Federal Trade Commission
Financial Statement Audit for Fiscal Year 2002
Management Letter

Follow Up of Prior Year Findings

1. Prior Year Finding: Rent Expense in Prior Years Included Both Overpayments and Underpayments.

As part of the OIG's review of rent paid to the General Services Administration (GSA) for Washington, D.C. and field locations, the OIG reviewed monthly rent charges and investigated unusual fluctuations. In all cases, the agency pays rent to GSA, regardless of whether the property is government or privately-owned. The monthly rent billing from GSA is charged directly against FTC's Treasury account through the On-line Payment and Collection System (OPAC). GSA provides a bill detailing its OPAC charges to the Administrative Services Office (ASO). Based on an examination of leases and GSA billing documentation, the OIG found that the agency under-paid rent at its Pennsylvania Avenue location during FY 2001. Additionally, it was believed that rent was overpaid on Boston Massachusetts properties, but refunds had not yet been received. These conditions are discussed below:

- The FTC receives an offsetting credit against its monthly rent bill for managing the headquarters facilities at 600 Pennsylvania Avenue. GSA incorrectly billed the FTC for most of 2001, as it under charged the Commission for rent by doubling up on the credit. When GSA discovered its error in September 2001, it charged the FTC in excess of $900,000 for unbilled rent. Notwithstanding, the correct rent total had been properly posted as an unliquidated obligation in the agency's accounting system, and was available when payment to GSA came due.

- The October 1999 rent bill entitled, *GSA Public Buildings Service Bill for Space and Services,* included charges for 205 Portland Street and 55 Summer Street in Boston, MA. While ASO officials notified GSA in writing on April 15, 1999 that the FTC would be vacating these locations by August 15, 1999, the GSA continued to bill the FTC via OPAC through January 2000 and February 2000, respectively. These charges resulted in overpayments of $62,272 for the Portland Street space, and $10,935 for the Summer Street space.

FY 2002 Finding Follow Up:

The OIG determined that the offsetting credit for the Pennsylvania Avenue location was properly handled in fiscal year 2002.

During fiscal year 2002, ASO staff determined that the agency, contrary to information provided earlier to the auditors, did not completely vacate the Massachusetts properties as defined in the occupancy agreement, so the agency is not entitled to a refund.

Payment errors (over or under payments) are not immediately within the control of the FTC as GSA makes direct charges to the FTC's appropriation account at Treasury. The agency receives documentation only after the fact detailing the amount transferred to GSA and the date of the transfer. It is therefore critical that ASO staff review this documentation monthly for possible errors to avoid small mistakes becoming large problems at year end. Toward this end, ASO assigned a staff person to monitor the monthly rent bills. The OIG noted that this review occurred in early FY 2002 as an overpayment was identified by ASO staff resulting in a timely refund to the agency.

Also, in keeping with a 2001 audit recommendation, ASO further refined this process by developing a matrix detailing expected monthly rent payments, by location, based on occupancy agreements (OA) or, in situations where OA's do not exist, on GSA-provided rent projections. As an added check against over or under payments, ASO stated that it will provide this report to the Financial Management Office (FMO) for comparison with budgetary and accounting records. The variance analysis of actual to budgeted rent costs has, in past years, been performed by the Budget Office (Budget).

This newly developed matrix, while an improvement over the 2001 process, did not provide the necessary data to accurately record a year-end rent accrual. As a result, the Budget Office developed its best estimate for the accrual. In the auditor's analysis of rent activity, the OIG calculated a year-end accrual amount that was $194,000 less than the estimate provided by Budget. As a result, FMO made an adjustment to reduce its year-end rent liability by $194,000

Given the accrual adjustment, the matrix developed by ASO has been modified to assist ASO in i) monitoring rent payments, ii) reconciling cost variances, and iii) providing an accrual estimate to the Finance Office that accurately reflects the year end rent liability. Another benefit of a fully-developed matrix would be to allow ASO to perform the variance analysis that Budget now involves itself with.

The OIG will follow up on ASO's monitoring, reconciling and reporting accrual rent estimates in the FY 2003 audit.

