

# FEDERAL TRADE COMMISSION



## PERFORMANCE AND ACCOUNTABILITY REPORT

FISCAL YEAR 2004

[www.ftc.gov/par](http://www.ftc.gov/par)

[gpra@ftc.gov](mailto:gpra@ftc.gov)

202-326-2222

600 Pennsylvania Avenue, NW, H-774, Attention PAR  
Washington, DC 20580

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## Part I: Management's Discussion and Analysis

### A Message From The Chairman

I am pleased to present the Federal Trade Commission's *Performance and Accountability Report* for Fiscal Year 2004. I was sworn in as Chairman of the FTC in August 2004, and have been impressed with the evident dedication of the staff to the mission of the agency, as well as with their significant accomplishments that have benefitted consumers across the nation. This report provides an overview of the FTC's mission, accomplishments, performance, and financial management.



In FY 2004, the FTC celebrated its 90<sup>th</sup> anniversary and took the opportunity to look back at the evolution of its mission, including the integration of the consumer protection and competition missions, and the advantages of having both programs in one agency. As I have learned, the **FTC** works **For The Consumer**, an apt summary of the agency's consumer protection and competition missions, both of which have the shared goal of improving consumer welfare.

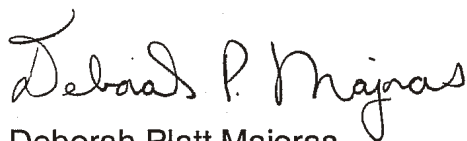
One example of the FTC's great work is the National Do Not Call Registry, which commemorated its one year anniversary in June 2004, and now includes over 64 million telephone numbers. Consumers are receiving far fewer telemarketing calls, and the Registry has been hailed by Congress, the media, and consumers as a beneficial and cost-effective government program. The FTC's FY 2004 accomplishments in such areas as the promotion of competition and innovation, competition advocacy, administrative litigation, identity theft, Internet fraud, spam, and deceptive healthcare claims are highlighted in this report. In the coming year, the FTC will continue to address these and other challenges of high priority to consumers. For more information on the FTC's activities and its wealth of consumer and business education, I invite readers to visit our Web site at [www.ftc.gov](http://www.ftc.gov).

Another important goal of the FTC is to implement good financial management practices to ensure that our resources are well-managed and wisely used. The FY 2004 independent financial audit resulted in the FTC's eighth consecutive unqualified opinion, the highest audit opinion available. The audit of the FTC's financial statements, which includes tests of internal control and compliance with laws and regulations, is conducted in accordance with Government Auditing Standards and the Office of Management and Budget (OMB) Bulletin No. 01-02.

The Records Consolidation Act of 2000 requires an assessment of the completeness and reliability of the program and financial data contained in this report. Based on criteria issued by OMB, I conclude that the data are complete and reliable. In addition, the FTC evaluated its management controls and financial management systems, as required by the Federal Managers' Financial Integrity Act. On the basis of the comprehensive management control program, I am pleased to certify, with reasonable assurance, that the agency is in compliance with the provisions of the Act.

Although we have not yet been evaluated by OMB under the President's Management Agenda, the FTC strives continuously to improve its practices in the five management initiative areas. In FY 2004, we particularly focused on information technology (IT) security and the integration of performance and financial systems. The inspector general has acknowledged our substantial progress in both areas, although there are still challenges to meet. The FTC is working to further strengthen its IT security and remain on top of current and future threats. In the financial management area, the agency has begun to implement its five-year strategic plan. A key component of the plan is the migration to a new core financial management system that will facilitate the integration of financial and performance systems.

I look forward to working with agency staff in the coming year to continue providing high quality service to American consumers.



Deborah Platt Majoras  
November 15, 2004

## About the Report

This Fiscal Year (FY) 2004 Performance and Accountability Report is the Federal Trade Commission's (FTC) second consolidated report prepared pursuant to the requirements of the Accountability of Tax Dollars Act of FY 2002 (Public Law 107-289) and subject to regulations issued by the Office of Management and Budget (OMB). Unless otherwise noted, the examples and statistics used in the Report represent FY 2004 activities, spanning the period of October 1, 2003, to September 30, 2004.

Part I, Management's Discussion and Analysis, provides an overview of the FTC's mission, performance, and financial activities. Part II, Program Performance, presents the results of the FTC's 2004 performance in accordance with its Government Performance and Results Act strategic plan. Part III, Audited Financial Statements, sets forth the FTC's FY 2004 audited financial statements, and related audit and management information.

The FTC has worked to present information in a clear and understandable manner and will continue to refine its process and format in future years to make this report a valuable tool for FTC managers, stakeholders, and members of the public interested in the accountability, performance, and activities of the agency. The report is available on the Internet at [www.ftc.gov/par](http://www.ftc.gov/par), or copies can be obtained by emailing [gpra@ftc.gov](mailto:gpra@ftc.gov), calling 202-326-2222, faxing 202-326-2329, or mailing Federal Trade Commission, 600 Pennsylvania Avenue, NW, H-774, Attention PAR, Washington, DC 20580. Comments from readers are encouraged and can be sent via the aforementioned email, fax, or mailing address.

## About the FTC

President Woodrow Wilson signed the FTC Act into law ninety years ago on September 26, 1914. Congress has charged the FTC with the broadest legislative mandate of any federal consumer protection agency. It is an independent federal agency with a staff of approximately 1,100. Its headquarters (pictured at right) is located in Washington, D.C., with offices in seven regions across the nation (for locations see [www.ftc.gov/ro/romap2.htm](http://www.ftc.gov/ro/romap2.htm)). The impact of the FTC on the nation's marketplace belies its small size. The FTC's activities affect the lives of consumers every day through, for example, the receipt of fewer telemarketing calls, lower prescription drug prices due to the availability of generic drugs, care labels in clothing, energy labels on appliances, health warnings on cigarette packages, or competitive prices for goods as a result of a blocked merger.



## FTC Consumer Resources



### FTC Consumer Complaint Form

OMB #3084-0047

[www.ftc.gov](http://www.ftc.gov)

Consumers are encouraged to call the FTC's Consumer Response Center (CRC) on its toll-free numbers – **1-877-FTC-HELP** or **1-877-ID-Theft** – with complaints, inquiries, or requests for education materials. The FTC's Web site, [www.ftc.gov](http://www.ftc.gov), also permits consumers to file online complaints and access information and education materials on a broad array of consumer issues, such as fraud, spam, identity theft, and credit practices. The FTC also has a dedicated page of its Web site in Spanish, *Proteccion para el Consumidor*, to mirror the English-language page, and has translated over 100 consumer publications into Spanish. The consumer complaints are used to target the agency's law enforcement and education efforts.

Through the [www.consumer.gov/sentinel](http://www.consumer.gov/sentinel) link, consumers can view summary data collected by the FTC, such as the scams that garner the most frequent consumer complaints; the scams that cost consumers most; the number of identity theft complaints, by state; the types of identity theft most frequently reported; and how to spot and avoid fraud and deception online and off. The FTC Web site also has a direct link to the government-wide public site, [www.firstgov.gov](http://www.firstgov.gov), and to a site created and maintained by the FTC, [www.consumer.gov](http://www.consumer.gov), a one-stop link to a broad range of federal consumer information resources.

#### Top 10 Consumer Fraud Complaints Calendar Year 2003

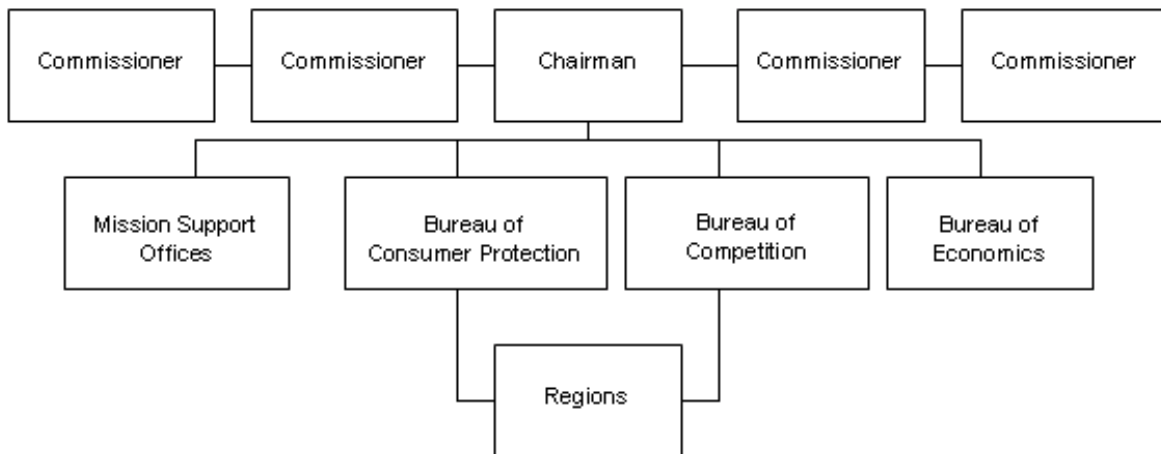
1. Identity Theft - 42%
2. Internet Auctions - 15%
3. Shop-At-Home/Catalogue Sales - 9%
4. Internet Services and Computer Complaints - 6%
5. Prizes, Sweepstakes, and Lotteries - 5%
6. Foreign Money Offers - 4%
7. Advance Fee Loans and Credit Protection - 4%
8. Telephone Services - 3%
9. Business Opportunities/Work-At-Home Plans - 2%
10. Magazine Buyers Clubs - 1%

## Organization

The FTC is headed by a Commission comprised of five members who are nominated by the President and confirmed by the Senate, and who serve staggered seven-year terms. The President chooses one Commissioner to act as Chairman. No more than three Commissioners can be of the same political party. At the end of FY 2004, the Chairman was Deborah Platt Majoras, and the Commissioners were Orson Swindle, Thomas B. Leary, Pamela Jones Harbour, and Jonathan Leibowitz.

The FTC has two major law enforcement bureaus, Consumer Protection and Competition, supported by an economics bureau, regional offices, and mission support offices. The agency enforces laws that prohibit business practices that are anticompetitive, deceptive, or unfair to consumers. It also promotes informed consumer choice and public understanding of the competitive process. The work of the FTC is critical in protecting and strengthening free and open markets in the United States and, increasingly, the world.

### FEDERAL TRADE COMMISSION ORGANIZATION CHART



## Regulatory Responsibility

The FTC was established by Congress in 1914 to enforce the FTC Act. Section 5 of the FTC Act prohibits “unfair methods of competition,” and was amended in 1938 also to prohibit “unfair or deceptive acts or practices.” In addition, the FTC enforces a variety of other consumer protection laws, such as the Fair Credit Reporting Act and Equal Credit Opportunity Act, and antitrust laws, such as the Sherman Act and Clayton Act. For a discussion of the agency’s regulatory authority, see the FTC FY 2003-2008 Strategic Plan, at [www.ftc.gov/opp/gpra/spfy03fy08.pdf](http://www.ftc.gov/opp/gpra/spfy03fy08.pdf), section entitled *Laws Enforced by the FTC*.



## Mission

At the start of the 21st century, global markets, high-technology innovation, and markets in transition to new ways of competing dominate the economic landscape. The FTC continues to adapt its mission strategies and workforce in response to these marketplace forces.

Consumer protection and antitrust law enforcement have played an important role in maintaining the competitiveness of U.S. markets. The FTC ensures that free markets work – that competition among producers and accurate information in the hands of consumers create the incentives to generate the best products at the lowest prices, spur efficiency and innovation, strengthen the economy, and produce benefits for consumers.

For competition to thrive, consumers must receive accurate information about products and services. Through its consumer protection mandate, the FTC protects consumers from fraud, deception, and unfair practices in the marketplace. It works to foster the exchange of accurate, non-deceptive information, allowing consumers to make informed choices in their purchasing decisions and to participate with confidence in the traditional and electronic marketplaces. The FTC addresses current issues of importance to consumers, including identity theft, consumer privacy, telemarketing fraud, Internet fraud, health care, and consumer credit.

At the same time, for consumers to have a choice of products and services at competitive prices and quality, the marketplace must be free from unreasonable restrictions on competition. Through its maintaining competition mandate, the agency enforces the laws that prohibit anticompetitive mergers and business practices. It promotes free and open competitive markets, which bring consumers lower prices, innovation, and choice among products and services. A significant portion of the FTC's resources are devoted to market segments that matter most to consumers, including energy, health care, prescription drugs, grocery retailing, and high tech. The FTC works to remove restrictions on competition so that markets can function at their best.

The FTC's legislative mandate to serve as a locus of professional expertise on competition and consumer protection issues makes the FTC highly distinctive among antitrust and consumer protection agencies worldwide. To position itself to make intelligent contributions to consumer protection and competition policy through litigation or non-litigation instruments, the FTC must make substantial investments in "policy research and development." Its capacity to enforce the antitrust and consumer protection laws, and its credibility as a voice for sound public policy, requires a continuing commitment to conduct research that increases its understanding of how markets and firms operate, the conditions under which business conduct is likely to harm consumers, and the effects of its previous enforcement efforts.

## History of the FTC

In recognition of the FTC's **90<sup>th</sup> anniversary** on September 26, 1914, the agency added a page to its Web site on FTC's history (see [www.ftc.gov](http://www.ftc.gov) **HISTORY OF THE FTC**). Readers can find articles on the origin of the agency, oral histories, annual reports, as well as information on the 100<sup>th</sup> anniversary of the FTC's predecessor, the Bureau of Corporation.



**President Woodrow Wilson signed the FTC Act into law on September 26, 1914.**

## Strategic Goals and Objectives

### FTC's Mission

To prevent business practices that are anticompetitive or deceptive or unfair to consumers; to enhance informed consumer choice and public understanding of the competitive process; and to accomplish these missions without unduly burdening legitimate business activity

### FTC's Vision

A U.S. economy characterized by vigorous competition among producers and consumer access to accurate information, yielding high-quality products at low prices and encouraging efficiency, innovation, and consumer choice.

The FTC provides annual performance plans to Congress that set forth its goals and objectives, and its performance measures and targets as required by the Government Performance and Results Act. The FTC has two strategic goals that link directly to its two missions, Consumer Protection and Maintaining Competition. Each goal has three objectives – **identify**, **stop**, and **prevent** illegal practices – and each objective has performance measures. The FTC uses strategic planning to set the strategies, implementation plans, performance measures, and targets for its goals. The FTC's Performance Plans and FY 2003-2008 Strategic Plan are available on its Web site at [www.ftc.gov/opp/gpra/index.htm](http://www.ftc.gov/opp/gpra/index.htm). The complete FY 2004 Performance Report with actual results is included in Part II, *Program Performance*, of this report.

**Strategic Goal 1 Protect Consumers**  
Prevent fraud, deception, and unfair business practices in the marketplace.

**Objective 1.1**      **Identify** fraud, deception, and unfair practices that cause the greatest consumer injury.

**Objective 1.2**      **Stop** fraud, deception, and unfair practices through law enforcement.

**Objective 1.3**      **Prevent** consumer injury through education.

**Strategic Goal 2 Maintain Competition**  
Prevent anticompetitive mergers and other anticompetitive business practices in the marketplace.

**Objective 2.1**      **Identify** anticompetitive mergers and practices that cause the greatest consumer injury.

**Objective 2.2**      **Stop** anticompetitive mergers and practices through law enforcement.

**Objective 2.3**      **Prevent** consumer injury through education.

## Program Performance Overview

The systems and methodologies for collecting performance data are reviewed by the FTC's Office of the Inspector General. Senior economists from the FTC's Bureau of Economics review statistical data, as appropriate. Performance measure results are reviewed by senior management and the Commission periodically throughout the fiscal year.

### Goal 1: Protect Consumers

The goal of the Consumer Protection Mission is to prevent fraud, deception, and unfair business practices in the marketplace. It works to accomplish this goal through three objectives, which are to: (1) **identify** fraud, deception, and unfair practices that cause the greatest consumer injury; (2) **stop** fraud, deception, and unfair practices through law enforcement; and (3) **prevent** consumer injury through education.

#### Objective 1: Identify fraud, deception, and unfair practices that cause the greatest consumer injury

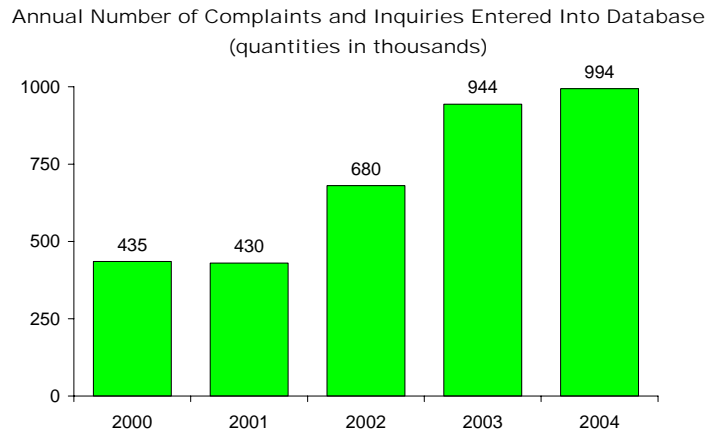
To identify the most prevalent and serious forms of fraud and deception, the FTC relies on its Consumer Information System (CIS) database, the largest database of consumer complaints in the world. The FTC collects complaints via its toll-free help lines, postal mail, and online. It also receives complaint data from a broad array of public and private partner organizations in the United States and Canada.

Analysis of the complaints in its CIS database enables the FTC to detect and respond rapidly to fraud, deception, and other illegal practices. This results in effective targeting of the agency's law enforcement and education resources. The continuous input of new complaints into the database helps the FTC and its law enforcement partners determine where and how the latest incidents of fraud may be occurring.

The FTC also shares complaints about fraud and deception with its law enforcement partners through *Consumer Sentinel*, a secure Web site that provides access to more than 2.0 million fraud and identity theft complaints. *Consumer Sentinel* is a unique and effective enforcement tool that permits more than 1,150 law enforcers in the United States, Canada, and Australia to determine whether a particular fraudulent scheme is local, national, or cross-border in nature, and also to help spot larger trends for law enforcement action.

The FTC determines its success under this objective using two performance measures. First, the agency measures the total number of consumer complaints and inquiries that are added annually to the CIS database (see graph below for actual results for the last five years). Second, it measures how many of these consumer complaints and inquiries relate to identity theft. The target for FY 2004 was to add at least 700,000 entries into the database, including 250,000 relating to identity theft. The FTC exceeded its target, adding 994,000 entries, including 314,000 relating to identity theft.

