal year 2002. During 2003, expenses for salaries and related benefits totaled \$114.3 million, or 65.4 percent of the gross cost of operations. Lease space rental amounted to \$16.8 million, or 9.6 percent, and the remaining \$43.6 million, or 25.0 percent, included travel, facility maintenance and equipment rental, utilities, imputed benefit costs, depreciation, future funded expenses, and other items. This supported 1,051 staff-years which the agency employed in fulfilling its mission.

The OIG also issued a *Management Letter to the FY 2003 Financial Statements (AR 03-057A)*. The objective of the management letter is to bring to management's attention financial and/or internal control weaknesses that the OIG discovered during the audit of the agency's financial statements and to make recommendations for corrective action. The audit also follows up on past recommendations made in the prior year's management letter. For example, this year's management letter contains two new findings and the status (follow up) of four prior-year findings. Follow up on one prior year finding identified \$16,750 in questioned costs. These costs resulted from an overpayment for leased parking fees by the agency to the General Services Administration.

In AR04-058, *Policy Review: Contractor Participation at Agency-Sponsored Social Events*, the OIG received an allegation of a possible violation of government contract regulations relating to the participation of contractor employees in agency-sponsored social events, such as holiday and retirement parties.

The OIG found that contractor employees occasionally plan and attend FTC-sponsored social functions during regular working hours. However, because the OIG found no agency or

government-wide policies or procedures to guide staff actions in this area, we did not attempt to determine who authorized and paid for such involvement. Further, because of a lack of written policy and/or guidance provided to contracting officer's technical representatives (COTR) in this area, it is likely that contractors and their employers are not being adequately instructed on their involvement in and attendance at such events.

The OIG believes that the agency needs a policy that provides practical guidance to agency COTR's on the narrow issue of contractor employees attending FTC-endorsed social events (retirement events, holiday parties, etc.). At a minimum, the policy should (i) ensure that the agency is charged only for work authorized under the contract; (ii) maintain an integrated (federal and contractor) work force with a high esprit de corps that is committed to the goal of helping the American consumer; (iii) remove any perception of favoritism, e.g., mingling with contractors at social events, regardless of who pays, when contracts are being recompeted; and (iv) avoid personal services by abandoning a process that requests contractor employees to perform certain social event planning tasks or attend certain functions without the knowledge or involvement of contractor management.

The OIG recommended that management develop a policy that addresses the issue of contractor participation in FTC-sponsored social events. Once established, the policy should be distributed to all agency COTR's and they in turn should be instructed to inform contractor representatives of the policy.

Audits in Which Field Work is Complete

Audit Report Number
AR 04-059

Subject of Review

Audit of the FTC's Transit Subsidy Program for Fiscal Year 2003 The Federal Government encourages the use of public mass transportation by its employees. Executive Order 13150, "Federal Workforce Transportation," effective October 2000, requires Federal agencies in the National Capital Region to provide employees with public transit subsidies approximating their commuting costs up to \$100 per month. In FY 2003, the FTC provided about \$700,000 in benefits to an average of 650 employees each month.

The objective of the audit was to determine whether controls are in place to ensure that (i) Department of Transportation (DOT) contractor invoices accurately reflect the amount of subsidy being distributed to agency staff on a monthly basis; (ii) the agency-paid transit subsidy is properly reflected in the agency's books and records and that all monthly adjustments are properly accounted for;

(iii) employees follow program guidelines when calculating their monthly subsidy request, thus ensuring that they receive only the amount of subsidy authorized under the program; and (iv) only eligible authorized agency staff receive a subsidy.

The OIG provided management with a draft audit report for its review and comments.

Audits in Which Field Work is In Progress

Audit Report Number
AR04-XXX

Subject of Review

Audit of the FTC's Technical Assistance Activities Funded by the U.S. Agency for International Development For over a decade, the FTC has assisted transition economies that are committed to market and commercial law reforms. With funding principally from the USAID, about 30 nations have received technical assistance with the development of their competition laws.

The Foreign Operations, Export Financing and Related Programs Appropriations Act of 2003 provides USAID with authority to make such fund transfers. In addition, and for the first time, the Act contains an audit provision directed to the Office of Inspectors General for recipient agencies. Specifically, Sec. 509(d) requires the OIG to perform periodic program and financial audits of the use of AID funds.

In keeping with this new mandate, an audit program was developed with the objectives to determine whether the costs charged against USAID funds (i) are supported by approved documentation and payroll allocations and that these allocations appear proper and reasonable and (ii) conform to the requirements stipulated by USAID in its Memorandum of Agreement and reimbursable work agreements.