2. Prior Year Finding: Credit Card Transaction Recording Process Would Be More Efficient Using Citibank Direct.

During the testing of the payment process related to Citibank credit card charges, the OIG noted that personnel at the NBC were spending approximately 32 hours per month or an annual cost of $9,500 to record coding changes to credit card transactions. Currently, the Citibank monthly bill electronically records its transactions into FTC's payment system. These transactions are automatically coded to organization, program and budget object class. When changes to any of these data fields are desired, e.g., to more specifically classify an item purchased or to make corrections to default codes, the individual cardholder must make manual changes on the individual statements and forward them to NBC. NBC staff then calls up on-line the transaction that was already posted and re-inputs the transaction to reflect these changes.

The OIG believes that the time spent on the routine change process can be avoided if FTC used the Citibank Direct program. The Citibank Direct program contains budget object codes that are generated automatically based upon the type of purchase (rather than just one default budget object class code). More importantly, it allows the cardholder to make changes to the codes on-line *prior* to final payment, thus eliminating the necessity for NBC staff to make such changes.

FMO staff informed the OIG that it is aware of the program benefits and, as such, will continue to work closely with Citibank to implement a more efficient system that meets FTC's unique matter reporting objectives.

FY 2002 Finding Follow Up:

The Assistant CFO for Acquisitions informed the OIG that the development of the online reconciliation process was not implemented in FY 2001 because Citibank was not able to resolve all program issues until early in FY 2002. FMO told the OIG that, since then, it has begun discussions with Citibank to implement the electronic process. According to these officials, Citibank was scheduled to begin work with the FTC in late June 2002 to set up the accounting "strings and templates" necessary for the reallocation program. The FMO's goal was for full FTC implementation by October 2002, but Citibank informed the FTC that it was making significant enhancements to the process that would be completed in February, 2003. Rather then implement an inferior version, the FTC chose to wait for the enhancements and implement the process at that time. FMO staff has informed the OIG that the enhancements were completed in February 2003, and implementation at the FTC is expected in March 2003.

The OIG will follow up on the implementation process in the FY 2003 audit.

3. Prior Year Finding: Accounts Payable (A/P) Accrual at Fiscal Year End is Understated.

While the recording of year-end A/P accruals improved in FY 2001 as the FMO implemented the OIG's prior recommendations, the OIG again found that the costs for still other services/goods delivered on or before September 30, 2001 were not accrued at year end. In each of these instances, the OIG noted that there were no invoices or receiving reports submitted, yet an agency liability still existed. Consequently, basing the recording of year-end accruals solely on having either an invoice or a receiving report on file was not sufficient for all transactions. The majority of the errors detected were included in adjustments to the financial statements after the OIG brought them to the attention of FMO.

To avoid a recurrence of under accruing, FMO should develop a list of these items each year to review when booking the year-end accruals. As an added check, FMO could make inquiries to COTRs to review the status of large contracts which may not routinely appear at year end.

FY 2001 Recommendation

> *a.) Maintain a list of goods/services that are likely to be accrued at year end. This list should then be reviewed to ensure that all applicable accruals are made.*

b.) For <u>large</u> undelivered orders not accrued via receipt of an invoice or receiving report, the OIG recommends that the FMO make inquiries of selected COTRs to determine if services/goods have been received and accrue accordingly.

FY 2002 Finding Follow Up:

During the current year testing, the OIG noted that FMO has made improvements to the process of capturing items that need to be accrued, as described above in (a.). However exceptions were still found that related to large undelivered orders (b.), e.g., nonrecurring items. The OIG noted $1,034,859 of expenses and an additional capital asset item for $800,000 that should have been accrued at September 30, 2002. This latter amount was subsequently recorded as a FY 2002 item as a result of our discussion with the FMO.

In the semiannual audit recommendation follow-up, management concurred with recommendation (b.), and told the OIG that a review of contracts and large-dollar goods/services received near year end had been performed to capture large undelivered orders. Further, COTR's were also contacted by Finance Office staff to determine whether the goods/services were received. Based on our FY 2002 update, it appears that these procedures were not fully implemented at the end of FY 2002. As the OIG again identified missed accruals, it is imperative that the Finance Office take steps to fully implement last year's recommendation in this area.

The OIG will follow up on the Finance Office's implementation of the OIG recommendations during the biannual audit follow-up process and in the FY 2003 audit.

4. Prior Year Finding: FTC's Capitalization Policy Is Not Routinely Followed.

FTC's capitalization policy states that all property, plant and equipment acquired with a unit value of $100,000 or greater and a useful life longer than two years are to be capitalized. Items purchased that do not meet these criteria are expensed. Depreciation of capitalized assets is calculated on a straight-line basis over the estimated useful lives of the assets.