The number of total annual entries has increased substantially in recent years. In response to the success of the CIS database, the agency has raised its target in each of its strategic plans. The graph below shows the upward trend of the annual actual results of this measure. The FTC began tracking identity theft entries in FY 2003, setting a target of 155,000 entries based on historical data. The actual result was 321,000 entries.

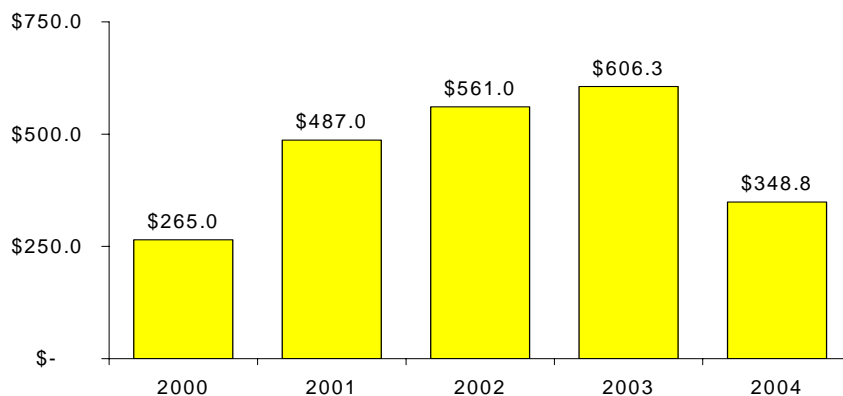


## **Objective 2: Stop fraud, deception, and unfair practices through law enforcement**

The FTC uses its law enforcement authority to stop fraud, deception, and unfair practices. Consumers save money each time a fraudulent operator is stopped by successful litigation or settlement with the agency. Savings to consumers are increased when the agency leads joint law enforcement initiatives with federal, state, and international partners.

The FTC determines its success under this objective using three performance measures. First, the agency measures the effectiveness of its law enforcement efforts to stop fraud by estimating the amount of money it has saved consumers based on the annual fraudulent sales of defendants. In FY 2004, the FTC saved consumers \$348.8 million, which represents 87 percent of its \$400 million target. The agency also set a target in its FY 2003-2008 Strategic Plan of saving consumers a total of \$2 billion by FY 2008. Having exceeded its annual target in FY 2003, and achieved 87 percent in FY 2004, the FTC is on track to reach its \$2 billion target. The amount of savings vary year-to-year based on the number of cases and amounts of fraudulent sales of defendants. The following graph demonstrates the amounts the FTC has saved consumers in recent years.

Dollar Savings for Consumers from FTC Actions which Stop Fraud  
(dollars in millions)



Second, as an indicator of the usefulness of the FTC's *Consumer Sentinel* complaints, the agency measures the number of data searches by its staff and other law enforcement personnel. This measure was added in FY 2003, with a target of 20,000 searches and an actual result of 27,685. In FY 2004, the actual number of *Consumer Sentinel* searches was more than 87,000, far exceeding the annual target of 24,000. However, *Consumer Sentinel* made several major changes and improvements in late September 2003, and staff estimate that almost half of the FTC and external law enforcement personnel usage may be related to the testing of these changes.

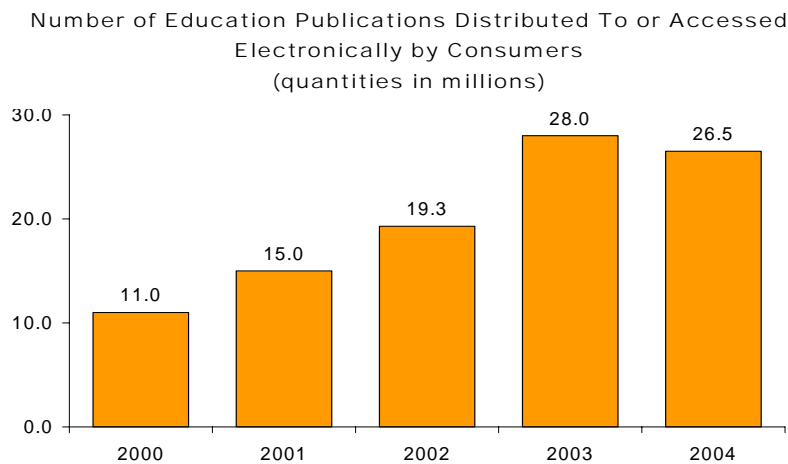
Finally, the agency measures the number of data searches by law enforcement personnel of the FTC's identity theft complaints. This measure also was added in FY 2003, with a target of 1,400 and actual results of 2,167. In FY 2004, the actual number of Identity Theft Data Clearinghouse searches by law enforcement personnel was 2,120, or 125 percent of the target of 1,700.

### **Objective 3: Prevent consumer injury through education**

Consumer and business education represents the first line of defense against fraud, deception, and unfair practices. Most FTC law enforcement initiatives include a consumer and/or business education component aimed at preventing consumer injury and unlawful business practices. Public education programs benefit consumers by alerting them to their rights under various consumer protection laws and providing practical tips on how to recognize and avoid scams and rip-offs. To reach the broadest possible audience, the FTC makes maximum use of the national media and outreach to lead more consumers to the FTC's Web site ([www.ftc.gov](http://www.ftc.gov)) and the one-stop government Web site for consumer information ([www.consumer.gov](http://www.consumer.gov)). Messages also reach the public through the FTC's Consumer Response Center (at 1-877-FTC-HELP) and hundreds of partners who distribute FTC materials, link to its Web site, or post the FTC's messages on their Web sites.

The FTC determines its success under this objective using three performance measures. First, the agency measures the total number of education publications distributed to or accessed electronically by consumers. Second, it measures the number of publications related to identity theft distributed to or accessed electronically by consumers. Finally, it measures the number of Spanish-language education publications distributed to or accessed electronically by consumers. The latter two measures were added in FY 2003 to track the FTC's efforts to respond to high-priority consumer issues.

The target in FY 2004 was to reach a total audience of at least 15 million with FTC education publications. The FTC exceeded this target by distributing 26.5 million publications. More publications continue to be distributed online (nearly 20 million) than in print (6.6 million). The 26.5 million includes 3.7 million publications related to identity theft, exceeding the target of 2.5 million, and 737,000 Spanish-language publications, exceeding the target of 400,000. In FY 2003, the FTC distributed 3 million publications related to identity theft and 458,000 Spanish-language publications. The FTC exceeded its targets in FY 2004 by such a wide margin due to the continuing increase in Internet accesses, and the large number of accesses of materials related to the Do Not Call Registry. The following graph shows the trend in distribution of all Consumer Protection Mission education publications in recent years.





## Goal 2: Maintain Competition

The goal of Maintaining Competition Mission is to prevent anticompetitive mergers and other anticompetitive business practices in the marketplace. It works to accomplish this goal through three objectives, which are to: (1) **identify** anticompetitive mergers and practices that cause the greatest consumer injury; (2) **stop** anticompetitive mergers and practices through law enforcement; and (3) **prevent** consumer injury through education.

### Objective 1: Identify anticompetitive mergers and practices that cause the greatest consumer injury

The FTC's Bureau of Competition and the Antitrust Division of the U.S. Department of Justice (DOJ) share responsibility for enforcing laws that promote competition in the marketplace. Competition benefits consumers by keeping prices low and the quality of goods and services high. Most mergers actually benefit competition and consumers by allowing firms to operate more efficiently. But some are likely to lessen competition. That, in turn, can lead to higher prices, reduced availability of goods or services, lower quality of products, and less innovation. Identifying and challenging anticompetitive mergers is a difficult task that can take thousands of hours of investigative work and, often, litigation.

The Hart-Scott-Rodino (HSR) Act requires that companies planning a merger, in which the size of the transaction and the parties exceeds thresholds prescribed by the Act, notify the FTC and DOJ before proceeding with the transaction. The FTC uses these "premerger notification reports" as its primary means for identifying potentially anticompetitive mergers, screening each proposed transaction to determine which require further investigation. Over the past two years, a less active economy and revised HSR thresholds have kept the number of reported transactions at moderate levels. The modified reporting thresholds did not alter the standard of legality for mergers, however, so the FTC has increased efforts to identify mergers not reported under HSR that might harm competition. These efforts include monitoring trade press and Internet resources, as well as following up on information from congressional offices, other Executive Branch agencies, state and local governments, consumers, businesses, and the antitrust bar about possibly anticompetitive mergers. The FTC uses similar means to identify business practices that may harm consumers.

The FTC determined its success under this objective in FY 2004 using two performance measures. First, the agency measured the percentage of significant HSR merger investigations concluded during the year that resulted in enforcement action. Significant HSR merger investigations are those in which the Commission issued a formal request for additional information – called a "second request" – from the parties under the HSR Act, typically representing no more than 2 to 3 percent of the premerger notification filings received. Second, it measured the percentage of significant nonmerger investigations concluded during the year that resulted in enforcement action. Significant nonmerger investigations are those in which the Commission approved the use of its authority to compel the submission of information.

The FTC's target for both measures was that the number of significant investigations concluded during the year that result in enforcement action will generally fall in the range from 60 to 80 percent. Results within this range show that the agency was successful in targeting potentially anticompetitive conduct because if the conduct was found not to be anticompetitive, no enforcement action would have been taken.

In FY 2004, 12 of 22 or 55 percent of significant merger investigations concluded during the year resulted in enforcement action. The reasons that this result fell outside the target range likely include (1) the small number of cases involved in the calculation and (2) an unusual number of difficult and close cases that ultimately were found not to require enforcement action. The FTC's performance on this measure over the past four years – 65 percent, based on 64 of 98 investigations – further suggests that the FY 2004 result is a statistical anomaly. The results on this measure in FY 2005 and beyond will help to answer this question.

In FY 2004, 5 of 8 investigations or 63 percent of significant nonmerger investigations concluded during the year resulted in enforcement action. This result is within the target range, though the small numbers make it difficult to draw any definitive conclusions. This measure is new for FY 2004, but in future years the FTC will report both annual and aggregate results.

## **Objective 2: Stop anticompetitive mergers and practices through law enforcement**

The FTC uses its law enforcement authority to stop anticompetitive mergers and practices both directly and indirectly. Through federal court or administrative litigation or by negotiated settlement, the agency saves consumers millions of dollars annually by preventing harmful mergers from taking place, by arranging for the restructuring of transactions to eliminate anticompetitive effects, or by stopping unlawful business practices. In addition to these direct actions, an effective FTC enforcement presence indirectly serves its objective by demonstrating to the business and legal communities that the agency can and will take successful legal action to stop anticompetitive transactions and practices.

The FTC determined its success under this objective using three performance measures. First, the agency measured the percentage of positive outcomes obtained in antitrust enforcement actions. Second, the agency measured the volume of commerce in markets in which the FTC took enforcement action to protect competition from the effects of unlawful mergers. Finally, the agency measured the volume of commerce in markets in which the FTC took enforcement action to protect competition from the effects of unlawful conduct. The latter two measures indicate the scope of the FTC's antitrust enforcement activities, and are new in FY 2004.

A positive outcome for an enforcement action includes abandonment of an anticompetitive transaction following an FTC challenge, a consent agreement to resolve antitrust concerns, or a successful result in administrative or federal court litigation after all proceedings, including appeals, have concluded. A negative outcome occurs when parties refuse to settle antitrust concerns raised by the FTC and the agency is unsuccessful in obtaining relief

through the courts or an administrative challenge. The FTC significantly exceeded its target of achieving positive outcomes in 80 percent of its enforcement actions by obtaining a positive result in 100 percent of the administrative and federal court enforcement actions it concluded during the year. In recent years, the FTC has achieved similar results on this measure, 95 percent in 2000, 94 percent in 2001, 100 percent in 2002, and 100 percent in 2003. These results benefit consumers both directly and indirectly – because the agency’s track record of success in obtaining the relief it deems necessary on consumers’ behalf helps persuade more parties to settle FTC charges rather than resist, which could lead to higher prices, reduced availability of goods or services, lower quality of products, and less innovation.

As discussed in the FTC’s 2003-2008 Strategic Plan, external factors, such as level of merger activity, may cause the results of the two volume of commerce measures to fluctuate significantly from year to year. Thus, the FTC’s targets for these two new measures are both expressed as aggregate totals over the five-year period. In FY 2004, the FTC took merger enforcement actions that protected competition in markets with a total of \$8.5 billion in annual sales. The FTC’s nonmerger enforcement actions in FY 2004 protected commerce in markets with a total of \$2.6 billion in annual sales.

Though these results are less than the annual averages needed to attain the five-year goals of \$200 billion (annual average \$40 billion) and \$100 billion (annual average \$20 billion), the FTC does not view them as an indicator of ultimate results because (1) merger activity appears to be increasing; (2) the Commission concluded no action was necessary in close cases somewhat more often than is the norm in FY 2004; (3) the results do not include data from several significant competition cases that are currently in litigation and are consuming a significant portion of the FTC’s antitrust resources; (4) a small number of major cases typically contribute a major portion of the final totals and no such cases were concluded in FY 2004; and (5) overall, the Maintaining Competition Mission continued to be highly productive in FY 2004, with no sign of slowing.

### **Objective 3: Prevent consumer injury through education**

The FTC increases awareness of antitrust law and policy and promotes compliance with the antitrust laws by educating the public about its activities and communicating its enforcement intentions. The agency’s methods of informing the public include development and publication of antitrust guidelines and policy statements; press releases and public dissemination of documents describing its formal actions; and well-publicized testimony, speeches, and publications.

The FTC strove to determine its success under this objective using two performance measures. First, the agency measured the number of hits on antitrust pages on the FTC’s Web site, of interest to the business and legal communities, and second, the number of hits on the antitrust pages of interest to policymakers and the public at large.

In FY 2004, the FTC’s Web site recorded more than 11 million total hits on antitrust-related pages, an increase of approximately 10 percent over FY 2003. The agency determined that

distinguishing between content more of interest to the business and legal communities, and content more of interest to the general public, was more problematic than expected. Generally, nearly all of the material holds interest for businesses and the bar. Much of that material is also of significant interest to members of the public. Only a small number of pages appear to be of interest to the public at large, but not to the business and legal communities. Because it is difficult to distinguish between the FTC's relative success in educating the business and legal communities and the general public, the agency will discontinue these two performance measures in FY 2005 and re-establish a combined measure of the total volume of hits to the antitrust pages of the FTC's Web site,

## Ongoing and Future Challenges

### Consumer Protection Mission

One of the greatest challenges the FTC faces is ensuring that consumer information is safeguarded. The FTC enforces a number of statutes and regulations that address consumer privacy. Consumers increasingly are concerned about the ways in which their personal information is used; consequently, companies that make specific privacy promises need to live up to them. Doing so will enhance the confidence that consumers have in the marketplace. The FTC is concerned with the misuse of personal information and is committed to both law enforcement and education of consumers and businesses in this area, including telemarketing, spam, financial privacy, and identity theft.

Recent amendments to the Telemarketing Sales Rule (TSR) include initiatives designed to afford consumers greater privacy protections. Most significantly, the National Do Not Call Registry enables consumers to protect themselves from unwanted and often intrusive telemarketing calls. A national survey shows that registered consumers are receiving significantly fewer telemarketing calls and those who are registered can file a complaint when a covered telemarketer calls. Although compliance with the Do Not Call Registry currently is high, the FTC is pursuing investigations and taking enforcement action against violators when warranted.

In December 2003, Congress enacted two measures that impose new responsibilities on the FTC. The Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN-SPAM Act) addresses a wide range of practices relating to spam. The Fair and Accurate Credit Transactions Act of 2003 (FACT Act) makes sweeping changes and additions to the Fair Credit Reporting Act to enhance accuracy and consumer access to credit information.

The FTC's future efforts will include significant activity under these Acts to combat spam, protect consumers' privacy, and stop deceptive debt counseling. In the spam arena, the agency works to protect consumers from fraudulent spam and to reduce the impact of deceptive spam by bringing law enforcement actions to stop deceptive or unfair spam practices. The FTC's work on the policy side will continue – conducting rulemakings and studies under the CAN-SPAM Act. The FTC also will continue its rulemaking and policy efforts under the FACT Act and its enforcement efforts to stop deceptive subprime lending practices, improper usage of pre-acquired account information, deceptive debt counseling, and other misuse of personal information, and to ensure that consumers have access to their credit information to confirm its accuracy.

Ongoing globalization and new information technologies create potentially enormous benefits for consumers, but can also raise new consumer protection concerns. Examples include opportunities for online fraud, cross-border fraud, loss of privacy, and identity theft.

Attacking telemarketing and business opportunity fraud and deceptive and abusive lending practices continues to be a challenge and a priority, as does protecting consumers from more traditional scams that have found new life on the Internet, including pyramid schemes and health-related fraud. The Internet has become an especially fertile ground for scam artists who can reach vulnerable consumers easily and cheaply online and immediately access both a national and an international marketplace.

Given the rise in cross-border fraud complaints that has occurred over the last several years, the FTC will continue to bring cases with international components. During FY 2004, the FTC submitted recommendations to Congress to give the FTC additional tools to fight cross-border fraud. Legislation implementing these recommendations has been introduced in Congress as the International Consumer Protection Act and, if enacted, will boost the agency's ability to pursue these important cases.

The agency will continue to target its efforts based on the analysis of consumer complaint data that it gathers. FTC databases – *Consumer Sentinel*, Identity Theft Data Clearinghouse, Consumer Information System, and spam database – enable the agency and its law enforcement partners to detect fraudulent trends and problems as they occur. The FTC's prospective challenges include maintaining a rich array of data, ensuring that its systems are fully used by the agency and its law enforcement partners, and ensuring that the information it collects is reliable. The FTC also continually strives to identify new methods of mining the data and sharing the results in innovative ways to assist its law enforcement partners. These efforts bear fruit in the cases brought by the FTC and other law enforcement agencies who have access to this data.

In addition to targeting the most serious problems for law enforcement action, the FTC also encourages non-regulatory solutions, such as education and voluntary compliance, that are effective but do not impede legitimate business activity. One particular area of focus in the next several years will be fraud, deception, and unfair business practices affecting Hispanic consumers and other minorities.

