

REPORT ON THE EXTERNAL PEER REVIEW OF THE  
AUDIT ORGANIZATION OF THE  
OFFICE OF THE INSPECTOR GENERAL  
FOR THE  
FEDERAL TRADE COMMISSION



Smithsonian Institution

OFFICE OF THE INSPECTOR GENERAL

DECEMBER 2007



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# Smithsonian Institution

Office of the Inspector General

December 12, 2007

The Honorable Howard L. Sribnick  
Inspector General  
Federal Trade Commission  
600 Pennsylvania Ave., N.W.  
Washington, D.C. 20580

## Opinion Report

Dear Mr. Sribnick:

We have reviewed the quality control system for the audit function of the Federal Trade Commission, Office of the Inspector General (FTC OIG), in effect for the 18 months ended March 31, 2007. A system of quality control encompasses the FTC OIG's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming to generally accepted government auditing standards (GAGAS). GAGAS, promulgated by the Comptroller General of the United States, set forth the elements of quality control. The FTC OIG is responsible for designing the system and for complying with it in all material respects.

Our objective was to determine whether the quality control system was adequate as designed and implemented to provide reasonable assurance that the FTC OIG met GAGAS and FTC OIG policies and procedures. Our responsibility was to express an opinion on the design of the system and on the FTC OIG's compliance with it.


Our review was conducted in accordance with the guidelines established by the President's Council on Integrity and Efficiency (PCIE). In performing our review, we obtained an understanding of the FTC OIG's system of quality control and tested compliance with the FTC OIG's quality control policies and procedures to the extent we considered necessary. These tests included the application of the FTC OIG's policies and procedures on selected audits. Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the quality control system or all instances of non-compliance. Nevertheless, we believe that the procedures we performed provide a reasonable basis for our opinion. A more detailed description of our scope and methodology is included in the next section of this report.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, projection of any evaluation of such a system to future periods is subject to the risk that the system may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures has deteriorated.

In our opinion, the quality control system for the audit function of the FTC OIG in effect for the 18 months ended March 31, 2007, has been designed to meet the standards established by the Comptroller General of the United States for a federal government audit organization and was complied with during the period to provide the FTC OIG with reasonable assurance of conforming with GAGAS. However, we identified numerous deficiencies with the FTC OIG's adherence to its policies and procedures, which were designed to provide reasonable assurance of conforming to GAGAS. These deficiencies are described in the following Findings and Recommendations section of the report.

I would like to thank you, Mr. Sammy Ragsdale, and Ms. Mary Harmison for the cooperation extended during our review. If you have any questions, please contact me or Stuart Metzger, Assistant Inspector General for Auditing, at 202.633.7050.

Sincerely,

  
A. Sprightley Ryan  
Inspector General

## Scope and Methodology

We reviewed the Federal Trade Commission, Office of the Inspector General's (FTC OIG) system of quality control for its audit function in effect for the 18 months ended March 31, 2007. We performed the peer review between May and September 2007 in accordance with the PCIE *Guide for Conducting Quality Control Reviews of the Audit Operations of Offices of Inspector General*, 2005 revision.

To obtain an understanding of the FTC OIG's audit operation and its quality control system, we reviewed its audit policies and procedures as documented in its *Audit Manual*, October 2006 and February 2007 editions. We held numerous discussions with the FTC OIG Audit Manager as well as the Inspector General. In performing our work, we considered the results of the prior peer review of the FTC OIG<sup>1</sup> and followed up to determine the extent to which corrective actions had been taken. Because the FTC OIG does not have an internal quality assurance monitoring function, internal quality assurance reviews were not available for our examination.

We tested compliance with the FTC OIG's system of quality control to the extent that we considered appropriate. We performed all fieldwork in Washington, D.C. The FTC OIG does not have regional or satellite offices. Our tests included a review of three of the four audit reports that cited compliance with GAGAS and were issued during the period October 1, 2005 to March 31, 2007. The report numbers, issue dates, and titles are summarized in the following table.

