FEDERAL TRADE COMMISSION

OFFICE OF INSPECTOR GENERAL

SEMIANNUAL

REPORT TO CONGRESS

October 1, 2004 - March 31, 2005

Report #32

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of Inspector General

The Honorable Deborah P. Majoras
Chairman
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Dear Chairman Majoras:

The attached report describes the Office of Inspector General's (OIG) activities for the first half of fiscal year 2005 and is submitted in accordance with Section 5 of the Inspector General Act of 1978, as amended.

During this six-month reporting period ending March 31, 2005, the OIG issued an audit of the FTC's FY 2004 financial statements and a companion report to management containing financial-related findings and recommendations resulting from that audit. The OIG also issued an Investigative Alert describing vulnerabilities in the agency's use of Federal Express mail services. In addition to these audits and reviews, the OIG completed fieldwork on an audit survey of the Do Not Call Registry and began fieldwork on (i) the FTC's implementation of the Federal Information Security Management Act for FY 2005 and (ii) an inspection of the agency's travel and purchase card programs.

In addition, the OIG processed 131 complaints/allegations of possible wrongdoing during the period, opened five new investigations into wrongdoing and closed five investigations. We reported the results of these closed investigations 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,

Adam R. Trzeciak
Acting 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 $905,700 for fiscal year 2005.

AUDIT ACTIVITIES

During this semiannual period, the OIG issued an audit of the FTC's FY 2004 financial statements and a companion report to management containing financial-related findings and recommendations resulting from the audit. The OIG also issued an Investigative Alert describing vulnerabilities in the agency's use of Federal Express mail services. In addition to these completed audits and reviews, the OIG completed fieldwork on select aspects of our review of the Do Not Call Registry. Finally, we began fieldwork on (i) the FTC's implementation of the Federal Information Security Management Act for FY 2005 and (ii) an inspection of the agency's travel and purchase card programs. Detailed information regarding these audits and reviews is provided below.

Completed Audits

Audit Report Number	Subject of Audit
AR 05-062	**Audit of the Federal Trade Commission's Financial Statements for the Fiscal Year Ending September 30, 2004**
AR 05-062A	**Management Letter to the FY 2004 Financial Statements**
IA 05-010	**Investigative Alert: Internal Controls to Prevent Misuse of FedEx Services are Lacking**

Summary of Findings for Reviews Issued During the Current Period

In AR 05-062, *Audit of the Federal Trade Commission's Financial Statements for the Fiscal Year Ending September 30, 2004*, 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, 2004 and 2003 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 eighth consecutive year that the FTC prepared financial statements for audit. The agency received an unqualified opinion, the highest opinion given by independent auditors.

The FY 2004 audited statements provide insight into the mission and operations of the Federal Trade Commission. The FTC had total assets of $252.9 million and $399.9 million as of September 30, 2004 and 2003, respectively. Approximately $145.0 million and $304.6 million of the 2004 and 2003 assets, respectively, were funds collected or to be collected and distributed through the consumer redress program, under the agency's consumer protection mission. In addition, $41.4 million in fiscal year 2004 and $41.2 million in fiscal year 2003 were held in a divestiture fund and will be subsequently disbursed per the terms of the divestiture agreement under the agency's maintaining competition mission. In addition, $66.5 million in fiscal year 2004 and $54.1 million in fiscal year 2003 in assets represent fund balances in appropriated accounts, account receivables and net capital assets.

Revenue and financing sources received in fiscal years 2004 and 2003 totaled $193.4 and $184.4 million, respectively. Exchange revenue, classified as earned revenue on the financial statements, was received from three sources: (i) the collection of premerger notification filing fees (ii) Do Not Call (DNC) user fees and (iii) reimbursements received for services provided to other government agencies. Financing was received through direct appropriations, appropriation transfers and imputed for costs absorbed by others.

Exchange revenue totaled $98.4 million and $62.4 million for fiscal years 2004 and 2003, respectively. The primary source of exchange revenue collected, $83.6 million in fiscal year 2004 and $56.0 million in fiscal year 2003, 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 assets of the merger transaction. The fee is divided equally between the FTC and the Antitrust Division of the Department of Justice (DOJ). The number of filings increased by 380 over the previous year with 1,394 and 1,014 recorded in fiscal years 2004 and 2003, respectively. Premerger filing fees represented 43.2 percent and 30.4 percent of the total revenue sources to the agency in fiscal years 2004 and 2003, respectively.

The second largest source of exchange revenue was Do Not Call fees. Fiscal year 2004 was the first full year in which DNC fees were collected. In September 2003, the FTC began collecting fees associated with the implementation and enforcement of the national Do Not Call Registry sufficient to cover registry costs. Telemarketers under the 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 agency collected $14.0 million in fees in fiscal year 2004 and $5.2 million in fiscal year 2003, representing 7.2 percent and 2.9 percent of the total financing sources, respectively. Earnings from reimbursable agreements with other federal agencies represented less than 1 percent of total earnings in both fiscal years.