### **Maintaining Competition Mission**

An important part of the FTC's antitrust agenda includes efforts to identify and investigate the misuse of government processes. These types of anticompetitive practices, such as the improper use of the Food and Drug Administration's regulatory process to delay entry of generic drugs, can exclude new competitors with little cost or risk to established firms, and therefore pose a very significant danger to consumers. The FTC also will continue to focus on the misuse of government processes involving intellectual property rights, such as when a firm improperly obtains intellectual property rights or litigates to enforce them in bad faith.

Transparency in FTC decision-making serves the agency's objectives. Public understanding of the types of transactions or conduct the FTC is likely to challenge and the reasons for agency action informs businesses, facilitates antitrust lawyers' counseling of their clients, and prevents harmful mergers or anticompetitive practices without need for government intervention. The FTC will continue to expand public awareness and understanding of its

actions by seeking to make its published documents about enforcement actions clear and understandable, explaining why it declined to take action in particular matters, and releasing general policy statements outlining the conditions under which it will apply its different powers.

The FTC also will continue to make full use of its uniquely broad array of policy instruments to provide intellectual leadership on competition issues. A key part of its responsibilities is to ensure that the agency remains at the leading edge of knowledge of both economic theory and real-world developments in the economy. The agency does so in a variety of ways, including sponsorship of public workshops, conferences, and hearings, and conducting its own research.

Antitrust enforcement no longer stops at U.S. shorelines. Today, more than 65 governments enforce various sets of competition laws, and that number is growing. Because of the continuing growth of commerce beyond national boundaries, these different antitrust enforcement authorities increasingly overlap and intersect. Inconsistencies and diverse requirements increase the costs faced by firms seeking to combine assets or businesses, establish distribution channels, or pursue other business arrangements. This includes both the cost of complying with different regulatory mechanisms and the risk of differing outcomes. Thus, the current growth and diversity in antitrust enforcement mechanisms can interfere with the common goal of promoting a competitive economy. The FTC will continue to work with various international groups to increase the procedural and substantive convergence of merger oversight authorities throughout the world. The FTC also will broaden and deepen its cooperation with international agencies on individual cases and antitrust policy issues.

## Significant Program Events

In FY 2004, the FTC focused on a variety of significant consumer protection and competition issues. These issues included consumer privacy, deceptive or anticompetitive practices affecting consumers' health, and proposed changes to governmental procedures. These accomplishments helped ensure that business and consumers alike reaped the full benefits of market competition and product innovation. (Hyperlink to related material.)

- **Do Not Call – Stopping Unwanted Telemarketing Calls.**

The National Do Not Call Registry has helped make dinnertime interruptions by telemarketers a thing of the past. Consumers registered 64 million phone numbers as of September 2004. A recent survey showed that 87 percent of registered consumers reported that they received fewer telemarketing calls. The study estimated that the decrease for each registered consumer was 24 calls per month.



[www.ftc.gov/bcp/online/edcams/donotcall/index.html](http://www.ftc.gov/bcp/online/edcams/donotcall/index.html)

- **Identity Theft – Fair and Accurate Credit Transactions (FACT) Act.** Identity theft adversely impacted 27.3 million consumers in the last five years, and is the top consumer complaint received by the FTC. The FACT Act, enacted in December 2003, provides the FTC important tools to help prevent identity theft and assist victims, and to enhance the accuracy of credit information and consumer access to such information. Within six months of the Act's signing by the President, the FTC issued a rule requiring that the three nationwide consumer reporting agencies



provide consumers, upon request, a free copy of their credit report once every 12 months. The FTC currently is working on a number of other rules, including a rule to allow military personnel to place an alert on their credit reports to help protect themselves from identity theft while they are deployed

[www.consumer.goheft/](http://www.consumer.goheft/)

- **Spam – CAN-SPAM Act.** Experts have estimated that unsolicited commercial email (spam) costs U.S. businesses between \$10 billion and \$87 billion annually. Additionally, consumers spend countless hours each year dealing with spam. The CAN-SPAM Act, also enacted in December 2003, provides the FTC with new tools to address this issue. In its first cases under CAN-SPAM, the FTC sued two spammers whose activities generated nearly one million consumer complaints to the FTC. The defendants were charged with clogging the Internet with millions of deceptive messages. Also, as directed by the Act, the FTC released a report to Congress on the feasibility of a Do Not Email Registry ("National Do Not Email Registry: A Report to Congress".) Domestically, the FTC continued to work with its federal, state, and local law enforcement partners on the Spam Task Force.



[www.ftc.gov/bcp/online/edcams/spam/index.html](http://www.ftc.gov/bcp/online/edcams/spam/index.html)



- **International Issues.** In 2004, the FTC and its international law enforcement partners identified tens of thousands of owners or operators of potentially open or vulnerable servers around the world and sent letters urging them to protect themselves from becoming unwitting sources of spam. In addition, through recommendations introduced in Congress as the International Consumer Protection Act, the FTC is working to obtain additional legislative authority to combat cross-border fraud. And, separately, the FTC is working with private competition entities worldwide to address and minimize policy divergences to ease regulatory burdens on firms that operate on a global basis.
- **Increased Administrative Litigation.** Throughout FY 2004, the FTC had up to a dozen antitrust cases pending at some stage of administrative litigation, more than at any time in the past two decades. The cases involved a variety of consumer issues including physician and dental services, pharmaceuticals, hospital services, transportation of household goods, computer software and hardware, and gasoline. Besides bringing consumers the benefits of increased competition in these markets, those cases that are fully litigated also provide opportunities for the FTC and the courts to provide detailed analysis and guidance on key policy questions for businesses and the bar. In addition, three consumer protection cases were also in administrative litigation during FY 2004.
- **Healthy Competition Equals Healthy Consumers.** In July 2004, the FTC and Department of Justice (DOJ) released a joint report (“Improving Health Care: A Dose of Competition”) to provide guideposts for policymakers who want to ensure access to quality care and help consumers make informed choices. Also, in FY 2004, the FTC required two pharmaceutical firms to disgorge \$6.25 million in illegal overcharges for children’s pain medication, took enforcement actions against several groups of physicians for allegedly fixing prices for their services, issued an adjudicative decision and opinion explaining how a patent settlement between two pharmaceutical manufacturers raised the price of blood pressure medication, and began administrative litigation challenging a consummated hospital merger.  
[www.ftc.gov/reports/healthcare/040723healthcarerpt.pdf](http://www.ftc.gov/reports/healthcare/040723healthcarerpt.pdf)
- **Attacking Deceptive Health Claims.** The FTC increased its attacks on deceptive health claims by bringing 23 enforcement actions involving dietary supplements and other products that were deceptively marketed for their ability to treat or cure a wide variety of health conditions. The FTC also encouraged the media to help in the fight against deceptive weight-loss advertisements by publishing a guide showing them how to identify and screen out bogus weight-loss claims.



[www.ftc.gov/bcp/online/edcams/redflag/index.html](http://www.ftc.gov/bcp/online/edcams/redflag/index.html)

- **Preventing Predatory Lending and Deceptive Debt Counseling.** The FTC published a consumer education brochure on predatory lending and brought several cases against deceptive credit counseling, debt collection, and other financial services companies. In one of these cases, one of the nation's largest debt-collection firms agreed to pay a \$1.5 million civil penalty to settle charges it violated the Fair Credit Reporting Act (FCRA) by reporting inaccurate information about consumer accounts to credit bureaus. This is the largest FCRA civil penalty ordered to date. In a case against a company that services home loans to high-risk borrowers, the FTC and the Department of Housing and Urban Development obtained three settlements requiring that a total of over \$40 million be returned to consumers.

[www.ftc.gov/bcp/online/edcams/credit/index.html](http://www.ftc.gov/bcp/online/edcams/credit/index.html)



- **Looking at the Impact of New Technology on Consumers.** The FTC hosted two workshops to explore and discuss the impacts of new technology on consumers. One workshop explored the uses, efficiencies, and implications for consumers associated with radio frequency identification (RFID) technology. A second workshop on spyware, adware, and other software explored issues associated with software that is loaded on personal computers without users' consent that gathers and sends information about users to third parties or adversely affects the computers' functioning.
- **Promoting Innovation.** The proper harmonization of competition policy and the patent system can benefit consumers by fostering the invention and development of new goods, services, and processes. To help achieve this goal, the FTC and DOJ held extensive public hearings that resulted in the release of an FTC report, "To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy," that offers ten recommendations for reducing the number of questionable patents, which can harm innovation. Also, to address intellectual property issues, the FTC is conducting administrative litigation in two matters involving allegedly anticompetitive behavior regarding patents and the standards-setting process.  
[www.ftc.gov/os/2003/10/innovationrpt.pdf](http://www.ftc.gov/os/2003/10/innovationrpt.pdf)
- **Competition Advocacy.** The FTC advises state and federal entities, as well as the courts, regarding the potential competitive impact of pending governmental actions. In FY 2004, the FTC issued a staff report on the Internet sales of contact lenses, "Possible Anticompetitive Barriers to E-Commerce: Contact Lenses," which advocated procompetitive prescription release and verification procedures and opposed restrictive private labeling practices. FTC staff opposed unauthorized practice of law rules that would prohibit the participation of laypersons in real estate closings in West Virginia and in workers compensation proceedings in Ohio. Staff also commented on gasoline sales-below-cost laws that would deter procompetitive price cutting in Alabama, Kansas, and Michigan.  
[www.ftc.gov/os/2004/03/040329clreportfinal.pdf](http://www.ftc.gov/os/2004/03/040329clreportfinal.pdf)

- **Promoting Competition in the Petroleum Industry.** In FY 2004, the FTC released the landmark staff report “The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement,” which represents a careful study of the structural changes and FTC involvement in the petroleum industry over the last 20 years. The report concluded that thorough FTC merger investigations and enforcement have helped to avoid potentially anticompetitive problems and higher gasoline prices for consumers. In addition, the Commission overturned an Administrative Law Judge’s decision to dismiss antitrust charges brought against Union Oil of California for allegedly defrauding the California Air Resources Board in connection with regulatory proceedings regarding the development of reformulated gasoline.



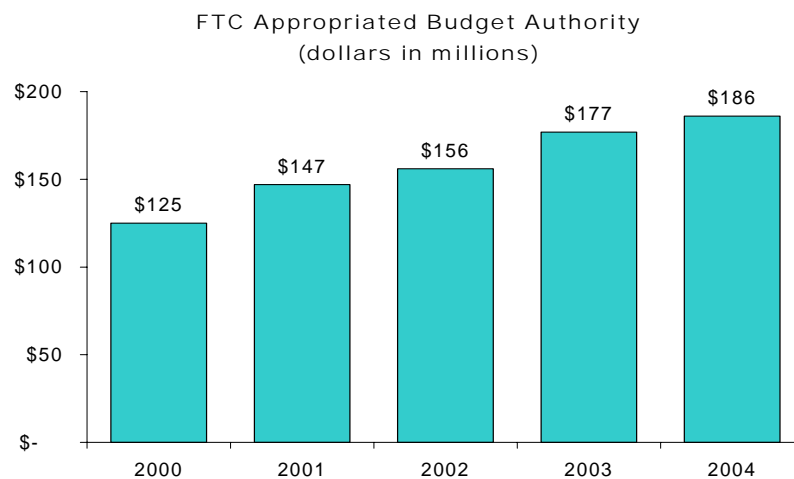
[www.ftc.gov/ftc/oilgas/index.html](http://www.ftc.gov/ftc/oilgas/index.html)

## Financial Performance Overview

As of September 30, 2004, the financial condition of the FTC was sound. The agency had sufficient funds to meet program needs and adequate financial controls in place to ensure obligations did not exceed available budget authority. The FTC prepared financial statements in accordance with the accounting standards codified in the Statements of Federal Financial Accounting Standards and Office of Management and Budget Bulletin No. 01-09, *Form and Content of Agency Financial Statements*.

### Sources of Funds

The FTC has an annual appropriation for Salaries and Expenses, and its appropriated funds are available until expended. The FTC's appropriated budget authority in FY 2004 was \$186 million. This amount represents an overall appropriation increase of \$9 million over FY 2003. In addition, the FTC received \$2 million for Reimbursable Activity, and carried over \$9 million in no-year funds from last fiscal year. The FTC's total amount of FY 2004 budgetary resources was \$197 million.



The FTC's budgetary resources are offset by the collection of fees from two sources. The Hart-Scott-Rodino (HSR) Antitrust Improvements Act, P. L. 101-162, requires parties to mergers valued over a specified threshold amount to submit premerger review filings, and to pay an appropriate filing fee, to the FTC. The FTC and the Antitrust Division, Department of Justice, equally share each dollar collected. Separately, the Do Not Call Implementation Act, P. L. 108-10, requires certain telemarketers to pay a fee to access telephone numbers in the National Do Not Call Registry from consumers who no longer wish to receive telemarketer calls. In FY 2004, the FTC's share of collected fees was \$84 million from HSR Premerger filing fees and \$14 million from Do Not Call registry fees. The total FY 2004 amount of the FTC's share of offsetting fees was \$98 million.

## Cost of Strategic Goals

In FY 2004, the gross cost of the Consumer Protection Mission, which relates to the Protect Consumers strategic goal, was \$104 million, and the gross cost of the Maintaining Competition Mission, which relates to the Maintain Competition strategic goal, was \$82 million. The FTC's total net cost of operations, i.e., gross cost less offsets, was \$88 million. These amounts are shown in the Statement of Net Cost, which can be found in Part III, *Audited Financial Statements*, of this report.

## Audit Results

The FTC received an unqualified audit opinion on FY 2004 financial operations. No material internal control weaknesses nor instances of substantial noncompliance with the Federal Financial Management Improvement Act were found. This was the eighth consecutive year the FTC received an unqualified opinion.

## Financial Statements

The FTC's financial statements summarize the financial activity and financial position of the agency in FY 2004. The financial statements, notes, and the balance of the required supplementary information appear in Part III, *Audited Financial Statements*.

## Systems and Control

The FTC maintains a system of internal controls to provide reasonable assurance that its assets are protected from fraud and abuse, transactions are properly executed and recorded, and operations are conducted in accordance with established policies and procedures. The FTC's accounting system conforms in all material respects with the principles, standards, and related requirements specified in the Federal Financial Management Improvement Act of 1996.

The FTC's accounting, personnel, payroll, and accounts payable processing is performed under contract by the Department of the Interior's National Business Center in Denver, Colorado. FTC has controls in place to ensure the integrity of both payment and payroll processing.

## Part II: Program Performance

### **Goal 1: Protect Consumers Prevent Fraud, Deception, and Unfair Business Practices in the Marketplace**

Congress has charged the FTC with the broadest legislative mandate of any federal consumer protection agency. While most federal consumer protection agencies have jurisdiction over a specific market sector, the FTC possesses broad law enforcement authority that encompasses most segments of the economy, including business and consumer transactions on the Internet. As the nation's leading consumer protection agency, its goal is to protect consumers by preventing fraud, deception, and unfair business practices in the marketplace. It applies three related objectives to achieve this broad-reaching goal:

- **Identify fraud, deception, and unfair practices that cause the greatest consumer injury.**
- **Stop fraud, deception, and unfair practices through law enforcement.**
- **Prevent consumer injury through education.**

First, the FTC identifies practices that cause consumer injury by analyzing the consumer complaint data collected in its Consumer Information System database, holding public discussions, and monitoring the marketplace, including the Internet. Next, the FTC uses this information to target law enforcement efforts. Its law enforcement program aims to stop and deter fraud and deception, protect consumers' privacy, and increase compliance with its consumer protection statutes to ensure that consumers have accurate information for purchasing decisions. Finally, the FTC targets its education efforts to give consumers the information they need to protect themselves from injury and to explain to businesses how to comply with applicable laws.

A priority of the FTC is to ensure that consumer information is safeguarded in the electronic marketplace so consumers will enjoy the same confidence in these commercial transactions that they enjoy in the traditional marketplace. Online commerce has the potential to deliver goods and services, often more conveniently, faster, and at lower prices than traditional brick-and-mortar operations. Online commerce promises significant benefits to consumers and the economy. The Internet also is stimulating the development of

innovative products and services that were barely conceivable just a few years ago and is enabling consumers to tap into rich sources of information that they can use to make better informed purchasing decisions.

There is real risk, however, that these benefits may not be realized if consumers associate the Internet with fraudulent operators. The boom in e-commerce has opened up fertile ground for fraud. In the FTC's experience, fraudulent operators are always among the first to appreciate the potential of a new technology and then use that potential to exploit and deceive consumers. Of particular concern is that Internet health fraud continues to plague consumers looking for solutions to serious illnesses. Traditional scams, such as pyramid schemes, also have found new life on the Internet. The FTC is using all the tools at its disposal – such as its consumer complaint database – to help target areas of consumer problems and is fashioning law enforcement and educational efforts to respond quickly and vigorously to these concerns.

Privacy of personal information is important, and companies that make specific promises to consumers about privacy must honor those promises. Companies that honor their promises add to consumer confidence in the marketplace. The FTC is concerned with the misuse of personal information and is fully committed to both enforcement and education in this area.

The FTC's comprehensive, multi-year review of the Telemarketing Sales Rule (TSR) revealed widespread consumer frustration over unwanted telephone solicitations, which some see as a violation of privacy in their home. To address this concern, in December 2002, the FTC amended the Rule to establish the National Do Not Call Registry. The Registry was launched in June 2003 and is being enforced. Covered telemarketers are prohibited from calling consumers who place their telephone numbers in the Registry. By the end of fiscal year 2004, more than 64 million telephone numbers had been registered. The 2004 Service to America Medal, recognizing inspiring achievements in public service, was awarded to the FTC Do Not Call Team.

The FTC also works on policy and enforcement efforts related to spam (unsolicited commercial e-mail). The FTC has brought more than 60 cases to date challenging deceptive spam. In addition, the CAN-SPAM Act, signed into law in December 2003, addresses a wide range of practices relating to spam. The CAN-SPAM Act prohibits falsifying either the content or the source of e-mail; prohibits abusive means of obtaining e-mail addresses to send a high volume of unwanted messages; requires that commercial e-mail be so identified; requires senders of commercial e-mail to allow recipients to "opt out" of future e-mail messages; and requires a warning label for e-mail with sexually oriented material. The FTC's rule requiring the warning label became effective on May 19, 2004. The CAN-SPAM Act directs the FTC to report to Congress on the feasibility of a Do Not Spam Registry. This report was presented to Congress in June 2004. In September 2004, the FTC released a report to Congress assessing whether and how a system that rewards members of the public for tracking down spammers would or could help improve enforcement of the CAN-SPAM Act. FTC staff continue to work on CAN-SPAM enforcement, rulemaking, and studies.