Audits Reviewed		
Report Number	Report Date	Report Title
AR 07-002	March 12, 2007	Review of the FTC Purchase Card Program
AR 07-001	November 13, 2006	FY 2006 FTC Financial Statement Audit
AR 07-001A	December 6, 2006	accompanying Management Letter
AR 06-071	March 29, 2006	Audit of the FTC Redress Administration Performed by Analytics, Inc.

We note that the audit of the FTC Purchase Card Program was performed by the FTC OIG while the audits of FTC's FY 2006 Financial Statements and Redress Administration were performed by the Independent Public Accounting (IPA) Firm of Dembo, Jones, Healy, Pennington, and Marshall, PC, under contract with the FTC OIG. For these two audits, we reviewed the FTC OIG's oversight documentation as well as the contractor's work papers.

Lastly, we had a number of communications with other OIG organizations, PCIE representatives, and with officials from the Government Accountability Office (GAO) to discuss our procedures, findings, and conclusions.

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<sup>1</sup> Office of the Inspector General, Federal Communications Commission, June 25, 2003, *Peer Review Report on the Federal Trade Commission Office of the Inspector General*

## Peer Review Findings and Recommendations

Based on our peer review of the FTC OIG's quality control system, we identified numerous deficiencies, which we considered in determining the opinion set forth in our report dated December 12, 2007. We consider a deficiency for peer review purposes to be a weakness in the design or operation of the reviewed organization's system of quality control that could adversely affect the organization's ability to comply with GAGAS<sup>2</sup> and its own policies and procedures. With respect to the FTC OIG's audit findings and conclusions for the reports we reviewed, nothing came to our attention that caused us to believe that they were materially incorrect.

During the course of our review, we also noted other matters relating to the lack of clarity in published documents on the Inspector General's lines of reporting authority, errors and omissions in the FTC OIG's Audit Manual, and the classification of reports in the FTC OIG's semiannual reports not done under GAGAS. We discussed these matters with the FTC OIG.

We believe that the findings described in this section represent opportunities for the FTC OIG to improve its system of quality control.

### Finding 1 – Improvements Needed in Adherence to Audit Documentation Standards

During our review, we followed up on the findings and recommendations from the FTC OIG's prior peer review report. That report found, in part, that for the one performance audit reviewed, the OIG's contractor did not prepare a written audit program. The report also recommended that the FTC OIG include the requirement that audits be conducted in accordance with *Government Auditing Standards* whenever it issues requests for audit services from independent public accountants or consultants.

While the FTC OIG concurred with these findings and indicated that it would take corrective action, we observed similar problems in our current peer review. For example, for one of the audits we reviewed, the FTC OIG's contractor did not prepare a formal approved audit program, but instead used a list of questions and procedures presented at the entrance conference.

In addition, we identified other weaknesses in documentation and reporting for the three audits we reviewed. For instance, GAGAS fieldwork standards for performance audits (GAS 7.41-7.43 and 7.66-7.69) state, and FTC OIG policies and procedures (Sections IV, page 3; V, page 4; VII, page 10; XVII, page 24, and XVIII, page 39) require that: (1) written audit plans should be prepared; (2) work papers should provide a clear understanding of their purpose, methodologies employed, conclusions, and sources of associated data; and (3) sampling plans should be documented. Further, FTC OIG policies and procedures require that reports be cross-indexed and independently referenced and that confirmations of independence should be completed by OIG FTC personnel for each audit assignment.

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<sup>2</sup> GAGAS are published by the U.S. Government Accountability Office under the title *Government Auditing Standards*. References to *Government Auditing Standards* in this report are to chapter and paragraph of the 2003 Revision, unless otherwise indicated.

For all three audits we reviewed, the work papers frequently did not contain purpose, source, or sufficient indexing. Additionally, FTC OIG staff did not complete independence confirmations (certifications). Moreover, for two of the audits, the work papers contained little evidence of FTC OIG supervision.