In addition to exchange revenue, other financing sources were realized through a direct appropriation from the General Fund of the Treasury and other non-expenditure transfers in the amount of $88.1 million in fiscal year 2004 and $115.6 million in fiscal year 2003. 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 2004 and 2003, the amount of direct appropriations and transfers represented 45.6 percent and 62.7 percent of total funding sources received.

The gross cost of operations for 2004 fiscal year was $185.9 million and represents an increase of 6.4 percent over the fiscal year 2003 gross cost of operations which was $174.7 million. During 2004, expenses for salaries and related benefits totaled $121.0 million or 65.1 percent of the gross cost of operations. Lease space rental expense was $17.1 million or 9.2 percent and the remaining $47.8 million, or 25.7 percent, included travel, facility maintenance and equipment rental, utilities, imputed benefit costs, depreciation and other items. These costs supported 1,057 staff-years employed in fulfilling the FTC's missions.

Agency enforcement activities often generate substantial funds which are used, to the extent possible, to provide redress to consumers who have been injured by deceptive practices, or, as with civil penalties, that are transferred to the U.S. Treasury as non-exchange revenue. These activities are reported on the Statement of Custodial Activity, which is a required financial statement for those federal agencies that collect non-exchange revenues (e.g., taxes, duties, fines, and penalties) for the General Fund of the Treasury, a trust fund, or other recipient entities. In FY 2004, for example, the agency obtained court-ordered judgments against defendants in FTC cases totaling $240 million.

During the financial statement audit, the OIG identified deficiencies in internal control that were not considered reportable conditions (that is, they did not rise to a level of seriousness to be reported in the auditor's opinion). Rather, the OIG communicated these findings to management in a letter (*Management Letter to the FY 2004 Financial Statements* (*AR 05-062A*)).

The objective of the management letter is to bring to management's attention financial and/or internal control weaknesses 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 three new findings and the status (follow-up) of five prior-year findings. One of the new findings identified inefficient cash management practices in the agency's consumer redress program resulting in lost interest income exceeding $100,000. The OIG recommended improved procedures to manage funds collected for redress.

In IA 05-011, *Investigative Alert: Internal Controls to Prevent Misuse of FedEx Services are Lacking*, the OIG identified vulnerabilities in the use of the agency's Federal Express (FedEx) mail delivery service that enabled an employee to accumulate approximately $2,000 in personal charges over several months which were paid by the FTC.

The OIG found that there were no controls in place to prevent or detect program abuse. For example, employee supervisors did not approve FedEx usage before shipment occurred, nor did they review invoices prior to payment. Also, the agency did not control FedEx account numbers, the equivalent of a credit card for FedEx usage. Had controls been in place in at least one of these three areas, it is doubtful that this employee could have misused these services to the extent and duration that he did.

To correct the control weaknesses, the OIG recommended that supervisors play a role in the review process to deter program abuse. Specifically, management should implement procedures requiring supervisory review of FedEx invoices and work with FedEx to develop an invoice format to facilitate this review.

The OIG discussed the report with program managers in the Administrative Services Office prior to its release. Management agrees with the OIG recommendation and has already taken steps to implement it.

Audits in Which Field Work is Complete

Audit Report Number	Subject of Review
AR 05-XXX	**Survey of Do-Not Call Registry Removal Procedures** The OIG 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.

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.

Audits in Which Field Work is In Progress

Audit Report Number	Subject of Review
AR05-XXX	**Program Inspection: Controls over the use of Agency Purchase and Travel Cards** Recent reports by the Government Accountability 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 and travel cards and (ii) any patterns of improper cardholder transactions, such as purchases of prohibited items.
AR05-XXX	**Review of the Federal Trade Commission Implementation of the Federal Information Security Management Act for Fiscal Year 2005** 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 again focus its review on the FTC's *Plan of Action and Milestones* at the time they are submitted to OMB to determine the extent to which 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	Subject of Review
AR05-XXX	**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, the Act contains an audit provision directed to Inspectors General for recipient agencies. Specifically, Sec. 509(d) requires OIG's to perform periodic program and financial audits of the use of USAID funds. In keeping with this mandate, the OIG audited the program in FY 2003. The second audit will again seek 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.
AR05-XXX	**Review of Annual Performance Measures Under the Government Performance and Results Act** Under the Government Performance and Results Act of 1993 (GPRA), virtually every federal agency is required to develop a five-year strategic plan, an annual performance plan and performance measures to assess how well the agency is meeting its performance objectives. Like many

other agencies, the FTC strives to capture all of the activities that FTC staff perform to achieve the agency's mission.

On an annual basis, the OIG reviews the agency's performance measures to determine whether systems are in place to accurately capture this information for external reporting. The OIG plans to expand the scope of the required review in a separate effort to look at whether the measures (i) are relevant to the agency's missions; (ii) cover the work of all direct enforcement staff; and (iii) are correctly matched to current year budgetary resources.

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 (FBI), the U.S. Postal Inspection Service, the U.S. Secret Service, the U.S. Marshal's Service, the Internal Revenue Service, Capitol Police, Federal Protective Service as well as state agencies and local police departments.