The OIG found that the FTC had not developed effective policy and/or procedures for capitalizing leasehold improvements and internal use software in keeping with Federal Accounting Standards Advisory Board requirements. During the OIG's review of expenses, it was determined that $359,527 in leasehold improvements should have been capitalized for amortization over 15 years as of September 30, 2001. In addition, costs incurred for the development of internal use software in the amount of $659,420 should have been capitalized for amortization over three years. Adjustments to the fiscal year 2001 financial statements were made by FMO for these two capitalized costs when the OIG brought these findings to its attention.

FY 2001 Recommendation

a.) FMO should issue policy and procedures for capitalizing leasehold improvements and internal use software.

b.) FMO should utilize separate object classifications for the recording of capitalized expenditures. If the accounting system capability exists, these separate object classifications should be made to automatically record the transactions into the proper standard general ledger accounts for capitalized assets.

FY 2002 Finding Follow Up:

FMO established and documented internal review procedures to identify leasehold improvements and internal use software. Modifications were made to the object classifications to improve accounting for capital assets. This issue has been resolved. No exceptions were found during this year's audit.

5. Prior Year Finding: Contract Services Are Being Performed Prior to Contract Award Date.

The OIG found that services were being performed without proper contractual documentation in place. In the review, the OIG identified eight instances from 29 vouchers reviewed where services began prior to a fully executed contract modification being in place. In these eight examples, a contract was signed, but changes to the contract were made after the start of the service in question. The effects of this outcome are twofold:

- The agency and the contractor are at risk when work is performed without an authorizing document; and

- Due to this breakdown in proper procedure, thousands of dollars of interest penalties are paid to vendors.

The Federal Acquisitions Regulations (FAR) states the following:

> (a) Only contracting officers acting within the scope of their authority are empowered to execute contract modifications on behalf of the Government (Section 43.102)
>
> (b) The contracting officer shall not execute a contract modification that causes or will cause an increase in funds without having first obtained a certification of fund availability (Section 43.105).

Based on our review of the contract documents and discussions with staff, the OIG learned that modifications are prepared after the commencement of services for a number of reasons, including to: (i) extend the period of performance (and) add funds to the contract, (ii) add staff not previously submitted by the contractor, and (iii) amend the delivery order (Statement of Work). By allowing work to proceed in this manner, the agency violated the two FAR provisions identified above. That is, COTRs (and program managers) permitted work to proceed without the contracting officer's authorization, in effect, operating as contracting officers. Furthermore, the OIG found that delays in paying invoices due to improper authorizing documents have resulted in the agency paying thousands of dollars in interest penalties to vendors.

The OIG believes that it is the responsibility of program managers and COTRs to monitor the contract to ensure that all work is authorized and that interest penalties do not accrue.

FY 2002 Finding Follow Up:

During our testing of payment vouchers, we detected only one case out of a sample of thirty four payment vouchers where services began before the contract period began. Due to the significant improvement in this area as documented in our testing, along with a decrease in interest paid to vendors, as described in item seven below, the OIG considers this issue closed.

6. Prior Year Finding: Redress Collections Held in Contractor and FTC Accounts are not Being Disbursed Timely.

As part of the audit procedures performed by the OIG in the 1999 - 2001 annual audits, the audit team analyzed cash on hand at redress contractors and in the FTC/Treasury suspense account to determine whether funds flowed through these accounts to consumers or to the U.S. Treasury (disgorged) timely.

Since the initial audit of these accounts in FY 1999, the agency has made steady progress in disbursing these funds to consumers or disgorging them to the U.S. Treasury more timely than in prior years. The OIG attributes much of this improvement to the development of policies and procedures recommended by the OIG in the first audit. Specifically, the OIG recommended that the Redress Administration Office (RAO) be given the authority to monitor and set deadlines for staff to dispose of redress funds. Reasons given for redress distribution delay, whether by staff, contractors or receivers, should be documented and routinely reported to senior management.

In response, bureau management has expanded RAO's responsibilities to monitor these open redress cases. The RAO now routinely documents the reasons given for redress delay and has developed an exception report for distribution to senior bureau management. Further, the RAO takes on a more active role in managing the time frame of redress distributions, in particular, those open for long periods of time. For its part, BCP management has established goals to close as many redress cases as possible within 18 months after a final judgment has been entered and to close all redress cases within 30 months unless exceptional circumstances exist.