In the consumer credit arena, the FACT Act, also signed into law in December 2003, made sweeping changes and additions to the Fair Credit Reporting Act. Notably, the FACT Act makes existing preemption provisions permanent and adds several provisions to combat identity theft and enhance accuracy and consumer access to credit information. The FACT Act requires the FTC, among other things, to engage in a number of rulemakings.

For most consumers, access to credit is essential to full participation in the nation's economy. Some unscrupulous lenders, however, deceive consumers about loan terms, rates, or fees. Bogus organizations target consumers with bad credit or significant consumer debt, promising to help them manage their debt or obtain credit otherwise unavailable to them. Consumers may pay hundreds of dollars for these services, only to receive nothing in return, or worse, to see their credit damaged even further. The FTC's enforcement actions target these deceptive lending schemes, especially in the subprime mortgage market, and those that involve deceptive credit counseling services.

### **Objective 1.1: Identify Fraud, Deception, and Unfair Practices That Cause Consumer Injury**

The first step in preventing fraud, deception, and unfair business practices in the marketplace is to identify the practices that cause the greatest consumer injury.

#### **Strategies**

To identify consumer protection problems, the FTC collects and analyzes data from many sources. Its Consumer Response Center receives consumer complaints and inquiries via a toll-free number (1-877-FTC-HELP), mail, and the Internet. Partners such as the National Fraud Information Center of the National Consumers League, the Internet Fraud Complaint Center (a partnership between the FBI and the National White Collar Crime Center), Better Business Bureaus, and PhoneBusters (the Canadian fraud database), also share the consumer complaint data they collect with the FTC.

All of this information is entered into the Consumer Information System database and then analyzed by FTC staff to identify trends and target fraudulent, deceptive, and unfair business practices. The agency shares the fraud complaints that it collects with more than 1,150 other law enforcement agencies across the United States, Canada, and Australia via an encrypted Web site called *Consumer Sentinel*. Although the FTC is not empowered to act on behalf of individual consumers, consumer complaint data obtained through *Consumer Sentinel* enables the FTC and its law enforcement partners to coordinate their enforcement efforts, and to spot trends and target the most serious consumer problems. Summary and trend data are shared on the public *Consumer Sentinel* site (<http://www.consumer.gov/sentinel>). The constant input and analysis of fresh complaint data have allowed the FTC to move quickly to stop illegal practices before they cause more harm to consumers.

Consumers can call the FTC's second toll-free number, 1-877-ID-THEFT, or view its Web site to obtain information about and report identity theft (<http://www.consumer.gov/idtheft>).



When they call the FTC or visit its Web site, consumers also can receive guidance on the steps they can take to resolve credit and other problems that may have resulted from identity theft. In FY 2004, the agency received 314,000 identity theft complaints and inquiries. The FTC uses this data to spot patterns that can help criminal law enforcement agencies prosecute identity theft and help businesses avoid the financial consequences of this crime. Criminal cases are identified by the joint FTC and U.S. Secret Service Case Referral Program, and strong leads are referred to regional task forces, many led by the Secret Service Financial Crimes Division.

The FTC also monitors advertising and marketing directed to youth, including violent entertainment products, online gambling, pornography, and alcohol.

Finally, the FTC also hosts workshops and conferences at which interested parties discuss practices that cause consumer injury, articulating concerns and identifying relevant

strategies to combat these problems. These workshops enable the FTC to hear a variety of views on timely topics and help all parties understand the ramifications of these issues. During FY 2004, the FTC hosted six workshops – on marketing of entertainment violence to children, weight-loss advertising guidelines, Hispanic outreach and law enforcement, spyware, Radio Frequency Identification (RFID) services, and protecting consumers in class actions.

**Performance Measure 1.1.1**

Annual number of consumer complaints and inquiries entered into database.

FY 2001 Actual: 430,000

FY 2002 Actual: 680,000

FY 2003 Actual: 944,000

**FY 2004 Target: 700,000**

**FY 2004 Actual: 994,000**

**Performance Measure 1.1.2**

Annual number of consumer complaints and inquiries related to identity theft entered into database.

FY 2003 Actual: 321,000

**FY 2004 Target: 250,000**

**FY 2004 Actual: 314,000**

**Performance Measures and Results**

To assess its effectiveness in identifying fraudulent and deceptive practices, the FTC measured the number of consumer complaints and inquiries added to its Consumer Information System database. Additional consumer data enables the agency to more effectively spot trends, identify emerging scams, and coordinate activities with other law enforcers. In FY 2004, the FTC added 994,000 entries into its database, exceeding its target of 700,000. Included in these 994,000 entries were 314,000 consumer complaints and inquiries related to identity theft,

exceeding the target of 250,000. These results reflect the increasing interest of organizations in contributing complaint data and consumers' growing awareness of the FTC's online complaint form and toll-free telephone numbers. They give the FTC a broader view of what reporting consumers are experiencing. The database allows the FTC and its law enforcement partners to identify and develop cases against fraudulent and deceptive operators that cause the greatest consumer injury. By analyzing consumer complaints, the FTC can identify and ultimately refine its enforcement and education efforts to target the

most serious consumer problems, including deceptive subprime lending, deceptive debt counseling, identity theft, Internet auctions, advance fee loan scams, fraudulent business opportunities or work-at-home plans, deceptive health or weight-loss advertisements, and magazine buyers clubs.

### **Performance Assessment and Future Trends**

Not only does the FTC's database help identify the most serious consumer protection problems, it quickly informs the agency of emerging scams so that the agency can move rapidly to stop consumer injury. In addition, by collecting data from consumers and other sources and sharing it with other law enforcers, the FTC is able to coordinate and augment the effectiveness of law enforcement agencies across the country and in Canada and Australia. To make the database even more valuable, the FTC continues to pursue new international partnerships to increase its collection of information from consumer agencies in other countries. For example, through the [econsumer.gov](http://econsumer.gov) Web site, the agency partners with other members of the International Consumer Protection Enforcement Network, an international group that identifies and shares information about worldwide consumer protection issues. Through [econsumer.gov](http://econsumer.gov), consumers in the 17 participating countries can file complaints using an online form and obtain consumer education materials. Law enforcement members can access a nonpublic site to obtain specific information about the complaints that consumers have filed.

The FTC will continue to expand its complaint database and increase its use by recruiting and training additional law enforcement partners. It also will make better use of its rich store of data by identifying repeat offenders and sharing this information with other law enforcers. In addition, the FTC will increase its capacity to analyze data quickly in order to identify and respond to frauds, deception, and identity theft in their early stages and help prevent consumer injury. The data will be used to provide more information to the public – by giving consumers information to protect themselves from scams, deceptive practices, and identity theft, and informing public policy discussions about consumer protection issues in the marketplace. The FTC also will continue to collect data on consumers' experiences and general inquiries and upgrade its system to track and analyze privacy-related complaints more effectively.

In addition, in September 2003, the FTC released the results of a survey showing that 27.3 million Americans have been victims of identity theft in the last five years, and that identity theft losses to businesses, financial institutions, and consumer victims total in the billions of dollars. In August 2004, FTC staff released a statistical survey of fraud in the United States that shows that nearly 25 million adults – or 11.2 percent of the adult population – were victims of fraud (not including identity theft) during the year studied (2002-2003). It showed that certain racial and ethnic minorities were much more likely to be victims of fraud than non-Hispanic whites. The group “American Indians and Alaska Natives” was the ethnic group most likely to be victims – nearly 34 percent had experienced one or more frauds in the preceding year. (Although the number of survey participants who described themselves as American Indians and Alaska Natives was small, the difference between that group and non-Hispanic whites was statistically significant.)

The FTC will evaluate how to use the results of these consumer fraud and identity theft surveys to assess and improve performance. Appropriately crafted follow-up surveys may be conducted.

### **Objective 1.2: Stop Fraud, Deception, and Unfair Practices Through Law Enforcement**

Once fraud, deception, and unfair business practices are identified in the marketplace, the FTC focuses its law enforcement efforts on areas where it can have the greatest impact for consumers.

#### **Strategies**

The FTC plays a vital role in protecting consumers' privacy, emphasizing both enforcement and education. It focuses on telemarketing, spam, identity theft, and financial privacy, as well as enforcement of the CAN-SPAM Act, FACT Act, Gramm-Leach-Bliley Act and the Safeguards Rule, the TSR as amended in December 2002, and Section 5 of the FTC Act.

Telemarketing fraud also continues to be a significant law enforcement priority. The FTC will continue to pursue telemarketing cases and enforce the National Do Not Call Registry. Other priorities include protecting consumers from more traditional scams and deceptive practices that have moved to the Internet.

One of the most effective tools in the battle against fraud and deception has been the law enforcement sweep – simultaneous law enforcement actions by federal, state, and/or local partners against numerous defendants nationwide that focus on a particular, widespread type of fraud and deception. Each sweep is supported by consumer education aimed at preventing future losses to the public. Since its first sweep in 1995, the FTC and its partners have brought more than 2,250 law enforcement actions in 80 sweeps against fraudulent and deceptive operators. This total includes 532 actions brought by the FTC alone. Thus, for every action that the FTC brings, its partners bring an average of three. In FY 2004, the FTC led 2 sweeps resulting in a total of 39 actions, including 10 FTC actions. In addition to leveraging agency resources, sweeps generate substantial local, regional, and international interest, thus further raising consumer awareness.

The FTC continues to make progress in addressing the globalization of fraud. In the past two years, the agency has brought more than 50 cases with international components and investigated many more. During this past year, the FTC developed legislative recommendations to give the FTC additional tools to fight cross-border fraud, which have been introduced in Congress as the International Consumer Protection Act. The agency also expanded its international partnerships – including a bilateral consumer protection cooperation agreement with the regulator in Ireland and a trilateral agreement with the U.K. and Australia to cooperate in combating fraudulent spam. The FTC also is raising international awareness about the need for technological solutions to address the proliferation of spam by participating in an Organization for Economic Coordination and

Development workshop on spam and announcing “Secure Your Server,” an international initiative with 39 agencies from 27 countries to reduce the flow of unsolicited commercial e-mail by urging organizations to close “open relay” and “open proxy” servers. As part of the initiative, the participating agencies identified tens of thousands of owners or operators of potentially open relay or open proxy servers around the world and sent letters urging them to protect themselves from becoming unwitting sources of spam.

In the nonfraud area, the FTC works to ensure compliance with the consumer protection statutes that it enforces. Given its broad jurisdiction and limited resources, it focuses on the most serious identified problems, using varied enforcement tools and encouraging self-regulation in appropriate situations. Information obtained from its Consumer Information System database and from monitoring national advertising enables the agency to focus its law enforcement actions on areas that pose the greatest risks to consumer health, safety, and economic well-being. The FTC also works with industry and interested groups to support private initiatives where appropriate.

### **Performance Measures and Results**

The agency’s FY 2004 target was to save consumers more than \$400 million by stopping fraudulent practices in the marketplace. In FY 2004, the FTC saved consumers an estimated \$348.8 million, which represents 87 percent of the annual target. Because the amount of savings varies year-to-year, in its 2003 - 2008 Strategic Plan the FTC also set a target of saving consumers at least \$2 billion by FY 2008. Having exceeded its annual target in FY 2003 and having achieved 87 percent in FY 2004, the agency is on track to meet its \$2 billion target. Consumer savings are measured by estimating the annual fraudulent and deceptive sales made by defendants in the 12 months prior to the FTC’s filing a complaint.

The savings calculation actually may underestimate the FTC’s impact because it assumes that the fraud and deception would have continued for only one additional year. However, it provides a uniform method for calculating savings and minimizes speculation about the

#### **Performance Measure 1.2.1**

Dollar savings for consumers from FTC actions that stop fraud and deception.

FY 2001 Actual: \$487 million

FY 2002 Actual: \$561 million

FY 2003 Actual: \$606 million

**FY 2004 Target: \$400 million**

**FY 2004 Actual: \$349 million**

#### **Performance Measure 1.2.3**

Number of data searches conducted by FTC and law enforcement personnel of the FTC’s *Consumer Sentinel* database.

FY 2003 Actual: 27,685

**FY 2004 Target: 24,000**

**FY 2004 Actual: 87,000**

#### **Performance Measure 1.2.4**

Number of data searches by law enforcement personnel of the FTC’s identity theft database.

FY 2003 Actual: 2,167

**FY 2004 Target: 1,700**

**FY 2004 Actual: 2,120**

likely duration of the fraud and deception. The law enforcement actions included in this measure were taken against individuals or companies, as well as scam artists operating schemes on the Internet. The FTC's experience in most cases is that once it files a complaint in federal district court and obtains a court order, the defendants stop their fraudulent practices. If they fail to comply, they are subject to contempt proceedings. Thus, in stopping these frauds, the agency stops further consumer losses to these defendants. By publicizing these law enforcement actions and distributing consumer education materials, it seeks to alert consumers to fraudulent and deceptive practices, educate them to avoid such practices in the future, and ultimately increase consumer confidence in the marketplace, while deterring similar behavior by would-be violators.

In FY 2004, over 87,000 data searches of *Consumer Sentinel* complaints were conducted by the FTC and other law enforcement personnel, far exceeding the target of 24,000. However, *Consumer Sentinel* made several major changes and improvements in late September 2003, and *Consumer Sentinel* staff project that almost half of the FTC and external law enforcement personnel usage may be related to the testing of these changes. The actual number of identity theft searches by law enforcement personnel in FY 2004 is 2,120, or 125 percent of the target of 1,700.

The FTC, along with the Secret Service and Department of Justice, initiated a training program in March 2002 to provide local and state law enforcement officers with practical tools to enhance combined efforts to combat identity theft, including information about accessing *Consumer Sentinel* data. Through FY 2004, the FTC and its partners, which now include the U.S. Postal Inspection Service and the American Association of Motor Vehicle Administrators, held 14 seminars and trained more than 1,800 law enforcement officers from more than 680 agencies.

### **Performance Assessment and Future Trends**

Based on *Consumer Sentinel* data, Internet fraud is significant and continues growing. The FTC is targeting the most pervasive online fraud and moving quickly to stop large, fast-growing Internet scams. From 1994 to present, the total number of cases involving fraudulent or deceptive marketing practices related to the Internet filed by the FTC has grown to more than 340. This figure includes more than 60 spam-related cases, most of which have been brought during the past two years. The FTC expects fraud to continue to grow as the use of the Internet rises and spam increases and, in response, it will increase its efforts to slow online fraud and prevent consumer injury. In particular, online fraud has the potential to reach consumers worldwide and cause great economic injury. As its technological expertise continues to develop, the agency will be better able to detect and deter online fraud before these schemes take hold. This effort, combined with strategies such as law enforcement sweeps, demonstrates the FTC's effectiveness in preventing consumer injury.

The FTC also continues to target deceptive and fraudulent advertising and other practices aimed at Hispanic consumers. The FTC will target frauds on the basis of *Consumer*

*Sentinel* and other data that identify the top problems for Hispanic consumers, the products and services aimed at the Hispanic community that are extensively advertised, particularly in major media, and the practices causing significant economic or other harm to this community. In FY 2004, the FTC hosted a workshop to further explore strategies for effective and high-impact education and law enforcement to protect the Hispanic community from fraud. The workshop offered an opportunity to discuss the nature and extent of consumer fraud against Hispanics, law enforcement programs targeting these frauds, and best practices for reaching the Spanish-speaking community with fraud prevention messages.

The FTC also will build on its coordination with criminal law enforcers. In FY 2004, the FTC created a dedicated section within the Bureau of Consumer Protection – the Criminal Liaison Unit – to coordinate with the FTC’s criminal law enforcement partners (principally, the Department of Justice and United States Attorneys’ Offices) and to spur an increase in consumer fraud prosecutions. These goals will be accomplished by identifying interested prosecutors and case agents, educating criminal authorities regarding the FTC’s mission and areas of expertise, and coordinating training to better prepare cases for criminal prosecution. By developing contacts with criminal prosecutors in a more systematic manner, the agency hopes to increase the number of criminal prosecutions of consumer fraud, including conduct that FTC staff have discovered, investigated, or prosecuted civilly.

The FTC also will continue its outreach to consumers and industry, and its collaboration with other law enforcement agencies, as it monitors deceptive debt counseling and subprime lending practices.

In addition to fighting fraud, the FTC also focuses on compliance through traditional advertising laws and the FTC’s Rules and Guides. It works cooperatively with its law enforcement partners, industry, and consumer groups to increase compliance. The scope of the agency’s current and upcoming priorities spans its broad jurisdiction, and this broad jurisdiction makes it difficult to measure the overall impact of its nonfraud activities. The FTC is exploring using new performance measures that focus its impact in more narrowly defined areas. Nonetheless, it will continue to use business and consumer education, as well as selective enforcement, to ensure broad compliance with the rules and regulations it enforces.

With respect to identity theft, although Congress established the FTC as the central clearinghouse for identity theft complaints, the FTC – a civil law enforcement agency – has no criminal authority to prosecute identity theft crimes. The information contained in its database, however, directly supports such criminal prosecutions. The agency has learned from experience that hands-on information and training provided to its customer law enforcement agencies greatly enhances their abilities to mine the information in the complaint database and ultimately prosecute identity theft crimes more successfully. Consequently, the FTC and its partners have provided identity theft training for local, state, and federal criminal enforcement groups.

### **Objective 1.3: Prevent Consumer Injury Through Education**

Consumer and business education is a first line of defense against fraud and deception.

#### **Strategies**

The FTC is committed to using education and outreach as cost-effective methods of preventing consumer injury, increasing business compliance, and adding an extra dimension to its law enforcement program. Virtually every consumer protection effort contains an educational component, from compliance surfs and law enforcement sweeps to the announcement of new rules and regulations. Through reports, publications, Web sites, media events, speeches, advocacies, and collaborative activities with other organizations, the FTC reaches tens of millions of consumers and businesses every year. In FY 2004, the agency issued 77 new or revised publications – covering traditional subjects such as weight-loss claims and credit issues; high-tech subjects such as online shopping, Internet auctions, and spam; and timely subjects such as identity theft, telemarketing, and privacy.

The Consumer Information System database helps the FTC tailor its education efforts to topical areas where fraud, deception, unfair practices, and information gaps are causing the greatest injury. Consumers are given the tools they need to spot potentially fraudulent and other illegal promotions, and businesses are advised how they can comply with the law. As with the agency's law enforcement, more of its educational efforts now involve the Internet. The FTC not only addresses consumer issues involving the Internet, such as spam and shopping online, but it also uses the Internet as a tool to reach consumers, for example, through its Web sites, online banner public service announcements, and online distribution of informational pieces called "news consumers can use."