Investigative Summary

During this reporting period, the OIG received 131 complaints/allegations of possible wrongdoing. Of the 131 complaints, 98 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 13 complaints were referred to other government and/or law enforcement agencies for ultimate disposition.

Of the remaining 20 complaints, 13 were closed without any action, one resulted in a preliminary investigation and one pertained to an allegation of waste that will be included in the OIG audit plan. The OIG opened investigations on the five remaining complaints.

Following is a summary of the OIG's investigative activities for the six-month period ending March 31, 2005:

Cases pending as of 9/30/04.........................	**6**
Plus: New cases...............................	**+5**
Less: Cases closed............................	**(5)**
Cases pending as of 03/31/05	**6**

Investigations Closed

The following investigations were closed during this reporting period:

The OIG received information that an agency staff attorney might be abusing the workman's compensation program by performing legal work for a former employer on the days the employee was not working at the FTC. During the investigation, the OIG learned that the FTC employee was married to the former employer, a criminal defense attorney, and that the FTC employee had failed to disclose this relationship during negotiations for employment with the FTC. Management's recommendation to hire the attorney at a specific grade and step level was based, in part, upon a competing offer letter from the former employer (and, unknown to management, spouse) of the prospective employee. For several years, the employee took steps to conceal the marital relationship from supervisors. The OIG consulted a prosecutor and received an informal declination to prosecute the matter. We referred the matter to management for disciplinary action and possible referral of the misconduct to the appropriate state bar.

The OIG investigated allegations of FTC impersonation received from a law firm whose corporate client received two E-mail messages that were sent using a spoofed E-mail address, purporting to be from the FTC. The messages implied that the corporate recipient might be in violation of antitrust statutes. The OIG issued a subpoena to obtain subscriber information for the spoofed E-mail messages and contacted the individual assigned to the computer internet protocol (IP) address from which the E-mail originated. The OIG informed the suspected author of the criminal sanctions associated with posing as a federal official, including using indicia of an official nature such as an FTC E-mail address. The OIG also informed him that if we learned of such conduct in the future, a referral to a prosecutor would be considered. Thereafter, we closed the case.

The OIG learned that an employee allegedly violated the criminal financial conflicts of interest statute (18 U.S.C. § 208). The Designated Agency Ethics Official referred the matter to the OIG after the employee discovered the violation following training he received on the financial conflicts statute. The employee recused himself from further personal and substantial participation in the particular matter that created the conflict. He further indicated his intent to divest his financial interest that created the conflict. We consulted with a prosecutor and received an informal declination to prosecute. The OIG sent the matter to management for referral to the Office of Government Ethics, as is statutorily required for violations of the financial conflicts statute. Following this referral, we closed the investigation.

Another investigation focused on alleged theft of funds from the agency's non-profit day care center, which receives some agency funds. The OIG conducted several interviews and determined that the suspected perpetrator is not an agency employee. We referred the matter to the Federal Protective Service, which had an ongoing investigation relating to the theft. We shared our investigative file with the assigned FPS criminal investigators who could compel the suspect to respond to questions. Following this referral, we closed our investigation.

The OIG received separate referrals from law enforcement authorities in two different municipalities. After opening an investigation and issuing subpoenas, we learned that the alleged criminal violations were also the subject of a separate ongoing criminal investigation that is nearing completion. To avoid duplication of effort, we shared our investigative findings with the other investigating body and closed the OIG investigation following referral.

We also closed a preliminary investigation into a matter that was referred to the OIG by management. Fraudulent charges had been posted to the FTC's telephone account since July 2004 by an anonymous individual. The OIG contacted the telecommunications service provider that billed the charges. Following the carrier's internal research, the OIG received assurances that credits totaling approximately $300 would be issued to the agency. We took no further action on this preliminary investigation.

Matters Referred for Prosecution

During this reporting period the OIG did not refer any cases to a federal prosecutor. However, the OIG consulted with a prosecutor on two investigations, as described above.

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 - 2004 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 reviewed no legislation.

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 or allegations of fraud, waste or abuse can also be emailed directly to chogue@ftc.gov. OIG mail should be addressed to:

Federal Trade Commission
Office of Inspector General
Room NJ-1110
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

TABLE I
SUMMARY OF INSPECTOR GENERAL REPORTING REQUIREMENTS

IG Act Reference	Reporting Requirement	Page(s)
Section 4(a)(2)	Review of legislation and regulations	11
Section 5(a)(l)	Significant problems, abuses and deficiencies	3 - 4
Section 5(a)(2)	Recommendations with respect to significant problems, abuses and deficiencies	4
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Section 5(a)(4)	Matters referred to prosecutive authorities	10
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	13, 14
Section 5(a)(7)	Summary of each particularly significant report	2 - 4
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	13, 14
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

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

TABLE III

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

		Number	Dollar Value
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	1	118,000
C.	For which a management decision was made during the reporting period	1	118,000
	(i) dollar value of recommendations that were agreed to by management	1	118,000
	based on proposed management action	1	118,000
	based on proposed legislative action	0	0
	(ii) dollar value of recommendations that were not agreed to by management	**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**