For the one audit performed by the FTC OIG, we noted additional weaknesses. For example, the work papers did not include a detailed master index, a write up of the exit conference, or a discussion of the sampling plan for testing controls. Moreover, the FTC OIG did not follow prescribed independent referencing procedures (pursuant to Chapter XVIII of its Audit Manual) on the report. We observed that the FTC OIG also did not document changes between its draft and final reports. In one case, the cited dollar amount of unauthorized purchases in the draft report was reduced by nearly one-half in the final report without a reference to audit documentation explaining the difference. Similarly, one of the draft report's conclusions on FTC's control system was that it was "not able to detect or prevent waste, fraud, and abuse." However, the OIG's final report concluded that FTC's "Financial Management Office has a system of internal control in place and operating." Again, we found no references in the final report to work papers explaining the reasons for the changed conclusion.

We identified many of the same deficiencies, as well as others, in the documentation of the two IPA audits we reviewed. These are discussed in more detail in Finding 2.

Better adherence to *Government Auditing Standards* and its audit manual policies and procedures will also serve to strengthen the correlation between the FTC OIG's audit objectives, audit programs, and audit reports. GAGAS states that "objectives are what the audit is intended to accomplish. They identify the audit subjects and performance aspects to be included, as well as the potential finding and reporting elements that the auditors expect to develop. Audit objectives can be thought of as questions about the program that auditors seek to answer." (GAS 7.04)

FTC OIG's Audit Manual, Audit Planning, page 12, states that the audit program documents the objectives, scope, and methodology of the audit and that the audit program should contain the specific steps, scope, and method of gathering and analyzing information to satisfy the objectives.

For one of the IPA audits, the audit objectives were not fully addressed. The IPA's audit report listed at least seven audit objectives. However, the IPA did not prepare a comprehensive audit program with procedures addressing each one. Instead, according to the FTC OIG Audit Manager, the entrance conference agenda and other procedures scattered throughout the work papers were used to guide the work. As a consequence, the objectives related to (i) testing laws and regulations and (ii) evaluating internal controls and assessing their adequacy did not appear to be fully addressed in the report.

For the audit performed by the FTC OIG, we believe the relationship between audit objectives, audit program procedures, and the reported results could have been made more explicit for one of the objectives. The audit program and report stated that the objective was to determine "whether internal controls were sufficient to detect and/or prevent fraudulent use of the purchase card." However, the report, instead of directly addressing the question of sufficiency of controls, stated that "Although the Financial Management Office has a system of internal controls in place and operating, some

adjustments are needed to enhance the security of the FTC purchase card program.” In our view, the FTC OIG did not fully answer the question about the sufficiency of the program’s controls in detecting or preventing fraudulent use of the purchase card.

### Recommendations

In accordance with the FTC OIG’s Audit Manual and GAGAS, we recommend that (1) the FTC OIG improve its compliance with audit documentation standards, especially in the areas of audit programs, work paper preparation, and cross-indexing between the two, and (2) the FTC OIG give greater attention to the development of audit objectives and the related audit programs, and ensure that audit conclusions and reported results clearly address the objectives.

### Finding 2 – Oversight of Audits Performed by IPAs Needs Strengthening

Two of the three audits<sup>3</sup> we reviewed were performed by the same independent public accounting (IPA) firm under contract to the FTC OIG, with the FTC OIG providing contract oversight.

Section 650 of GAO’s Financial Audit Manual (FAM), “Using the Work of Others,” provides detailed guidance, including an oversight checklist, to assist OIGs in monitoring the audit work performed by IPAs. The PCIE also issued guidance in its “Monitoring Tool for Financial Statement Audits” that describes oversight procedures, including the use of checklists. Implementing these checklists helps to ensure that IPAs perform quality audits and that they comply with GAGAS.

The FTC OIG Audit Manual states that “the OIG will closely control and monitor all work of the contractor to ensure contract terms are met and that contractors comply with GAGAS.” The Audit Manual assigns responsibility for oversight of all audit services contracts to its Audit Manager. It establishes minimum documentation requirements such as the need to retain copies of the contracts and related modifications, deliverables, invoices, and receiving reports. However, we saw little guidance on required oversight procedures for the review of planning documents, audit programs, and selected audit tests and procedures, and few procedures for documenting the Audit Manager’s conclusions resulting from the monitoring efforts.