The FTC coordinates with hundreds of private and public partners to provide information about specific promotions, products, and services. It continues to manage the consumer.gov Web site, which is linked with the interagency firstgov.gov Web site, which offers one-stop access to federal consumer information. The FTC continues to increase the federal agency partnership base for consumer.gov, with more than 180 agencies participating. In FY 2004, the FTC took the lead for the sixth consecutive year in organizing National Consumer Protection Week. This year's campaign theme was financial literacy. Its partner organizers were the National Association of Consumer Agency Administrators, AARP, the National Consumers League, the Council of Better Business Bureaus, the Consumer Federation of America, the U.S. Postal Service, the U.S. Postal Inspection Service, the National Association of Attorneys General, and the Department of Justice.

To reach the expanding population of Hispanic consumers in the United States, the FTC has furthered its Hispanic Outreach Program. The Spanish-language page on the FTC Web site has been expanded and includes translations of more than 100 consumer publications.

## Performance Measures and Results

The FTC gauges the impact of its education efforts by tracking the number of consumer and business education publications it distributes to the public in response to consumer requests. Ideally, the agency would like to measure the extent to which its educational materials improve consumer understanding and help them get better value for their money.

### Performance Measure 1.3.1

Total number of education publications distributed to or accessed electronically by consumers.

FY 2001 Actual: 15.0 million  
FY 2002 Actual: 19.3 million  
FY 2003 Actual: 28.0 million  
**FY 2004 Target: 15.0 million**  
**FY 2004 Actual: 26.5 million**

### Performance Measure 1.3.2

Number of education publications related to identity theft distributed to or accessed electronically by consumers.

FY 2003 Actual: 3.0 million  
**FY 2004 Target: 2.5 million**  
**FY 2004 Actual: 3.7 million**

### Performance Measure 1.3.3

Number of Spanish-language education publications distributed to or accessed electronically by consumers

FY 2003 Actual: 458,000  
**FY 2004 Target: 400,000**  
**FY 2004 Actual: 737,000**

This effect would be extremely difficult to measure, but tracking the distribution of publications provides a rough idea of how many consumers believe the information will prove useful. In FY 2004, the FTC exceeded its target of 15 million publications by distributing 26.5 million publications. This includes 3.7 million publications related to identity theft, exceeding the target of 2.5 million and 737,000 Spanish-language publications, exceeding the target of 400,000. The FTC exceeded these targets in FY 2004 due to the continuing increase in Web hits, and the large number of materials related to the Do Not Call Registry.

Historically, FTC outreach projects have been lauded for their excellence and FY 2004 proved to be no exception. The FTC's Southwest Region's "Consumer College" – a series of free one-hour consumer classes for students of El Centro Community College in Dallas – was named one of three grand prize winners in the *College Planning & Management* magazine's first Community College Innovation Awards Program. The FTC's Alaska Native Art campaign was honored with an ACE award from the National Association of Consumer Agency Administrators. (This is the second award our Alaska Native Art Campaign has received.) In addition, four FTC projects – Do Not Call outreach, Getting Credit, Spam Forum materials, and Operation Phoney Philanthropy – received awards in the National Association of Government Communicators Annual Blue Pencil competition. The Do Not Call Registry and Spam Forum won two top ClickZ Marketing Excellence Awards. In addition, the Do Not Call campaign received the 2004 Service to America



Medal, recognizing inspiring achievements in public service, and an American Marketing Association award.

## **Performance Assessment and Future Trends**

The FTC seeks to alert as many consumers as possible to the telltale signs of fraud, deception, and unfair business practices, and other critical consumer protection issues. Use of the Internet to disseminate information about fraud and technology-related matters plays an integral role in the FTC's education, deterrence, and enforcement efforts, permitting the agency to reach vast numbers of consumers and businesses quickly, simply, and at low cost.

The measure of the number of publications distributed by the FTC indicates its impact in educating consumers, although it does not fully capture the millions of FTC publications that are distributed to consumers by others. While the number of print publications the FTC distributed remained relatively static, the number of publications accessed through the Internet soared as more consumers and businesses go online. In 1996, the agency distributed only 140,000 publications online. In FY 2004, nearly 20 million online publications were distributed. These numbers illustrate the Internet's coming of age as a mainstream medium and highlight its usefulness in any large-scale educational campaign. Consequently, the FTC will continue to increase its use of its Web site, [www.ftc.gov](http://www.ftc.gov), and the multi-agency Web site, [www.consumer.gov](http://www.consumer.gov), to reach consumers, businesses, law enforcement officials, and the media more efficiently and effectively.

In FY 2005, the FTC will continue to focus consumer and business education efforts on subjects identified by its consumer complaint databases where information gaps cause the greatest injury, such as financial literacy, spam, privacy, globalization, Internet scams, fraudulent schemes, and identity theft. In the privacy area, it will use an approach that has proven successful in the past by establishing an outreach program to increase consumer awareness of and business compliance with the privacy information required by the Gramm-Leach-Bliley Act, including the Safeguard Rule, and FACT Act. The FACT Act also makes the FTC a participant in the newly-created Financial Literacy and Education Commission. The FTC will continue to creatively use technology, including new interactive media, to extend the reach of consumer and business education. Also, as highlighted by its new performance measures, the agency will continue to focus outreach in the identity theft arena and its efforts to reach the nation's growing Hispanic population. The FTC will continue to work to identify and educate underserved consumer groups to help protect them from becoming victims of fraud.

## **Goal 2: Maintain Competition Prevent Anticompetitive Mergers and Other Anticompetitive Business Practices in the Marketplace**

The work of the FTC's Maintaining Competition Mission is critical to protect and strengthen the free and open markets that are the cornerstone of a vibrant economy. Aggressive competition among sellers in an open marketplace gives consumers the benefit of lower prices, higher quality products and services, maximum choice, and innovation leading to beneficial new products and services. The FTC's goal is to promote vigorous competition by using the antitrust laws to prevent anticompetitive mergers and stop business practices that diminish competition, such as agreements among competitors about prices or other aspects of competition (referred to as nonmerger enforcement). The agency applies three related objectives to achieve this broad-reaching goal:

- **Identify anticompetitive mergers and practices that cause the greatest consumer injury.**
- **Stop anticompetitive mergers and practices through law enforcement.**
- **Prevent consumer injury through education.**

First, the FTC staff identify mergers and business practices that have resulted in or are likely to result in anticompetitive effects by conducting thorough factual investigations and applying economic analysis to distinguish between actions that threaten the operation of free markets and those that are benign or pro-competitive. This step is critical because a merger or business practice may be either neutral, beneficial (by enabling sellers to be more efficient and pass those savings along to consumers), or harmful (by enabling sellers to reduce the output of their product and raise the price to consumers). Thus, indiscriminate or ill-considered intervention in the marketplace may do more harm than good.

Second, once the FTC identifies a harmful or potentially harmful merger or business practice, it takes enforcement action under the antitrust laws to stop it, either through an administrative challenge or in federal court. In many instances, the agency is able to reach an agreement with the parties that remedies its competitive concerns and avoids litigation.

Third, the FTC seeks to prevent anticompetitive activity by educating businesses and consumers about the antitrust laws and its efforts to ensure competitive markets. Increased knowledge and understanding facilitate businesses' efforts to comply with the law and enable consumers to identify anticompetitive activity more readily and bring it to the FTC's attention for possible enforcement action.

### **Objective 2.1: Identify Anticompetitive Mergers and Practices That Cause the Greatest Consumer Injury**

The first step in preventing anticompetitive mergers and anticompetitive business conduct is determining which mergers and business practices are anticompetitive.

#### **Strategies**

The FTC seeks to identify anticompetitive mergers and practices with as much accuracy as possible. While certain business conduct (such as price fixing among competitors) is clearly anticompetitive, mergers and many other forms of business conduct can benefit, harm, or have no effect on consumers. Consequently, both under- and over-enforcement can harm consumers' interests. The agency seeks to take enforcement action against transactions or conduct that harms consumers, but at the same time, avoids taking enforcement action that prevents businesses from completing transactions or engaging in practices that fundamentally benefit consumers, or would have no effect. The FTC also tries to accomplish this task as efficiently as possible so that it can devote the bulk of its resources to further investigation of, and possible challenge to, the most problematic mergers and practices. A related, but important, consideration is to conduct the inquiry in a way that minimizes the cost or inconvenience to businesses.

Identifying anticompetitive mergers is a top priority in the Maintaining Competition Mission. The premerger notification requirements of the Hart-Scott-Rodino (HSR) Act provide the FTC with an effective starting point for identifying anticompetitive mergers, acquisitions, and joint ventures (collectively referred to as mergers) before they are consummated. The HSR Act requires companies to report certain proposed mergers to the FTC and Department of Justice (which jointly enforce the HSR Act) and wait for a specified period (usually 30 days) to allow for antitrust review.

The FTC's staff carefully examine each transaction reported under HSR to determine whether it poses a threat to competition. The agency seeks to identify as many of the competitively harmless transactions as possible within the initial waiting period, both to conserve resources and to minimize the delay imposed on businesses. In most cases, the staff can make a reasonable judgment about whether a merger has the potential to be anticompetitive or not after an initial screening based on materials filed with the HSR notification. The agency may authorize a more extensive investigation of transactions that raise more difficult questions. Under the HSR Act, the agency may issue a formal request for additional information from the parties (a "second request"), which extends the initial waiting period. Given the typical scope and complexity of the issues, and the fact that the

HSR statute permits only one request for additional information relating to a transaction, an investigation extended by the issuance of a second request almost always requires a significant investment of resources by both the agency and the parties.

Most HSR transactions raise no antitrust issues, and the antitrust agencies permit these to proceed. Together, the FTC and the Department of Justice Antitrust Division issued second requests in less than 3 percent of reported mergers in FY 2004. Moreover, the enforcement agencies frequently complete the initial screening in less time than is allowed under the HSR Act. In these instances, the government grants “early termination” of the HSR waiting periods, allowing transactions to go forward more quickly. Approximately two of every three filed transactions received early termination in FY 2004.

Amendments to the HSR Act, effective in 2001, changed the criteria governing which mergers must be reported under the Act. Despite the revised filing thresholds and a general decline in merger activity from the historic peak levels reached during the late 1990's and 2000, the FTC has continued to face a demanding merger review workload. The renewal of economic growth, together with the increased pace of mergers in FY 2004, may foreshadow the beginning of a more vigorous period of merger activity. The agency received 1,377 HSR filings in FY 2004, a 42 percent increase over the FY 2003 total. In addition, the dollar value of transactions is also on the rise; the value of transactions reported during FY 2004 was about 55 percent higher than the total for FY 2003. The number of mergers requiring investigation also increased. The FTC issued 20 second requests, a 33 percent increase over FY 2003.

While the HSR Act amendments reduced the number of mergers subject to the advance reporting requirement, they did not change the standard of legality for mergers. While the vast majority of potentially problematic mergers continue to be subject to the revised HSR filing requirements, smaller merger transactions may still be anticompetitive. Consequently, the FTC now devotes more attention to the identification of unreported, usually consummated, mergers that could harm consumers. This effort involves monitoring the trade press, industry sources, and the Internet to stay informed of industry developments; following up on case leads from congressional offices, other Executive Branch agencies, and state and local governments; and encouraging consumers, businesses, and the bar to notify the FTC of possibly anticompetitive mergers. The agency also investigates consummated mergers that appear to have had an adverse effect on consumers. In FY 2004, two of the agency's merger enforcement actions involved transactions (one consummated and one not) that were not subject to HSR reporting requirements.

In the nonmerger area, agency staff review complaints received from consumers, businesses, congressional offices, and elsewhere to identify potentially anticompetitive nonmerger business practices. In addition to responding to complaints from the public, the FTC has pursued a “positive agenda” of planned initiatives; that is, it has taken a systematic and proactive approach to identifying specific conduct likely to pose the greatest threat to consumer welfare. Fundamentally, the focus continues to be on the types of practices, such as agreements among competitors, that are most likely to harm consumers. Other

considerations include whether the relevant sector of the economy is one, such as health care or energy, that has a significant impact on consumers' daily lives; the deterrent effects of antitrust enforcement on businesses; whether the FTC has enforcement experience in an area that will enable the agency to make an impact quickly and efficiently; and whether the matter presents an opportunity to contribute positively to the development of antitrust law.

## **Performance Measures and Results**

The FTC used two performance measures to determine how well it identified anticompetitive mergers and practices in FY 2004.

The first measure is the percentage of HSR second request investigations concluded during the fiscal year that ultimately resulted in enforcement action (i.e., consent agreements, administrative complaints, Commission authorizations to seek a preliminary injunction, and merger transactions abandoned after the FTC initiated an antitrust investigation). The target for this measure is for at least 60 percent, but no more than 80 percent, of second request investigations to result in an enforcement action. The universe for this measure consists of investigations completed during the fiscal year, regardless of when the second request was issued, because second request investigations often extend beyond fiscal year boundaries. Matters ultimately resulting in enforcement action typically involve more extensive investigations than those that do not, so limiting the universe to those transactions in which a second request was issued and the matter was concluded within the same fiscal year could skew the results by disproportionately excluding enforcement outcomes.

Meeting the minimum percentage set for the measure (60 percent) signifies that the agency effectively identified likely candidates for enforcement action during the initial HSR waiting period. The upper percentage of the target range for this measure (80 percent) is also important. Because the need for enforcement is apparent from the beginning in many transactions, the agency could raise its percentage under this measure by setting overly rigorous standards for the issuance of second requests. However, such an approach would likely screen out some matters for which a fuller investigation would demonstrate the need for enforcement. Therefore, a result approaching 90 or 100 percent on this measure would suggest that the agency potentially may have failed to pursue some illegal mergers.

In FY 2004, the FTC took enforcement action in 12 of 22, or 55 percent, of the second request merger investigations concluded during the fiscal year. This figure represents a decrease from the 68 to 70 percent recorded for this measure in each of the years 2001 - 2003. The agency issued 20 second requests in FY 2004, an increase of 5 over FY 2003. This increase is consistent with the higher number of reported mergers, and does not reflect a change in the standards governing when a second request is warranted.

### **Performance Measure 2.1.1**

Percent of HSR requests resulting in enforcement action.

FY 2001 Actual: 68%

FY 2002 Actual: 68%

FY 2003 Actual: 70%

**FY 2004 Target: 60-80%**

**FY 2004 Actual: 55%**

**New**

### **Performance Measure 2.1.3**

Percent of nonmerger investigations which resulted in enforcement action.

**FY 2004 Target: 60-80%**

**FY 2004 Actual: 63%**

The FTC used a new measure of its success in identifying possibly illegal conduct in FY 2004. This measure is a ratio similar to that used to measure the agency's success in identifying anticompetitive mergers: the percentage of significant nonmerger investigations (i.e., those in which the Commission has authorized the use of its compulsory process authority) that ultimately result in enforcement action.

The target for this measure is that between 60 and 80 percent of investigations result in enforcement action, where the universe consists of nonmerger investigations in which the Commission authorized the use of compulsory process that were completed during the fiscal year. A percentage below 60 percent may suggest that the FTC is targeting enforcement resources ineffectively by investigating too many competitively benign practices (and unduly burdening businesses as a result). A percentage higher than 80 percent may suggest that the agency is focusing too narrowly and thus potentially allowing problematic business practices to go forward without sufficient review.

In FY 2004, the FTC took enforcement action in 5 of 8 or 63 percent of the completed nonmerger investigations in which it used compulsory process, a result within the targeted range. The agency initiated 26 nonmerger investigations and authorized the use of compulsory process in 5 nonmerger investigations. These figures represent a decline from FY 2003 levels, reflecting the shifting focus to matters in litigation, as discussed below.

## **Performance Assessment and Future Trends**

The issuance of a second request is a significant step in a merger investigation. Because the law permits only one second request, the FTC typically issues a very comprehensive request that calls for all relevant information on all possible issues in the investigation. Given the size of the parties involved and the necessarily broad scope of the inquiry, a response may consist of hundreds (or even thousands) of boxes of documents. Gathering and examining this material involves a major resource commitment by the parties and by FTC attorneys and economists. The HSR Act prevents the parties from proceeding with the merger while this process is taking place. Consequently, a second request can sometimes result in significant delays in closing a transaction.

For all of these reasons, the FTC does not lightly issue a second request. In fact, it does as much as possible within the initial 30 day waiting period to determine which transactions

pose no competitive threat, so that the truly benign mergers may proceed without the delay and expense of a second request. In FY 2004, for example, the FTC issued second requests in less than 2 percent of the mergers reported under HSR. At the same time, it is far easier to remedy an anticompetitive merger *before* it is consummated, so the agency makes every effort to identify and give careful scrutiny to potentially harmful mergers during the HSR waiting period.

The FTC's first measure reflects the balance between these two considerations. If the staff uses the initial HSR waiting period effectively, the agency should be able to "clear" the great majority of reported transactions, permitting them to go forward without further delay or burden. The FTC should also be able to isolate for more intensive investigation those transactions that could be harmful. While the initial screening process should permit as many benign transactions as possible to pass through, the focus should not be so narrow that only those transactions in which an antitrust problem is relatively obvious are subject to further investigation, while other transactions that may be similarly harmful, but in more subtle ways, can proceed unchallenged.

The result for FY 2004, 55 percent, is below the target range of 60 to 80 percent. No discernable change in standards for issuing a second request or for taking enforcement action occurred during the relevant period. The agency believes that the change in results is primarily a function of the small numbers involved (i.e., only 22 investigations are included in the computation). 2004 also witnessed an unusual number of cases involving difficult decisions to close investigations based on key facts that became available only as a result of staff's thorough investigation.<sup>1</sup> Over a more extended period (2001-2004) involving a more representative group of merger investigations, 68 percent of the FTC's completed merger investigations involving second requests resulted in enforcement action. The number of merger enforcement actions undertaken in FY 2004 is somewhat lower than the results from earlier fiscal years. The FTC took 15 merger enforcement actions, compared with annual totals ranging from 21 to 24 enforcement actions in the years 2001-2003. The decline is largely attributable to the unusual number of close cases being closed, as well as the lower level of merger activity in late 2003, which may have resulted in fewer enforcement actions in early 2004.