AR04-XXX

Review of the Federal Trade Commission Implementation of the Federal Information Security Management Act for Fiscal Year 2004 The Federal Information Security Management Act of 2002 (FISMA)

requires an independent assessment of Federal agency information security programs and practices to determine their effectiveness. The OIG will evaluate the adequacy of the FTC's computer security program and practices for its major systems. This year, the OIG will focus its review on the FTC's *Plan of Action and Milestones* at the time they are submitted to OMB to determine to what extent the agency has implemented previously agreed to OIG and other internally-identified recommendations. This will enable the OIG to provide more timely feedback to management on the results of its efforts to address weaknesses. In addition, the OIG will consider other well known vulnerabilities, including access controls to FTC databases by program and IT staff.

Planned Audits

Audit Report Number
AR04-XXX

Subject of Review

Audit of the Use of Government Purchase and Travel Cards Recent reports by the General Accounting Office and Inspectors General, as well as congressional hearings and press reports, have once again raised serious concerns regarding the adequacy of internal control systems that monitor the use of the more than 2.5 million Government credit cards in circulation. To date, millions of dollars of fraudulent and unauthorized expenditures have been made using these cards. While the purchase and travel card programs have increased efficiency in the federal acquisition process, they have also created large, new opportunities for fraud and abuse.

The overall objective of this audit will be to ensure that the credit card programs have effective internal controls to prevent abuses. The OIG will also perform transaction tests to identify (i) potentially fraudulent, improper and abusive uses of purchase cards and (ii) any patterns of improper cardholder transactions, such as purchases of prohibited items.

AR04-XXX

Survey of Do-Not Call Registry Removal Procedures

The OIG has learned of some consumers being inadvertently removed from the Do-Not-Call Registry without their knowledge or consent. DNC officials informed the OIG that on occasion, when a caller makes

changes to his/her phone service the local companies might mistakenly identify such requests as a disconnect. In turn, when the agency's contractor routinely scrubs the registry, it also identifies such numbers as disconnects and removes them from the DNC registry.

In conclusion, the objectives of this OIG survey are to assess whether adequate internal controls are in place and appropriately working to guard against any unintended removal of consumers from the DNC registry.

INVESTIGATIVE ACTIVITIES

The Inspector General is authorized by the IG Act to receive and investigate allegations of fraud, waste and abuse occurring within FTC programs and operations. Matters of possible wrongdoing are referred 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 can give rise to administrative, civil or criminal investigations. OIG investigations might also be initiated based on the possibility of wrongdoing by firms or individuals when there is an indication that they are or were involved in activities intended to improperly affect the outcome of particular agency enforcement actions. 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 criminal investigations during the past several years, the OIG has sought assistance from, and worked jointly with, other law enforcement agencies, including other OIG's, the Federal Bureau of Investigation, the U.S. Postal Inspection Service, the U.S. Secret Service, the U.S. Marshal's Service, the Internal Revenue Service, Capitol Hill Police, as well as state agencies and local police departments.

Investigative Summary

During this reporting period, the OIG received 110 complaints/allegations of possible wrongdoing. Of the 110 complaints, 74 involved issues that fall under the jurisdiction of FTC program components (identity theft, credit repair, etc.). Consequently, the OIG referred these matters to the appropriate FTC component for disposition. Another eight complaints were

referred to other government and/or law enforcement agencies for ultimate disposition.

Of the remaining 28 complaints, 23 were closed without any action, two are being monitored during the pendency of an administrative adjudication at the FTC, two are matters that are under investigation by the OIG and one resulted in an OIG audit.

Following is a summary of the OIG's investigative activities for the six-month period ending March 31, 2004.

Cases pending as of 9/30/03.....	5
Plus: New cases.....	+2
Less: Cases closed.....	(2)
Cases pending as of 3/31/04.....	5

The first closed investigation resulted from an allegation made by an agency employee regarding a possible security breach of his personal computer. This employee, before discussing his concerns with the OIG, had informed management of his suspicions. Management investigated this employee's allegations and concluded that no intrusion had occurred. Believing that some of his concerns had not been fully investigated by management, this employee came to the OIG.

Beginning with a chronology of the alleged intrusions, the OIG researched each allegation to determine whether the activity reported constituted an attempted intrusion and performed independent testing to determine the true nature of the activity reported. While the employee's concerns appeared valid, detailed research and testing revealed them to be unfounded. The OIG agreed with management that no intrusion had occurred and closed the investigation.

The second closed investigation involved an alleged leak of nonpublic information by an FTC staff member. Counsel for the defendant in a consent decree proceeding raised the allegation with the OIG. The OIG investigation did not develop sufficient evidence to establish that the alleged unauthorized disclosure occurred. We informed management of our investigative findings and closed the matter.