We found that documentation of the FTC OIG’s oversight of its IPA audits was deficient in the following ways:

- For both audits we reviewed, the FTC OIG did not use the recommended checklists or any other written quality assurance program to guide and document its oversight of the IPA’s work. As a consequence, the FTC OIG’s oversight documentation was ad hoc. We saw no evidence that the FTC OIG reviewed the IPA’s planning documents, risk assessments, audit programs, quality control documentation, prepared-by-client (PBC) listings, and other key records. Timely review of key quality control documents can detect flaws and gaps in audit approach and procedures. For example, in the case of one of the audits, the IPA used audit programs for non-profit organizations rather than using available federal financial statement audit programs.

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<sup>3</sup> The Audit of the FTC Redress Administration and the FY 2006 FTC Financial Statement Audit.



- The FTC OIG did not establish the Type of Reporting and the Level of Review it would use for either of the IPA audits. Both Section 650 of the FAM and the PCIE guidance describe procedures for establishing a Type of Reporting and Level of Review. While several factors need to be considered, when the type of report to be issued is one in which there is no reference to the contractor (even though the contractor performed the audit), as was the case with the FTC OIG on both audits, higher Levels of Review are generally necessary.

Higher Levels of Review require significantly more evidence of close monitoring by the FTC OIG than it documented for these audits. By issuing a report with no disclosure of the degree of reliance on the IPA's work, the FTC OIG is taking ownership and responsibility for the IPA's work and is holding out that its understanding of the work papers and related audit procedures and results is complete and of a high level.

- For both audits, the FTC OIG did not obtain from the IPA certifications of independence, its latest peer review report, or a documented description of the IPA's Quality Control System as required by GAO and PCIE guidance. The FTC OIG Audit Manual prescribes that it is the responsibility of the OIG to confirm that the IPA's quality assurance program is effective. It specifies that the FTC OIG must verify that the contractor received a favorable peer review report, that qualified contractor personnel are assigned to the audit, and that written certifications are retained in the OIG files to establish current and continuing independence.
- Although the FTC OIG Audit Manual requires compliance with GAGAS, we also found that many of the FTC OIG oversight work papers did not include : (1) the title, purpose and source of the data; (2) evidence of supervisory review and cross-indexing of the work papers and draft reports; and (3) write-ups of entrance conferences or status meetings. Moreover, independent referencing procedures on draft or final reports were generally not followed.
- For one of the IPA audits, the FTC OIG performed few oversight procedures and maintained little oversight documentation. Closer oversight would have found that the IPA's work papers were deficient in the following areas: the IPA (i) did not adequately cross-index its audit programs to its work papers; (ii) did not adequately cross-index the report footnotes to supporting documentation; and (iii) failed to include an indexed and independently referenced Management Letter in its work papers.
- For the other IPA audit, we noted that the FTC OIG's oversight binder was more substantial but lacked sufficient evidence of review notes and examination of the IPA's analyses and tests. It also did not contain the necessary procedures and documents that would have identified deficiencies such as the lack of an approved audit program.
- For one of the audits, the contract modification specified that the IPA was to conduct a "financial audit" in accordance with GAGAS. The associated final audit report indicated that it was a "financial-related audit" in accordance with GAGAS and AICPA's Generally Accepted Auditing Standards (GAAS). In our view, some of the

audit objectives were performance-related and a performance audit may have been more appropriate. In any case, the FTC OIG did not retain evidence of how it ensured that the IPA complied with applicable standards.

While the FTC OIG did not maintain a binder documenting its oversight of one of the IPA audits, its binder for the other audit documented efforts to review some of the IPA's work papers and conduct supplemental audit testing in areas the IPA did not cover. Nonetheless, the FTC OIG needs to strengthen oversight of its IPAs, as well as the documentation of its oversight, to reduce audit risk and provide a high level of assurance that professional standards are met and audit objectives are fully addressed.

### Recommendation

We recommend that the FTC OIG more fully implement the GAO and PCIE guidance on monitoring, ensure that the type of audit and applicable audit standards under which the IPA conducts the audits are clearly identified and documented, and ensure that its IPAs understand the OIG's documentation and other oversight requirements.