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<sup>1</sup> The Commission issued statements explaining its decision not to take enforcement action in several merger cases during FY 2004. See, e.g., Federal Trade Commission, Statement of the Commission, *In the Matter of Sunoco Inc./Coastal Eagle Point Oil Company*, File No. 031 0139 (Dec. 29, 2003), available at <<http://www.ftc.gov/os/caselist/0310139/031229stmt0310139.pdf>>; Federal Trade Commission, Statement of the Commission, *In the Matter of Caremark Rx, Inc./AdvancePCS*, File No. 031 0239 (Feb. 11, 2004), available at <<http://www.ftc.gov/os/caselist/0310239/040211ftcstatement0310239.pdf>>; Federal Trade Commission, Statement of the Commission, *RJ Reynolds Tobacco Holdings, Inc./British American Tobacco p.l.c.* File No. 041 0017 (June. 22, 2004) available at <<http://www.ftc.gov/os/2004/06/040622batrjrstmt.pdf>>

The result on the second measure – 63 percent of completed nonmerger investigations involving compulsory process resulting in enforcement action – shows that the agency was successful in targeting potentially anticompetitive conduct. The same caveat about small numbers and the law of averages applies here as well, however. Because this measure was based on only eight completed investigations involving compulsory process, a different outcome in only one or two investigations would have had a significant impact on the result.

## **Objective 2.2: Stop Anticompetitive Mergers and Practices Through Law Enforcement**

Law enforcement represents the most direct method by which the FTC pursues its goal of stopping mergers and business practices that significantly threaten competition and harm consumers. In both merger and nonmerger enforcement, the FTC focuses primarily on transactions or practices most likely to harm consumers, that is, mergers of firms competing in the same market or markets, and agreements among direct competitors. Other activities, such as unilateral action by a single firm, or a merger or agreement involving a supplier and customers or between a firm and a potential competitor, also may threaten competition and therefore are subject to FTC scrutiny.

Since the FTC and DOJ jointly enforce the HSR Act, the FTC directs much of its attention and resources to certain segments of the economy that are particularly important to consumers and in which it has particular expertise. These include energy and natural resources, food, health care, consumer goods and services, pharmaceuticals, and technology.

### **Strategies**

To stop potentially anticompetitive mergers and practices through law enforcement, the FTC seeks legal remedies under the antitrust laws, through federal court action, administrative proceedings, or negotiated settlements. For mergers, the preferred – that is, the most effective and cost-efficient – strategy is to prevent anticompetitive mergers before they occur. The agency implements this strategy primarily through its authority to seek a federal court injunction preventing the transaction. In many cases, the merging parties elect not to defend a court challenge and instead agree to resolve competitive concerns through a consent agreement. This approach is suitable when the competitive problem relates to only a portion of the transaction, so a divestiture of assets sufficient to preserve or restore competition will allow other competitively neutral or beneficial aspects of the merger to go forward. In other instances, the parties may abandon a transaction after assessing the likely outcome of an FTC court challenge.

When a merger already has been consummated, the FTC generally relies on its internal administrative remedial powers to restore competition lost as a result of the merger. Administrative litigation seeking to restore competition following an alleged illegal merger likely will become more frequent in light of the revisions to HSR premerger filing thresholds.



In nonmerger matters, the FTC seeks to stop ongoing activity that harms competition. The Commission may initiate administrative proceedings before an Administrative Law Judge to adjudicate the issues and establish a basis for an order that the parties to the proceeding “cease and desist” the conduct. The FTC also has authority to seek relief in federal courts, though it uses this option sparingly in nonmerger matters. Again, the agency is often able to negotiate a consent agreement with the parties that remedies the problem without need for litigation.

In both merger and nonmerger matters, thorough investigation, as well as sophisticated legal and economic analysis, is of critical importance to ensuring accurate assessment of the potential for competitive harm resulting from the transaction or conduct in question and, if necessary, demonstrating the likelihood of harm before an adjudicative body. When the FTC concludes that the likelihood of such harm indicates a law violation, and no settlement is possible, the Commission authorizes its staff to litigate the matter.

As described above, the “life cycle” of an FTC enforcement matter includes identification of potentially anticompetitive activity, investigation, and a decision to close the matter or to take enforcement action (usually a settlement but sometimes litigation). Following the end of the “merger wave” of the 1990's, the FTC has devoted significant attention in recent years to restoring its nonmerger program. Beginning in 2001, the agency emphasized identification of anticompetitive conduct, opening at least twice the number of nonmerger investigations in each of the years 2001-2003 as it opened in 2000. As work was completed on these investigations, the result was a significant number of nonmerger enforcement actions.

Many of the FTC's nonmerger inquiries of the past few years have involved complicated policy questions or cutting-edge legal issues, and many of the investigations resulted in issuance of an administrative complaint (though settlement remained a more frequent outcome). At the same time, the 2001 change in HSR filing thresholds dictated more focus on non-reportable mergers, which are normally contested through administrative proceedings.

Together, these factors resulted in a significant increase in the number of administrative complaints issued. In FY 2003, for example, the Commission issued more administrative complaints than in any year since 1985, and it issued an additional three complaints in FY 2004. Accordingly, the focus in FY 2004 was more on litigating cases than on developing new ones. During FY 2004, in addition to conducting pretrial preparations and defending against various appeals, the staff fully litigated three administrative trials before Administrative Law Judges, matching the number completed during all of the 1990's.

## Performance Measures and Results

In FY 2004, the FTC used three measures of its success in stopping potentially anticompetitive mergers and practices through law enforcement. These measures are (1) the percentage of positive outcomes when the FTC challenges anticompetitive mergers and practices, (2) the estimated dollar volume of commerce in markets in which the FTC took successful action to protect competition from anticompetitive mergers, and (3) the estimated dollar volume in markets in which the FTC took successful action to protect competition from anticompetitive conduct. The latter two measures are new in FY 2004.

Economic theory and evidence demonstrate that competition results in lower prices, better quality, and more innovation in markets. Because successful enforcement of the antitrust laws protects competition and therefore promotes these consumer benefits, it is important that the FTC succeed when it challenges anticompetitive mergers and practices. Even if the agency successfully identifies an anticompetitive merger or practice, consumers derive no benefit unless it obtains a positive outcome – that is, appropriate relief, through either settlement or successful litigation.

The frequency with which the agency obtains positive outcomes is an important indicator of its success in producing tangible benefits for consumers. In FY 2004, the FTC's target was to obtain a positive result in at least 80 percent of the matters in which it determined that a merger or a course of conduct is anticompetitive. Positive results include the parties' abandonment of an anticompetitive transaction after antitrust concerns are identified, an administrative consent agreement to resolve antitrust concerns, or a successful challenge in court. A negative result occurs when parties refuse to settle antitrust concerns raised by the agency, and court action fails to achieve the agency's objectives. This is not to say that the FTC, or any law enforcement agency, should win every case. Some cases involve very close questions, on which reasonable minds can and do differ. Other cases may be very difficult from a litigation standpoint, but still worth pursuing, and all of the FTC's antitrust challenges are defended by highly competent and well-financed counsel.

In addition, the FTC's responsibilities include taking action to help shape the development of the antitrust laws. Fulfillment of this duty requires occasionally litigating cases involving more than the usual degree of risk, such as cases in which there is no clear precedent and the FTC is seeking to establish a new legal principle. In other instances, the FTC brings cases seeking to benefit consumers by clarifying, or perhaps improving upon, existing precedent. The FTC now has several cases pending in administrative litigation that involve legal issues that have not been resolved definitively by the courts. While the agency's

complaints are grounded on sound policy considerations and the Commission's "reason to believe" there is a law violation is based on the staff's investigation, the ultimate outcomes depend on legal determinations often made by courts following appeal of Commission decisions, as well as development of a full factual record. The FTC's mission includes bringing cases that highlight difficult issues and seeking to persuade the courts of the merit of its views on what the law should be. Bringing cases that test the boundaries of the law is an important part of the FTC's responsibilities, even though the results are far from certain. The target on this measure reflects the reality that, even when the agency brings a meritorious case and litigates it well, success is not assured. In addition, setting the standard too high could be detrimental if the effect were to deter the agency from bringing important, but risky, cases.

The agency exceeded its target for this measure in FY 2004, achieving relief through litigation, reaching a successful settlement agreement, or persuading parties not to proceed with an anti-competitive acquisition in all 26 enforcement matters brought to conclusion during the fiscal year.

Antitrust enforcement saves consumers money by preventing price increases that likely would have occurred due to the loss of competition if an anticompetitive merger had gone forward unchallenged, or that have occurred as a result of anticompetitive conduct. In past years, the FTC estimated the dollar savings to consumers resulting from its enforcement actions. Some stakeholders commented, however, that this methodology was flawed in certain respects. Accordingly, the agency replaced the two "consumer savings" measures beginning in FY 2004.

The new measures indicate the scope of the FTC's antitrust enforcement activities, but without attempting to quantify the specific benefit to consumers. For both merger and nonmerger enforcement, the agency now measures the volume of commerce in markets in which it takes successful enforcement action. The new measures should provide similar

#### **Performance Measure 2.2.1**

Percentage of positive outcomes when the FTC challenges anticompetitive mergers and practices.

FY 2001 Actual: 94%

FY 2002 Actual: 100%

FY 2003 Actual: 100%

**FY 2004 Target: 80%**

**FY 2004 Actual: 100%**

#### **NEW**

#### **Performance Measure 2.2.3**

Dollar volume of commerce in markets in which the FTC took successful action to protect competition from anticompetitive mergers.

**5-Year Target: \$200 billion**

**FY 2004 Actual: \$ 8.5 billion**

#### **NEW**

#### **Performance Measure 2.2.4**

Dollar volume in markets in which the FTC took successful action to protect competition from anticompetitive conduct.

**5-Year Target: \$100 billion**

**FY 2004 Actual: \$ 2.6 billion**

indications of the scope of FTC antitrust enforcement activity, but will not include the troublesome aspects of the previous consumer savings measures.

As noted in the FTC's 2003-2008 Strategic Plan, external factors, such as level of merger activity, may cause the results to fluctuate significantly from year to year. Consequently, the two volume-of-commerce targets are each expressed in terms of an aggregate target for the five-year strategic plan period, rather than as yearly targets.

The five-year target for the volume of commerce in markets benefitting from FTC merger enforcement action is \$200 billion. In FY 2004, the FTC's merger enforcement actions affected markets in which the total volume of commerce was \$8.5 billion. This figure is well short of the annual average needed over the five-year Strategic Plan period to meet the target.

The five-year target for the volume of commerce in markets benefitting from FTC nonmerger enforcement action is \$100 billion. In FY 2004, the FTC's nonmerger enforcement actions affected markets in which the total volume of commerce was \$2.6 billion. This figure is also well short of the annual average needed over the five-year Strategic Plan period to meet the target.

### **Performance Assessment and Future Trends**

In FY 2004, the FTC achieved a positive outcome in 100 percent of the challenges initiated by the agency, exceeding its target of an 80 percent success rate by a significant margin. Although the agency currently has an unusually high number of antitrust cases in administrative litigation, with several resulting in Commission decisions in FY 2004, none has reached the point of finality. As the initiatives launched in 2001-2003 proceed through the administrative process, with some ultimately being presented for review by the courts, the agency will obtain a truer measure of the success of its recent efforts.

That some of its pending cases have not yet reached final resolution does not detract from the FTC's strong performance on this measure in FY 2004. Parties who agree to cease and desist orders, or who abandon mergers about which the agency has expressed concern, do so in recognition of both the FTC's policy expertise and its ability to successfully litigate contested matters. If the agency were perceived to be less successful in obtaining the relief it deems necessary on behalf of consumers, more parties would resist rather than settling FTC charges.

The results on the two volume-of-commerce measures illustrate why the agency expressed its targets in terms of five-year amounts. Several factors indicate that future results should be higher and the five-year targets attainable. First, merger activity, though increasing, is still well short of the level it is likely to reach as the economy continues its recent pattern of expansion. Second, even at a static level of merger activity, based on historical information, the agency is likely to bring more merger cases in FY 2005 and beyond. Third, the recent surge in administrative litigation means that much of the FTC's current merger

and nonmerger enforcement efforts are being devoted to matters not yet included in any measure. Fourth, the size of individual FTC cases varies widely, and a small number of large matters can have a significant impact on these measures. For example, two nonmerger cases currently in administrative litigation each involve markets with annual sales of roughly \$30 billion. If the FTC were to prevail in both cases, together they would account for more than half the five-year nonmerger volume of commerce target. Even one case of that magnitude would alone account for more than the annual average needed to reach the target. Finally, the agency's record over the past several years is consistent with the targets, and viewed comprehensively, the FTC's productivity over the past year has been extremely high.

### **Objective 2.3: Prevent Consumer Injury Through Education**

In addition to its law enforcement activity, the FTC provides substantial information to the business community and consumers about the role of the antitrust laws and businesses' obligations under those laws.

#### **Strategies**

The FTC uses education and outreach to help prevent consumer injury, increase business compliance, and augment its law enforcement efforts. The agency pursues this strategy through guidance to the business community; outreach efforts to federal, state, and local agencies, business groups, and consumers; development and publication of antitrust guidelines, policy statements, and reports; and speeches and testimony. By using these mechanisms to signal its enforcement policies and priorities, the FTC deters would-be violators of the antitrust laws.

FTC law enforcement efforts also are made more effective by public awareness of what types of conduct are likely to be challenged as law violations. Through press releases about FTC actions and publication of related materials on the agency Web site, the public facts underlying FTC actions provide bases for companies to evaluate the likelihood that other transactions likely would face challenge.

At the close of the year, nine administrative proceedings were pending, far more than at any time in the past two decades, signifying continuation of heavy litigation demands on the agency. Each of these cases may provide (or has provided) an opportunity for the FTC to set out in detail its analysis of important legal issues. Understanding fully the types of transactions or conduct the FTC is likely to challenge, and the reasons for the agency's actions, greatly facilitates antitrust lawyers' counseling of their clients and prevents many anticompetitive mergers from being proposed or anticompetitive practices from being implemented.

In addition, the FTC educates the public through guidelines; congressional testimony (such as testimony on gasoline pricing and competition in the pharmaceutical industry); conferences, hearings, and workshops (such as the series of hearings on the

interrelationship between antitrust and intellectual property law and hearings on health care and competition law and policy); advisory opinions (addressing issues such as the scope of the Nonprofit Institutions Act); and reports (such as the FTC staff's study on sale of wine via the Internet).

As a complement to FTC enforcement activity, the agency also advises other federal and state government officials about the possible effect that various regulatory proposals may have on competition. By providing economic analysis and other informed guidance, the FTC can help policymakers better understand the impact of their decisions in creating, maintaining, or forestalling competitive markets. The FTC has a long and distinguished history in this area. The FTC advocates market-based solutions through the publication of studies and reports, as well as participation in state and federal legislative and regulatory forums. The agency also participates as an amicus curiae in judicial proceedings when the FTC's involvement can help remove protectionist regulations, when substantial questions of antitrust law are involved, or when the FTC can add a different perspective to the deliberations because of special knowledge or experience.

The FTC also seeks to make its law enforcement presence visible and its enforcement policies transparent in order to serve its objectives through deterrence. Each successful enforcement action not only promotes competition in specific market(s), but also serves to communicate to the business and legal communities that the FTC can and will move successfully to challenge the type of merger transaction or conduct at issue. The agency explains the relevant facts and issues of cases in which it obtains a consent agreement in press releases and in published "Analyses To Aid Public Comment" so the nature of the problem is clear.

The FTC is seeking to provide greater transparency concerning its decision-making by issuing statements explaining why it declined to take action in merger investigations of significant public interest. More generally, the FTC issues policy statements describing the criteria it will use in determining to take certain actions. In FY 2004, for example, the agency released a statement explaining the factors it will use to determine whether to seek monetary remedies, such as disgorgement or restitution, in antitrust cases. Also in FY 2004, the FTC released extensive data on horizontal merger investigations and challenges to help the public evaluate the likelihood of an antitrust challenge to a particular merger.

Opinions issued by the Commission in adjudicative matters not only serve as legal precedent, but also help to explain in depth the FTC's policies and their underlying rationale. For example, in adjudicative decisions issued during FY 2004, the Commission illustrated the application of the analytical framework it employs to determine the legality of collaboration between direct rivals,<sup>2</sup> clarified the "clear articulation" prong of the state

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<sup>2</sup> *Schering-Plough Corp.*, Dkt. No. 9297 (Dec. 18, 2003) (Opinion of the Commission).

action doctrine,<sup>3</sup> and addressed several important aspects of the *Noerr-Pennington* doctrine.<sup>4</sup>

## Performance Measures and Results

In FY 2004, the FTC advised the public on its enforcement decisions by: (1) issuing press releases and related documents describing enforcement actions and other significant non-enforcement activities; (2) issuing public explanations of its reasons not to take enforcement action in appropriate instances to increase transparency in decision-making; (3) studying and reporting, consistent with its historic role, on significant policy issues and competitive conditions in particular markets; (4) responding to requests from other government entities for advice on the implications for competition and consumers of proposed regulatory actions; (5) appearing before business, bar, and consumer groups, as well as before congressional committees, to address competition-related subjects; and (6) maintaining effective coordination and liaison with foreign competition authorities.

The FTC previously used two performance measures to assess its public education efforts: the number of initiatives, including speeches, testimony, reports, policy statements, etc., taken to educate the public during the fiscal year and the number of times that members of the public visit antitrust-related content on the FTC's Web site. The number of "hits" on antitrust content is a good indicator of the quantity of information provided to the public, as well as its quality (because visitors will stay longer and return more often if the information is helpful).

In reviewing its performance measures while developing its 2003-2008 Strategic Plan, the FTC determined that the first of these measures (the number of outreach initiatives) did not effectively indicate the FTC's performance in education and outreach because the various items counted are not of equal weight, and the measurement of activities, such as the number of speeches given, may indicate the level of effort put toward an objective, but not the FTC's effectiveness in accomplishing it. Consequently, this measure is no longer in use.

The second measure under this objective – the volume of traffic on antitrust content on the FTC's Web site – provides a much better indication of both the quantity and quality of information provided to the public. The FTC publishes virtually all significant public documents on its Web site, including press releases announcing its antitrust law enforcement actions, with links to significant underlying documents, as well as all of its guidelines, reports, speeches, competition advocacy filings, advisory opinions, and other similar materials.

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<sup>3</sup> *South Carolina Board of Dentistry*, Dkt. No. 9311 (July 30, 2004) (Opinion of the Commission).