In the FY 2001 audit, the OIG identified 87 redress cases totaling $45 million on account at the FTC or with one of the two agency redress contractors on 9/30/01. Of this amount, 32 accounts ($14.1 million) were between 18 months and 139 months old. The OIG selected 17 of these 32 accounts ($11.4 million) to review the justification for keeping them open past the BCP-established deadline. According to BCP managers, eight of the 17 cases involved "*exceptional circumstances*," requiring the cases to remain open. These circumstances provided by BCP follow:

- *Case 1 & 2.* Only the district court can order disgorgement; original orders do not permit it automatically;
- *Case 3.* Per court order, monies were used to establish an escrow account as security against repeat offenses by the defendant;
- *Case 4.* Consumer education plan is currently being written;
- *Case 5.* Staff has been requested to prepare an additional distribution and is working on this now;
- *Case 6*. Monies are still being collected as assets are liquidated and fraudulent conveyance actions are being litigated;
- *Case 7.* Second distribution was stayed pending appeal. Appeal was decided in FTC's favor in summer of 2001. Now trying to collect an additional $1.3 million held offshore. If collected, consumers will receive 450 percent more on their claims; and
- *Case 8.* District court is delaying disgorgement pending further collection actions.

The remaining nine accounts were classified by BCP as ***active***, generally meaning that a distribution had recently been completed, or was imminent. According to BCP, five of the nine cases were about to be closed; three were in the final accounting phase (that is, awaiting a final accounting report from the relevant contractor), and one was in the final distribution phase.

Regarding the eight cases that remain open due to "exceptional circumstances," the OIG did not expand its financial statement audit scope to determine whether the justifications provided by BCP merit holding these accounts open.

FY 2002 Update

The OIG selected nine cases for review that were over 18 months old and had minimal account activity (collections or disbursements) for one year. BCP had classified these nine cases as "exceptional circumstances," to explain their status. BCP management provided the OIG with justifications for each case's classification. The justifications provided by management were reasonable and, in the view of the OIG, supported maintaining the case in the "open" status.

The OIG considers this issue closed, but will continue to annually review the status of redress cash held at contractors.

7. Prior Year Finding: Receiving Reports Are Not Prepared Timely

Interest penalties paid to vendors for late payments by the agency pursuant to the Prompt Payment Act are usually the result of receiving reports not filed timely. In FY 2001, the agency made 534 interest payments, amounting to $20,252. The Prompt Payment Act requires that agencies pay their bills timely (e.g. within thirty days) and take discounts when applicable. When invoices are not paid timely, interest penalties accrue. The interest rate applied is established by Treasury. Based on a review of the documentation and information collected from COTRs, the OIG identified the following four causes for interest penalties:

1. Late submission of receiving reports.
2. Contract modifications after completion of the work.
3. Processing requirements at NBC.
4. Continuing resolutions impact on purchase orders.

FY 2001 Recommendations

The OIG recommended that:

a.) The Finance Office provide a schedule of monthly interest penalties paid to pertinent Bureau/Office heads and to regional directors. The schedule should identify, at a minimum, the vendor, the penalty amount and a statement that bureau/office funds are being used to pay the penalty.

b.) The assistant CFO for Acquisitions should inform vendors/contractors when a contract is awarded that invoices that exceed order limitations will not be eligible for late interest payments.

c.) The Assistant CFO for Finance instruct NBC to approve invoices for payment based on labor category, rather than the identification of individuals. Amounts charged for labor categories not approved by FTC should be excluded from payment until a modification is received. Interest penalties should then accrue on the unpaid amount 30 days from the modification date.

d.) When sending receiving reports and copies of invoices to COTRs, the Assistant CFO for Finance identify a due date for their return to the finance office. This due date should take into account the processing requirements at NBC.

e.) The Assistant CFO for Acquisitions require COTRs to submit purchase requisitions prior to the start of any service, to include situations where the agency must operate under a continuing resolution. Order requests submitted after the commencement of the service should require the approval of the COTRs supervisor.

FY 2002 Finding Follow Up:

When alerted to interest penalty finding, FMO took immediate steps to address their causes. FMO sent letters to bureau/office heads alerting them to office/bureau interest penalty expenditures by vendor. Interest penalty letters are now sent out quarterly. Further, NBC, at the direction of FMO, now approves invoices for payment based on labor category, and identifies due dates for all receiving reports. The FMO set up a new policy where they will not pay any invoice that does not have an approved contract or contract modification.