### Observation – FTC OIG Audit Manual Should Be Amended

As a final observation, in our view, the FTC OIG's Audit Manual should be amended to enhance quality control procedures. During the course of our peer review, we used the FTC OIG's February 2007 version of its Audit Manual as the primary source for its audit policies and procedures. We also read its October 2006 version and used it for comparative purposes as well. We noted that the manuals contained instances of outdated references to audit guidance and standards, and lacked procedures for performing attestation engagements. The manuals also did not sufficiently address (i) the independent referencing of reports for audits that were performed by FTC OIG staff, (ii) audit supervision, and (iii) requirements for an internal monitoring function that determines, on an ongoing basis, whether the policies and procedures related to the standards are suitably designed and are being effectively applied. Given the FTC OIG's small size and structure, it is not practicable to establish an elaborate internal monitoring function. However, its manuals did not describe compensating procedures to reflect the absence of such a function.

To its credit, the FTC OIG issued a revised Audit Manual in August 2007. The manual updates references to audit guidance and standards, and includes a brief discussion of attestation engagements. Moreover, the manual recognizes that the FTC OIG does not have the resources to establish a quality control system, limiting its ability to comply with standard quality control procedures established in GAGAS. Accordingly, the OIG took some measures to mitigate risks associated with its limited quality control abilities.

To address the independent referencing issue, the FTC OIG signed a Memorandum of Understanding (MOU) with the Federal Maritime Commission (FMC), effective October 2007. The MOU calls for each OIG to conduct independent referencing reviews on audits conducted by non-contract personnel of the other OIG. To better address audit supervision, the revised manual clarifies that for audits performed by its in-house audit manager, the Inspector General will review the audit program and other work papers relating to critical analyses that directly support audit findings. The OIG also developed a

report review checklist for the Inspector General to use as a guide when reviewing audit reports.

The above improvements notwithstanding, we believe there are opportunities for the FTC OIG to further strengthen its policies and procedures. First, we have two observations regarding audit supervision. The FTC OIG manual requires that work papers be reviewed at the conclusion of fieldwork. In our opinion, waiting until the end of fieldwork to perform supervisory review of work papers is risky and not in accord with best practices. Supervision, including review of work papers, should be continuous throughout the audit to ensure that objectives are fully addressed and audits are performed in an efficient and effective manner and in compliance with all applicable standards. For the FTC OIG, because the office is so small and no other in-house audit resources are available, the quality of supervision over audits performed by its audit manager also will depend on the experience and qualifications of the Inspector General. In our view, if the Inspector General does not have experience in conducting audits in accordance with professional standards, then even with his or her best efforts, only limited assurances can be made.

Second, we have observations on the need for other compensating controls to reduce the risks associated with gaps in the quality control system. The July 2007 revision of *Government Auditing Standards* states that an audit organization should include policies and procedures in its system of quality control that collectively address the following six key elements: (1) leadership responsibilities for quality; (2) independence, legal, and ethical requirements; (3) engagement management, including the initiation, acceptance, and continuance of audit and attestation engagements; (4) human resources related to capabilities and competence to perform audits in accordance professional standards and legal and regulatory requirements; (5) engagement performance, documentation, and reporting, and (6) monitoring of quality. (GAS 3.53)

Regarding the sixth element on monitoring of quality, GAGAS state that the nature, extent, and formality of an audit organization's system of quality control will vary based on the audit organization's circumstances, such as the audit organization's size and the nature and complexity of its audit work. (GAS 3.51) PCIE guidance acknowledges that smaller audit organizations may not have an audit staff sufficient to fully implement an internal monitoring function. However, the guidance is clear that these OIGs must establish a compensating control structure to fulfill the requirements.

GAGAS also require audit organizations to analyze and summarize the results of their monitoring procedures at least annually. Under GAGAS, supervisory review of work papers and audit reports alone are not sufficient monitoring controls. One way the FTC OIG may be able to address this issue is to expand its MOU with the FMC OIG to include an annual monitoring review that would provide reasonable levels of assurance that this standard is met.