<sup>4</sup> *Union Oil of California*, Dkt. No. 9305 (July 6, 2004) (Opinion of the Commission).

Use of the Internet to disseminate information about antitrust and other competition-related matters plays an integral role in the FTC's education and deterrence efforts, permitting the agency to convey a wealth of information quickly, simply, and inexpensively to the business, legal, and regulatory communities, and to consumers. The second measure more directly reflected the FTC's effectiveness because it measured outcomes based on the agency's constituencies' assessment of the usefulness of the agency's published materials. That is, the level of activity on the FTC Web site depends to a large degree on the scope, utility, and reliability of the information made available there. People will revisit the site to the extent that what they find there is of value. Matters that are of great importance to the public – as determined by the public – will draw a large number of visitors. But if the material presented is irrelevant, difficult to understand, or misleading, then interest in the site inevitably will diminish.

**NEW**

**Performance Measure 2.3.2**

Measure and establish appropriate target for the number of hits on the FTC antitrust Web site relevant to business and legal communities.

**FY 2004 Target: TBD**

**FY 2004 Actual: 7.7 million**

**NEW**

**Performance Measure 2.3.3:**

Measure and establish appropriate targets for the number of hits on the FTC antitrust Web site relevant to policy makers and the general public.

**FY 2004 Target: TBD**

**FY 2004 Actual: 0.3 million**

Note: There were approximately 3 million Web hits that were deemed to be relevant to both the general public and the business/legal communities (i.e., we cannot say the page is "primarily" relevant to one or the other.) Added to the actual results above brings the total hits to approximately 11 million.

In FY 2004, the FTC determined to expand on the measure that was based on Web hits by distinguishing between education of the business and legal communities and education of the public in general. Educating the legal and business communities about the applicable legal standards and enforcement policies helps to facilitate their compliance with the law, while educating the public in general, including policymakers, about the benefits of competition helps to ensure continued support for the agency's efforts.

The agency sought to distinguish these two categories of visitors to its Web site, not by identifying and classifying individuals, but by identifying the content on the site that would be primarily relevant to each group. In practice, this plan proved more problematic than envisioned. Very little of the published material could be said to be relevant to the general public only, and much of the information on the site holds significant interest for both segments.

In FY 2004, the FTC's Web site recorded more than 11 million hits on antitrust-related content, an increase of approximately 10 percent over the level recorded in FY 2003. Although some of the increase may reflect increased overall use of the

Internet as an information resource, this result still indicates significant continued public interest in the FTC and its Maintaining Competition Mission. In addition, the broad and



increasing distribution of FTC educational and policy materials through electronic channels represents important leveraging of the FTC's resources.

Of the 11 million total hits on antitrust-related content, approximately 70 percent were on pages deemed to be primarily relevant to the business and legal communities, approximately 3 percent were on pages deemed to be relevant primarily to the general public, and the remaining 27 percent were on pages deemed to be of similar interest to both groups. These distinctions proved to be very difficult to make with any great assurance. Therefore, the agency will discontinue these two performance measures in FY 2005, and re-establish a combined measure of the total volume of hits to the antitrust pages of the FTC's Web site.

### **Performance Assessment and Future Trends**

The FTC possesses a broad array of policy instruments that complement its enforcement authority and help to educate the public. Through the use of hearings, workshops, research projects, reports, studies, advocacy filings, and amicus briefs – all in coordination with its enforcement initiatives – the agency provides intellectual leadership on competition issues and offers valuable education to the public. From the beginning, the FTC was conceived to be more than just an enforcement agency. President Woodrow Wilson saw the FTC as "an indispensable instrument of information and publicity, as a clearing house for the facts by which both the public mind and the managers of great business undertakings shall be guided . . ."

Today's FTC has fully integrated all of the agency's various capabilities and applies them in a strategic and sensible way to accomplish its goals directly, and indirectly, by facilitating public understanding of policy and the agency's objectives. The FTC remains strongly committed to the importance of education and outreach and will continue to place emphasis on these efforts and expand its activities in this area in the future.

The FTC fills two educational roles in the Maintaining Competition Mission. First, education serves to leverage the FTC's enforcement resources by explaining the scope of the antitrust laws, demonstrating that the FTC is active in bringing enforcement actions against certain types of mergers and practices, and signaling future enforcement intentions – all of which serve to deter harmful marketplace activity. Just as citizens benefit from the effect of the local "cop on the beat" in deterring crime, consumers ultimately benefit when the FTC makes its presence visible. As noted by the American Bar Association Section of Antitrust Law, "private compliance efforts are a critical prophylactic against anticompetitive behavior, and the effectiveness of private compliance efforts is directly affected by the nature and clarity of the communication of enforcement priorities."<sup>5</sup>

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<sup>5</sup> American Bar Association Section of Antitrust Law, *The State of Federal Antitrust Enforcement - 2001*, at 11 (Jan. 2001).

Second, the FTC can apply its expertise and advocacy skills to analyze important policy issues over which the FTC has no direct authority and to advise and persuade relevant policymakers about the virtues of competition. For example, in FY 2004, the FTC addressed issues including proposed state laws to regulate pricing of gasoline (which would likely have the unintended effect of harming consumers), the ongoing process of opening electricity markets to competition, and the adverse effect of limitations on new competition in markets for professional services.

With the growing importance of the Internet as a vital source of information in today's society, the volume of traffic on the FTC's Web site will continue to be a meaningful indicator of FTC success in educating the public at large, policy makers, and the business and legal communities, and in stimulating public interest in the agency's work. The agency will continue to seek ways to refine this important information to gain better understanding of its success in fulfilling this objective and to help assess how it might do so more effectively.

## **Part III**

### **Audited Financial Statements**

#### **Message from the Chief Financial Officer**

The Federal Trade Commission recognizes the importance of public disclosure and accountability. This report is a demonstration of our commitment to fulfill the FTC's fiduciary responsibilities to American taxpayers.

I am pleased to present the Federal Trade Commission's financial statements for FY 2004. For the eighth consecutive year, our inspector general, aided by an independent public accounting firm, issued an unqualified opinion on the FTC's consolidated financial statements. This is the highest possible audit result.

These financial statements fairly present the FTC's financial position and were prepared in accordance with the hierarchy of accounting principles approved by the Federal Accounting Standards Advisory Board and the Office of Management and Budget Bulletin 01-09, "Form and Content of Agency Financial Statements." The FTC is fully committed to the principles of the Chief Financial Officers Act of 1990 and the Federal Financial Management Improvement Act of 1996.

Our goals for FY 2005 include continuing the same high level of quality financial services that resulted in our unqualified opinion and improving those services. We also will focus on implementing our five-year financial management strategic plan. Our first step has been to document our current financial management processes and systems. We will use this information to develop our requirements for a new core financial management system that will improve our operations and permit us to better integrate financial, program, and performance data. Through these efforts, we will strive to continue to produce timely, reliable, and useful data.

Henry Hoffman  
Chief Financial Officer

## Limitations of the Financial Statements

Responsibility for the integrity and objectivity of the financial information presented in the financial statements rests with FTC management. The accompanying financial statements have been prepared in conformity with the hierarchy of accounting principles approved by the Federal Accounting Standards Advisory Board (FASAB) and the Office of Management and Budget (OMB) Bulletin 01-09, *Form and Content of Agency Financial Statements*. FTC is fully committed to the principles and objectives of both the Chief Financial Officers (CFOs) Act of 1990 and the Federal Financial Management Improvement Act of 1996. Comparative data for the prior fiscal year is presented. The statements should be read with the realization that they are for a component of the U.S. Government, i.e., a sovereign entity.

## Audit of FTC's 2004 Principal Statements

The Office of Inspector General of the Federal Trade Commission has examined the Agency's financial statements. The Inspector General's report on the principal statements, internal controls, and compliance with certain laws and regulations accompanies the statements.

## Financial Resources and Results of Operations

The accompanying statements summarize the FTC's financial position, disclose the net cost of operations and changes in net position, provide information on budgetary resources and financing, and present the sources and disposition of custodial revenue for the years ended September 30, 2004 and 2003. 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 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. 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

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; the collection of premerger notification filing fees, Do Not Call (DNC) user fees, and reimbursements received for services provided to other government agencies.

Financing was received through direct appropriations, appropriation transfers and imputed for costs absorbed by others.

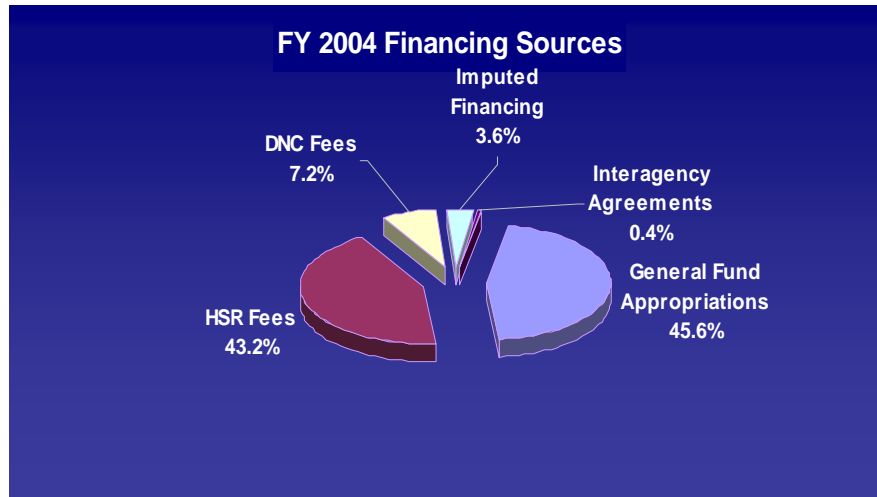
Exchange revenue totaled \$98.4 million and \$62.4 million for fiscal years 2004 and 2003, respectively. The primary source of exchange revenue collected, \$83.6 million in fiscal year 2004 and \$56.0 million in fiscal year 2003, was premerger filing fees. The FTC collects a filing fee from each business entity that files a *Notification and Report form* transaction, 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 Department of Justice (DOJ). The disposition of amounts collected for the DOJ is reported on the Statements of Custodial Activity. 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. The Registry operates under Section 5 of the FTC Act, which enforces the Telemarketing Sales Rule (TSR). Telemarketers under the FTC's jurisdiction are required to pay a user fee and download from the DNC database a list of consumer's telephone numbers who do not wish to receive calls. Fees are based on the number of area codes downloaded. \$14.0 million in fees were collected in fiscal year 2004, and \$5.2 million in fiscal year 2003. Fiscal years 2004 and 2003 DNC fees represented 7.2 percent and 2.9 percent of the total financing sources.

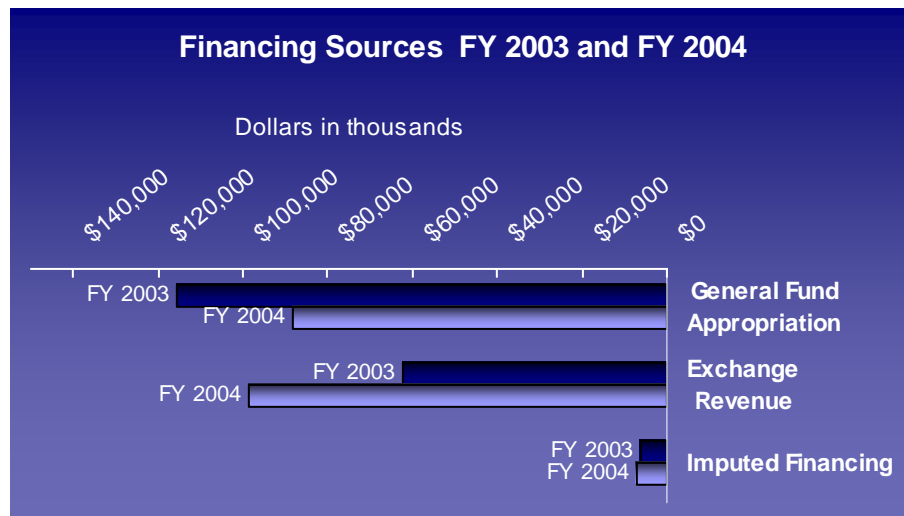
The third source of exchange revenue was earned through reimbursable agreements with other federal agencies. Total earnings were \$0.8 million and \$1.2 million, representing 0.4 percent and 0.6 percent for fiscal years 2004 and 2003, respectively.

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.

An imputed revenue source, as described in Note 9 of the financial statements, was recognized, which matched the unfunded employee benefits cost, in the amount of \$7.0 million for fiscal year 2004, and \$6.4 million in fiscal year 2003. These represented 3.6 percent and 3.4 percent of total financing sources for fiscal years 2004 and 2003, respectively. Fiscal year 2004 revenue sources are presented in the following chart.



Financing sources that are not needed to fund the cost of operations are added to Cumulative Results of Operations and Net Position. The accompanying chart compares major financing sources for fiscal years 2004 and 2003



## Cost of Operations

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 staff years over the previous fiscal year.

## Custodial Activity

The Statement of Custodial Activity (SCA) is a required financial statement under *Statement of Federal Financial Accounting Concepts (SFFAC) No. 2* 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.

Fighting consumer fraud is one of the FTC's highest priorities; consumers are bilked out of billions of dollars a year by perpetrators of traditional fraud and fraud on the Internet. In fraud cases, the FTC files actions in federal district court to bring an immediate halt to ongoing business activities and freeze defendants' assets. The FTC then pursues court orders that permanently ban the fraudulent activities and provide redress to consumers. In non-fraud cases, usually involving advertising claims, redress may be obtained for consumers in settlement of administrative complaints. In addition, when a company or individual violates an FTC Trade Regulation Rule, a statute enforced by the agency, or a prior agency order, the FTC seeks federal district court orders permanently barring future violations and requiring payment of civil penalties. These agency enforcement activities often generate substantial funds that are used, to the extent possible, to provide redress to consumers who have been injured by the deceptive practices, or, as with civil penalties, are transferred to the Treasury Department as non-exchange revenue. These activities are reported on the SCA, which forms part of the FTC's financial statement package.

In addition, the SCA also identifies the portion of the premerger filing fees collected during the year in which they are transferred to DOJ.



OFFICE OF  
INSPECTOR GENERAL

FEDERAL TRADE COMMISSION  
WASHINGTON, D.C. 20580

Chairman Majoras:

The Office of Inspector General has audited the Federal Trade Commission's (the Commission) 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, and has considered internal control over financial reporting and the FTC's compliance with laws and regulations.

***Opinion on Financial Statements***

In our opinion, the financial statements referred to above, including the notes thereto, present fairly, in all material respects, the Commission's assets, liabilities and net position as of September 30, 2004 and 2003, and the net costs and changes in net position, its budgetary resources, financing and custodial activities for the years then ended, in conformity with accounting principles generally accepted in the United States.

***Other Accompanying Information***

Our audits were conducted for the purpose of forming an opinion on the FY 2004 and 2003 principal financial statements of the Commission taken as a whole. The information discussed below is presented for purposes of additional analysis and is not a required part of the principal financial statements.

- The information in the Required Supplementary Information section has been subjected to the auditing procedures applied in the audit of the Commission's principal financial statements and, in our opinion, is fairly stated in all material respects in relation to the principal financial statements taken as a whole.
- Performance measurement information contained in the Management Discussion and Analysis and Program Performance sections of the Commission's annual financial statements contains additional information required by the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this additional information. However, we did not audit the information and express no opinion on it. This information is, however, addressed in our assessment of internal control discussed below.



### ***Opinion on Internal Control***

In planning and performing our audits, we considered the Federal Trade Commission's internal control over financial reporting by obtaining an understanding of the Commission's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02, "*Audit Requirements for Federal Financial Statements*". We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

With respect to internal control related to performance measures reported in the Management Discussion and Analysis and Program Performance sections, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

### ***Reportable Conditions***

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

We noted certain other matters involving the internal control over financial reporting that we have reported to the Commission's management in a separate letter (Management Letter AR 05-062A).

## *Compliance with Laws and Regulations*

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Commission's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the Commission. However, the objective of our audit of these financial statements, including our tests of compliance with selected provisions of applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions contained in statutes and regulations, that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the statement of financial position referred to above or that sensitivity warrants disclosure thereof.

The results of our test of compliance disclosed no instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards or OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The results of our tests disclosed no instances in which the agency's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

With respect to items not tested, nothing came to our attention to cause us to believe the Commission had not complied, in all respects, with those provisions.

## *Responsibilities and Methodology*

Management has the responsibility for:

- preparing the financial statements in conformity with generally accepted accounting principles described in Note 1 to the financial statements;
- establishing and maintaining an effective internal control over financial reporting; and
- complying with applicable laws and regulations.

Our responsibility is to express an opinion on these financial statements based on our audit. Generally accepted auditing standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misrepresentation and presented fairly in accordance with the generally accepted accounting principles. We performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on these financial statements and not to provide an opinion on the internal control over financial reporting. We are also responsible for testing compliance with selected provisions of applicable laws and regulations that may materially affect the financial statements.

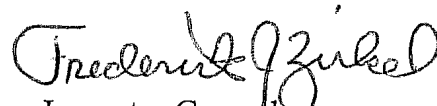
In order to fulfill these responsibilities, we

- obtained an understanding of the design of relevant internal controls and determined whether they had been placed in operation;
- assessed control risk;
- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the financial statements;
- tested compliance with selected provisions of the laws and regulations that may materially affect the financial statements; and
- performed other procedures that we considered necessary in the circumstances.

Our audits were conducted in accordance with auditing standards generally accepted in the United States; *Government Auditing Standards*, as issued by the Comptroller General of the United States; and OMB Bulletin No. 01-02. We believe that our audits provide a reasonable basis for our opinion.

While this report is intended solely for the information and use of the Federal Trade Commission, the Office of Management and Budget and the Congress, it is also a matter of public record, and its distribution is, therefore, not restricted.

Washington, D.C.  
October 29, 2004

  
Inspector General  
Federal Trade Commission

## Office of Inspector General Management Challenges

### Information Technology

**Management Challenge:** To maintain a comprehensive information security program that safeguards Commission data from internal and external threats.

**Agency Progress in Addressing the Challenge:** The President has placed a high priority on securing the Federal government's operations and assets. Protecting the information and information systems on which the Federal government depends requires agencies to identify and resolve current security weaknesses and risks and to protect against future vulnerabilities and threats.