The OIG determined that these procedures have been effective at reducing interest expense. The amount and frequency of interest payments decreased dramatically during the last six months of the fiscal year. For example, although total interest paid during FY 2002 was only slightly below the interest paid in FY 2001 ($18,884 vr. $20,252), the majority of FY 2002 interest was paid in the first six months of the year ($16,470) before the OIG recommendations were implemented. By contrast, in the last six months of FY 2002, interest penalties totaled $2,412.

The OIG Considers this finding closed.

8. Prior Year Finding: Parking Benefits Are Not Accurately Reported

Parking provided to an employee at or near the employer's place of business is considered a qualified transportation fringe benefit. Internal Revenue Service (IRS) regulations permit employees provided with this benefit to exclude it from their income, up to a certain monthly limit ($185 in 2002). If the parking benefit has a value that is more than this limit, the excess must be included in the employee's income and reported on his/her IRS from W-2.

For calendar year 2000, the most recent year for which W-2's had been prepared, the OIG examined the list of individuals designated as receiving parking benefits valued in excess of the exclusion. For the ten employees designated as receiving parking benefit income, three employees' W-2's were incorrect. Of the three incorrect, two had their parking benefit income over-reported and one had no benefit income reported.

FY 2001 Recommendation

> *a.) Near the end of the calendar year, HRMO validate parking-benefit data supplied to NBC to ensure that its instructions to NBC have been properly processed.*
>
> *b.) ASO calculates the value of non-reserved parking spaces using a process similar to reserved-parking evaluation to determine if they exceed the IRS exclusion. Any value in excess should be reported as benefit income.*

FY 2002 Finding Follow Up:

Our testing indicated that the proper amounts were submitted and entered in the payroll system for parking benefits. The OIG considers this issue closed.

Current Year Finding

1. FY 2002 Finding: Reconciliation of Premerger Fees between FMO Records and Premerger Notification Office's Database is Incomplete.

FTC's Premerger Notification Office (PNO) receives, reviews and processes applications for potential mergers. As part of the premerger application, a fee must be submitted. The premerger review process does not begin until both the application and the fee have been received. The premerger application filing is recorded in the PNO's database.

FMO monitors and records premerger fees that have been credited to FTC's premerger account at Treasury. Most fees are paid via wire transfer. Information on these fees is downloaded to the FTC via Treasury's Cashlink reporting system.

FMO had implemented a monthly reconciliation process to compare its records of premerger fees received and confirmed by Treasury to PNO's premerger filings recorded in its database. However, the reconciliation process was incomplete as it only compared the records between FMO and PNO without addressing differences between the two systems. The emphasis of the comparison was to identify all the deposited premerger fees that were credited by Treasury (FMO's records). No further monitoring or research was performed for filings that appeared on the PNO database, but not listed in the FMO records for the month of reconciliation.

Without reconciling these two databases, FMO and PNO cannot ensure the accuracy and completeness of the two systems, and that proper controls are being maintained to capture all premerger transaction activity. As the agency depends on these fees for its operating funds, and maintains half of these funds in a custodial capacity for DOJ, it is imperative that the accuracy of these systems be ensured.

The OIG noted that differences between the two sets of records can result from the timing of the recording. However, without tracking and researching the differences until resolution, FMO cannot ensure the accuracy and completeness of the two systems.

In addition, the reconciliation process is performed manually. FMO staff compares fees received at Treasury against premerger applications received in PNO. As the fee information is available on Cashlink,, PNO should look into the feasibility of importing data from Cashlink into its premerger application system to enable it to perform an electronic reconciliation. An exception report could then be generated identifying those filings that had no corresponding fee at Treasury, and those fees that had no corresponding application at the PNO.

Recommendation:

The OIG recommends that:

a.) FMO and PNO establish a monthly reconciliation process that 1) compares FMO's premerger fee records with PNO's premerger database records, 2) identifies records that are in FMO's records, but not in PNO's database (and vice versa), and 3) tracks the differences to subsequent postings or other resolution measures. The monthly reconciliation preparer's supervisor should review and approve the reconciliation.

b.) Based upon the data from the monthly reconciliation, FMO should prepare quarterly a journal entry to record its premerger fees on an accrual basis.