Lastly, in our opinion, the manual needs additional guidance to fully implement the July 2007 GAGAS requirements in several other areas, including ethical principles, external impairments to independence, and performance audit standards related to significance, audit risk, and internal control.

### Recommendation

We recommend that the FTC OIG amend its Audit Manual to ensure that the six elements of quality control are fully addressed and that its policies and procedures for supervision and other areas discussed in this peer review report provide reasonable assurance of compliance with the 2007 Revision to *Government Auditing Standards*.

### Views of FTC OIG Management Officials

The Inspector General provided a formal written response to our draft report and concurred with our recommendations. The FTC OIG will (1) update policies and procedures to more fully address GAGAS standards; (2) strengthen its monitoring procedures over IPA audit work; and (3) improve alignment of its Audit Manual with the quality control elements in the 2007 Revision to *Government Auditing Standards*. We believe that the FTC OIG's planned actions meet the intent of our recommendations and we consider them resolved.

The full text of the FTC OIG's response is included as Exhibit A.

## EXHIBIT A – VIEWS OF FTC OIG MANAGEMENT OFFICIALS



Office of Inspector General

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

December 7, 2007

Ms. A. Sprightley Ryan  
Inspector General  
Office of the Inspector General  
Smithsonian Institution  
MRC 1204  
PO Box 37012  
Washington DC 20013-0712

Re: Official Draft Report on the External Peer Review of the Audit Organization of the  
Office of the Inspector General for the Federal Trade Commission

Dear Ms. Ryan:

Thank you for the opportunity to review and comment on the formal draft report on your external peer review of our audit office. We appreciate the work of your staff in providing an independent evaluation of our internal quality control system. The report concludes that the FTC OIG quality control system is designed to meet the standards established by the Comptroller General of the United States for a Federal Government audit organization and that these standards have been complied with during the period ended to provide the FTC OIG with reasonable assurance of conforming with applicable auditing standards, policies, and procedures.

As you requested, the following comments are in response to your observations and recommendations to further enhance our internal quality control system.

### Improvements Needed in Adherence to Audit Documentation Standards

We agree with your recommendations and have taken the following actions. The FTC OIG signed a Memorandum of Understanding (MOU) with the Federal Maritime Commission (FMC), effective October 2007. The MOU calls for each OIG to review audit and attestation products completed by the other's OIG auditors, in compliance with Government Auditing Standards (GAGAS) July 2007 Revision, Section 3.50 through 3.54. An auditor with the FMC/OIG will provide an independent quality assurance review of audit and attestation products completed by auditors of the FTC/OIG. In addition, we will also review our existing policies and procedures and update them as necessary to ensure our policies explicitly address the GAGAS standards referenced in your report.

Ms. A. Sprightley Ryan  
December 07, 2007  
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Oversight of Audits Performed by IPAs Needs Strengthening

We agree with your recommendation and will review our existing monitoring procedures to ensure that they address all audit work that is performed by independent public accountants, including the annual financial statement audit. We will utilize the guidance in the professional standards (GAGAS, incorporating GAAS) in this area. We will consider using procedures from the PCIE/GAO Financial Audit Manual Section 650 (FAM 650) "Using the Work of Others," not only because FAM 650 incorporates the professional standards that provide guidance in this area, but also because it provides examples of procedures that the auditor generally should perform in designing and performing oversight when using the work of other auditors.

FTC OIG Audit Manual Should be Amended

We issued a revised Audit Manual in August 2007 that updated references to audit guidance and standards, and reflected compliance with the July 2007 revision of *Government Auditing Standards*. We agree with your suggestion to further improve the manual and will review our August 2007 Manual and update it as necessary to ensure that our policies and procedures address the six elements of quality control from the July 2007 *Government Auditing Standards*.

We appreciate the efforts of you and your staff in conducting this review, and we thank you and all of your staff that we dealt with for your assistance and cooperation during the conduct of this review.

Sincerely,



Howard L. Sribnick  
Inspector General