Matters Referred for Prosecution

During the current reporting period the OIG conferred with a Federal prosecutor on a matter involving the unauthorized disclosure of information by an agency employee. After receiving a declination from the prosecutor, the matter was referred to management for final disposition.

OTHER ACTIVITIES

Significant Management Decisions

Section 5(a)(12) of the Inspector General 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 disagreed and management did not revise any earlier decision on an 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 can be accessed via the world wide web at: <http://www.ftc.gov/oig>. A visitor to the OIG home page can download recent 1996-2004 OIG semiannual reports to Congress, the FY 1998 - 2003 financial statement audits, and other program and performance audits issued beginning in FY 1999. A list of audit reports issued prior to FY 1999 can also be ordered via an e-mail link to the OIG. In addition to this information resource about the OIG, visitors are also provided a link to other federal organizations and office of inspectors general.

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.

Review of Legislation

Section 4(a)(2) of the IG Act authorizes the IG to review and comment on proposed legislation or regulations relating to the agency or upon request affecting the operations of the OIG. During this reporting period, the OIG provided comments upon request to the PCIE/ECIE leadership in response to (i) Congressional-hearing questions regarding the issue of OIG consolidation, (ii) draft legislation to amend various provisions of the IG Act, (iii) proposed legislation entitled the *Improved Government Accountability Act* aimed at strengthening IG independence, and (iv) recently-passed legislative provisions affecting IG pay when the IG is a member of the Senior Executive Service.

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 OIG telephone number is **(202) 326-2800**. To report suspected wrongdoing, employees and the public should call the OIG's investigator directly on **(202) 326-2618**. A confidential or anonymous message can be left 24 hours a day. Complaints of allegations of fraud, waste or abuse can also be email directly to chogue@ftc.gov.

The OIG is located in Suite 1110, 601 New Jersey Avenue, Washington, D.C. Office hours are from 8:30 a.m. to 6:00 p.m., Monday through Friday, except federal holidays. Mail should be addressed to:

Federal Trade Commission
Office of Inspector General
Room NJ-1110
600 Pennsylvania Avenue, NW
Washington, DC 20580

TABLE I
SUMMARY OF INSPECTOR GENERAL
REPORTING REQUIREMENTS

<u>IG Act Reference</u>	<u>Reporting Requirement</u>	<u>Page(s)</u>
Section 4(a)(2)	Review of legislation and regulations	10
Section 5(a)(1)	Significant problems, abuses and deficiencies	1-4
Section 5(a)(2)	Recommendations with respect to significant problems, abuses and deficiencies	3-4
Section 5(a)(3)	Prior significant recommendations on which corrective actions have not been made	10
Section 5(a)(4)	Matters referred to prosecutive authorities	9
Section 5(a)(5)	Summary of instances where information was refused	9
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	1
Section 5(a)(8)	Statistical tables showing number of reports and dollar value of questioned costs	12
Section 5(a)(9)	Statistical tables showing number of reports and dollar value of recommendations that funds be put to better use	13
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	10
Section 5(a)(11)	Significant revised management decisions	9
Section 5(a)(12)	Significant management decisions with which the inspector general disagrees	9

TABLE II
INSPECTOR GENERAL ISSUED REPORTS
WITH QUESTIONED COSTS

	<u>Number</u>	<u>Dollar Value</u>	
		<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>1</u>	<u>8,400</u>	[<u>0</u>]
B. Which were issued during the reporting period	<u>1</u>	<u>16,750</u>	[<u>0</u>]
Subtotals (A + B)	<u>2</u>	<u>25,150</u>	[<u>0</u>]
C. For which a management decision was made during the reporting period	<u>2</u>	<u>25,150</u>	[<u>0</u>]
(i) dollar value of disallowed costs	<u>1</u>	<u>16,750</u>	[<u>0</u>]
(ii) dollar value of cost not disallowed	<u>1</u>	<u>8,400</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</u>
A. For which no management decision has been made by the commencement of the reporting period	<u>0</u>	<u>0</u>
B. Which were issued during this reporting period	<u>0</u>	<u>0</u>
C. For which a management decision was made during the reporting period	<u>0</u>	<u>0</u>
(i) dollar value of recommendations that were agreed to by management	<u>0</u>	<u>0</u>
- based on proposed management action	<u>0</u>	<u>0</u>
- based on proposed legislative action	<u>0</u>	<u>0</u>
(ii) dollar value of recommendations that were not agreed to by management	<u>0</u>	<u>0</u>
D. For which no management decision has been made by the end of the reporting period	<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>