The OIG has performed numerous IT security audits over the past several years, both in response to legislative mandates and to the OIG's strategic plan. Each year, the agency has made steady improvements in its overall security posture, culminating in an FY 2004 *Federal Information Security Management Act* audit where no significant deficiencies were observed. Just within the last year, the FTC (i) certified and accredited one of its Major Applications and one General Support system; (ii) made significant improvements in the Plan of Action & Milestones tracking and reporting process; (iii) developed policies and procedures that addressed various security issues; and (iv) developed a scanning and remediation program for system vulnerabilities.

In addition to these and other technical improvements, the FTC also made selected structural changes to enhance security. Within the last year, the IT Operations Section assumed responsibility for all production systems. Prior to this time and contrary to recommended industry practices, developers had substantial privileges on production applications and data. Software is now secured in a locked room and all new and revised hardware and software are authorized, tested, and approved prior to implementation. Finally, default system passwords have been changed and Change Management procedures are now in use to manage and track system changes.

Overall, management has started to evolve its security approach to conform to procedures and guidance issued by the National Institute of Standards and Technology, the Federal government's recognized IT security expert.

**The challenge ahead:** While the agency has made many needed changes and improvements in the development of an overall IT security program, the agency must continue to strengthen itself against those threats posed by insiders, i.e., its employees and contractors. The timely removal of accounts belonging to individuals who have left the agency, including those belonging to IT contractors, has been a weakness, as often times those individuals bypass formal checkout processes. Of equal concern are the expansive roles and privileges the agency assigns to staff (to include IT staff) to access sensitive databases. Finally, the substantial progress made by the agency to implement a sound security program could quickly reverse itself if management should become complacent, believing that yesterday's security improvements will protect it against tomorrow's attacks.

## FINANCIAL MANAGEMENT

**Management Challenge:** To integrate programmatic and financial accounting systems.

**Agency Progress in Addressing the Challenge:** Virtually all Federal departments and agencies are required to prepare financial statements in a proscribed format that will help external readers gain a basic understanding of how the entity has used the resources provided to it by Congress. To further this effort, these same agencies are also required to develop strategic plans and performance measures, and to report agency progress in meeting their performance targets.

Although not required by law, FTC management chose to prepare financial statements for audit beginning with fiscal year 1997. By preparing annual financial statements and by undergoing an annual audit the FTC has been able to successfully bring together all support and program-related financial activities. In fact, every year since 1997 the agency has produced a Statement of Custodial Activity that details all mission-related financial activities of the agency in accordance with government-wide accounting standards issued by the Federal Accounting Standards Advisory Board. In order to accomplish this outcome, new responsibilities were assigned to staff, organizations were created and systems were established. Yet, with all of this success, work remains to be performed.

**The Challenge Ahead:** The FTC continues to rely on essentially the same financial accounting system it had in place in 1997 to meet all Treasury, OMB, management and financial statement preparation requirements. However, much has changed since this time. For example, performance-related information must now be accumulated and reported in the annual Performance and Accountability Report. Systems to record Hart-Scott-Rodino filing fees and Do-Not-Call fees, or to accumulate year to date civil penalty and consumer redress amounts, currently necessitate some level of manual reconciliation at the close of each accounting period. In short the agency's central accounting system is not fully integrated with the various program subsidiary systems that are in place to record and account for program-related financial activities. While the agency has been able to accurately accumulate this information in the past, new requirements will surely strain the systems now in use. In short, systems used by program staff should be integrated with the financial accounting system to allow management to begin to routinely tie cost information appearing in the Statement of Net Cost to its selected performance goals and objectives.

**FTC Financial Statements for Fiscal Year End 2004**

**FEDERAL TRADE COMMISSION  
BALANCE SHEETS  
As of September 30, 2004 and 2003  
(Dollars in thousands)**

	<u>2004</u>	<u>2003</u>
<b>Entity Assets:</b>		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 2)	\$ 44,627	\$ 40,900
Accounts Receivable, Net (Note 4)	121	231
Total Intragovernmental Assets	<u>44,748</u>	<u>41,131</u>
Advances and Prepayments	-	9
Property, Plant, and Equipment, Net (Note 5)	<u>14,270</u>	<u>9,138</u>
Total Entity Assets	<u>59,018</u>	<u>50,278</u>
<b>Non-Entity Assets:</b>		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 2)	19,531	6,355
Cash and Other Monetary Assets (Note 3)	111,489	101,391
Accounts Receivable, Net (Note 4)	<u>62,879</u>	<u>241,895</u>
Total Non-Entity Assets	<u>193,899</u>	<u>349,641</u>
<b>Total Assets</b>	<u>\$ 252,917</u>	<u>\$ 399,919</u>

*The accompanying notes are an integral part of these statements.*

**FEDERAL TRADE COMMISSION  
BALANCE SHEETS  
As of September 30, 2004 and 2003  
(Dollars in thousands)**

	<u>2004</u>	<u>2003</u>
<b>Liabilities:</b>		
Liabilities Covered by Budgetary Resources:		
Intragovernmental Liabilities:		
Accrued Benefits	\$ 645	\$ 463
Accounts Payable	1,510	1,605
Total Intragovernmental Liabilities	<u>2,155</u>	<u>2,068</u>
With the Public:		
Accounts Payable	7,867	7,726
Accrued Salaries	3,625	2,727
Total Liabilities Covered by Budgetary Resources	<u>13,647</u>	<u>12,521</u>
Liabilities Not Covered by Budgetary Resources:		
Intragovernmental Liabilities:		
Undisbursed Premerger Filing Fees	6,530	1,600
Other Liabilities (Note 6)	1,380	2,538
Total Intragovernmental Liabilities	<u>7,910</u>	<u>4,138</u>
Actuarial FECA Liabilities	1,948	2,089
Accrued Annual Leave	7,496	7,183
With the Public (Note 6)	186,384	345,936
Total Liabilities Not Covered by Budgetary Resources	<u>203,738</u>	<u>359,346</u>
Total Liabilities	<u>217,385</u>	<u>371,867</u>
<b>Net Position: (Note 7)</b>		
Balances:		
Unexpended Appropriations	36	142
Cumulative Results of Operations	35,496	27,910
Total Net Position	<u>35,532</u>	<u>28,052</u>
<b>Total Liabilities and Net Position</b>	<u>\$ 252,917</u>	<u>\$ 399,919</u>

*The accompanying notes are an integral part of these statements.*



**FEDERAL TRADE COMMISSION**  
**STATEMENTS OF NET COST**  
**For the Years Ended September 30, 2004 and 2003**  
(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
<b>Program Costs</b>		
<u>Maintaining Competition Mission:</u>		
Intragovernmental gross costs	\$ 19,692	\$ 20,443
Less: Intragovernmental earned revenue	(722)	(1,011)
Intragovernmental net costs	<u>18,970</u>	<u>19,432</u>
Gross costs with the public	62,083	61,688
Less: Earned revenue with the public (Note 12)	<u>(83,598)</u>	<u>(56,015)</u>
Net costs with the public	<u>(21,515)</u>	<u>5,673</u>
Net Cost Maintaining Competition Mission	<u>(2,545)</u>	<u>25,105</u>
<u>Consumer Protection Mission:</u>		
Intragovernmental gross costs	25,063	23,052
Less: Intragovernmental earned revenue	(86)	(148)
Intragovernmental net costs	<u>24,977</u>	<u>22,904</u>
Gross costs with the public	79,015	69,563
Less: Earned revenue with the public (Note 12)	<u>(13,984)</u>	<u>(5,239)</u>
Net costs with the public	<u>65,031</u>	<u>64,324</u>
Net Cost Consumer Protection Mission	<u>90,008</u>	<u>87,228</u>
<b>Net Cost of Operations</b>	<u><u>\$ 87,463</u></u>	<u><u>\$ 112,333</u></u>

*The accompanying notes are an integral part of these statements.*

**FEDERAL TRADE COMMISSION**  
**STATEMENTS OF CHANGES IN NET POSITION**  
**For the Years Ended September 30, 2004 and 2003**  
(Dollars in thousands)

	<u>2004</u>		<u>2003</u>	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
<b>Beginning Balances</b>	<u>\$ 27,910</u>	<u>\$ 142</u>	<u>\$ 18,281</u>	<u>\$ 350</u>
Budgetary Financing Sources:				
Appropriations Received	-	88,435	-	115,299
Appropriations Transferred-In/Out	-	67	-	110
Other Adjustments (Rescissions)	-	(536)	-	-
Appropriations Used	88,072	(88,072)	115,617	(115,617)
Other Financing Sources:				
Imputed Financing (Note 9)	6,977	-	6,345	-
Total Financing Sources	<u>95,049</u>	<u>(106)</u>	<u>121,962</u>	<u>(208)</u>
Net Cost of Operations	<u>(87,463)</u>	<u>-</u>	<u>(112,333)</u>	<u>-</u>
<b>Ending Balances</b>	<u>\$ 35,496</u>	<u>\$ 36</u>	<u>\$ 27,910</u>	<u>\$ 142</u>

*The accompanying notes are an integral part of these statements.*

**FEDERAL TRADE COMMISSION**  
**STATEMENTS OF BUDGETARY RESOURCES**  
**For the Years Ended September 30, 2004 and 2003**  
(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
<b>Budgetary Resources:</b>		
Budget authority		
Appropriation	\$ 88,435	\$ 115,299
Net Transfers - Current Year Authority	68	110
Net Transfers - Prior Year Balances	(1)	-
Unobligated Balance:		
Beginning of Period	8,642	7,813
Spending Authority from Offsetting Collections		
Earned		
Collected	98,500	62,336
Receivable from Federal Sources	(110)	77
Change in Unfilled Customer Orders		
Without Advance from Federal Sources	40	(362)
Anticipated for rest of year, without advances		
Recoveries of Prior Year Obligation	2,306	624
Temporary Not Available pursuant to Public Law		
Enacted Reductions		
Rescissions - New Budget Authority	<u>(536)</u>	<u>-</u>
<b>Total Budgetary Resources</b>	<u><u>\$ 197,344</u></u>	<u><u>\$ 185,897</u></u>
<b>Status of Budgetary Resources:</b>		
Obligations incurred		
Direct	89,213	106,257
Reimbursable	<u>99,704</u>	<u>70,998</u>
Subtotal	188,917	177,255
Unobligated Balance		
Available	1,027	444
Not Available	<u>7,400</u>	<u>8,198</u>
<b>Total Status of Budgetary Resources</b>	<u><u>\$ 197,344</u></u>	<u><u>\$ 185,897</u></u>
<b>Summary of Obligations and Outlays:</b>		
<b>Obligated balance net beginning of period</b>	<u><u>32,257</u></u>	<u><u>21,786</u></u>
Obligated balance net end of period:		
Accounts receivable	(121)	(240)
Unfilled customer orders from federal sources	(55)	(15)
Undelivered orders	22,729	19,992
Accounts payable	<u>13,647</u>	<u>12,520</u>
<b>Total obligated balance net end of period</b>	<u><u>\$ 36,200</u></u>	<u><u>\$ 32,257</u></u>
Outlays:		
Disbursements	182,739	166,444
Collections	<u>(98,500)</u>	<u>(62,336)</u>
<b>Net Outlays</b>	<u><u>\$ 84,239</u></u>	<u><u>\$ 104,108</u></u>

*The accompanying notes are an integral part of these statements.*

**FEDERAL TRADE COMMISSION**  
**STATEMENTS OF FINANCING**  
**For the Years Ended September 30, 2004 and 2003**  
(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
<b>Resources Used to Finance Activities:</b>		
Budgetary Resources Obligated		
Obligations incurred	\$ 188,917	\$ 177,255
Less: Spending authority from offsetting collections and recoveries	(100,736)	(62,675)
Obligations net of offsetting collections and recoveries	<u>88,181</u>	<u>114,580</u>
Other Resources		
Imputed financing from costs absorbed by others	<u>6,977</u>	<u>6,345</u>
Total Resources Used to Finance Activities	<u>95,158</u>	<u>120,925</u>
<b>Resources Used to Finance Items not Part of the Cost of Operations:</b>		
Change in budgetary resources obligated for goods and services ordered but not yet received or provided	(2,697)	(6,991)
Resources that finance the acquisition of assets	<u>(7,063)</u>	<u>(4,217)</u>
Total resources used to finance items not part of the net cost of operations	<u>(9,760)</u>	<u>(11,208)</u>
Total Resources Used to Finance the Net Cost of Operations	<u>85,398</u>	<u>109,717</u>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	313	516
(Decrease) increase in FECA liability	<u>(179)</u>	<u>(189)</u>
Total components of the net cost of operations that will not require or generate resources in future periods	134	327
Components not Requiring or Generating Resources:		
Depreciation and amortization	1,931	1,421
Change in accounting estimates (Note 15)	-	758
Loss on disposition of asset	<u>-</u>	<u>110</u>
Total components of the Net Cost of Operations that will not require or generate resources	<u>1,931</u>	<u>2,289</u>
Total Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period	<u>2,065</u>	<u>2,616</u>
<b>Net Cost of Operations</b>	<u>\$ 87,463</u>	<u>\$ 112,333</u>

*The accompanying notes are an integral part of these statements.*

**FEDERAL TRADE COMMISSION**  
**STATEMENTS OF CUSTODIAL ACTIVITY**  
**For the Years Ended September 30, 2004 and 2003**  
(Dollars in thousands)

(Refer to Note 11)

<b>Sources of Collections:</b>	<u>MC Mission</u>	<u>CP Mission</u>	<u>2004 Total</u>	<u>2003 Total</u>
Premerger Filing Fees (Net of Refunds) (a)	\$ 82,190	\$ -	\$ 82,190	\$ 57,600
Civil Penalties and Fines (b)	756	5,786	6,542	8,506
Redress (c)	-	337,585	337,585	101,768
Divestiture Fund (d)	184	-	184	216
Funeral Rule Violations	-	30	30	13
	<u>83,130</u>	<u>343,401</u>	<u>426,531</u>	<u>168,103</u>
	<u>-</u>	<u>(179,016)</u>	<u>(179,016)</u>	<u>147,065</u>
<b>Total Non-exchange Revenues</b>	<u>\$ 83,130</u>	<u>\$ 164,385</u>	<u>\$ 247,515</u>	<u>\$ 315,168</u>
<b>Disposition of Revenue Collected:</b>				
Treasury General Fund	756	20,176	20,932	22,573
Department of Justice	77,259	-	77,259	57,683
Receivers (f)	-	161	161	112
Redress to Claimants (g)	-	294,058	294,058	69,566
Contractor Fees Net of Interest Earned (h)	-	7,638	7,638	4,932
Attorney Fees (h)	-	3,208	3,208	11,071
	<u>78,015</u>	<u>325,241</u>	<u>403,256</u>	<u>165,937</u>
	<u>5,115</u>	<u>(160,856)</u>	<u>(155,741)</u>	<u>149,231</u>
<b>Total Disposition of Revenues Collected</b>	<u>\$ 83,130</u>	<u>\$ 164,385</u>	<u>\$ 247,515</u>	<u>\$ 315,168</u>
<b>Net Custodial Collections</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

*The accompanying notes are an integral part of these statements.*

**FEDERAL TRADE COMMISSION**  
**REQUIRED SUPPLEMENTARY INFORMATION**  
**As of September 30, 2004 and 2003**  
(Dollars in thousands)

**Intragovernmental Assets:**

	<u>Fund Balance with Treasury</u>		<u>Accounts</u>	<u>Total</u>	<u>Total</u>
	<u>Entity</u>	<u>Non-Entity</u>			
<b>Trading Partner Agency:</b>					
Treasury	\$ 44,627	\$ 19,531	\$ -	\$ 64,158	\$ 47,255
Agency for International Development	-	-	59	59	86
Other Government Agencies	-	-	62	62	145
<b>Total Intragovernmental Assets</b>	<b>\$ 44,627</b>	<b>\$ 19,531</b>	<b>\$ 121</b>	<b>\$ 64,279</b>	<b>\$ 47,486</b>

**Intragovernmental Liabilities:**

	<u>Accrued</u>	<u>Accounts</u>	<u>NA</u>	<u>Total</u>	<u>Total</u>
	<u>Benefits</u>	<u>Payable</u>		<u>2004</u>	<u>2003</u>
<b>Trading Partner Agency:</b>					
Covered by Budgetary Resources:					
Department of Commerce	\$ -	\$ -	\$ -	\$ -	\$ 2
Department of Labor	18	-	-	18	-
U.S. Postal Inspection Service	-	12	-	12	8
Department of Justice	-	-	-	-	6
Government Printing Office	-	7	-	7	-
General Services Administration	-	1,370	-	1,370	1,411
Office of Personnel Management	470	43	-	513	343
Department of Treasury	157	78	-	235	298
<b>Total Covered by Budgetary Resources</b>	<b>\$ 645</b>	<b>\$ 1,510</b>	<b>\$ -</b>	<b>\$ 2,155</b>	<b>\$ 2,068</b>
Not Covered by Budgetary Resources:					
Department of Justice	\$ -	\$ 6,530	\$ -	\$ 6,530	\$ 1,600
Department of Labor	-	395	-	395	433
Department of Treasury	-	985	-	985	2,105
<b>Total Not Covered by Budgetary Resources</b>	<b>\$ -</b>	<b>\$ 7,910</b>	<b>\$ -</b>	<b>\$ 7,910</b>	<b>\$ 4,138</b>

**FEDERAL TRADE COMMISSION**  
**Required Supplementary Information**  
**For the Years Ended September 30, 2004 and 2003**  
(Dollars in thousands)

**Exchange Revenue from Reimbursable Agreements**

<u>Trading Partner:</u>	<u>2004</u>	<u>2003</u>
U.S. Agency for International Development	\$ 429	\$ 563
U.S. Department of State	142	-
Department of Justice	90	503
Federal Mine Safety & Health Review Commission	41	52
Department of the Treasury	39	-
U.S. Trade and Development Agency	36	3
Medicare Payment Advisory Commission/GSA	20	25
U.S. Postal Inspection Service	8	7
Department of Commerce	3	3
U.S. Environmental Protection Agency	-	1
U.S. Patent and Trademark Office	-	2
<b>Total Exchange Revenue from Reimbursable Agreements</b>	<b>\$ 808</b>	<b>\$ 1,159</b>

**Related Costs:**

<u>Budget Function Classification:</u>	<u>2004</u>	<u>2003</u>
Other Advancement of Commerce	\$ 808	\$ 1,159
<b>Total Related Costs</b>	<b>\$ 808</b>	<b>\$ 1,159</b>

**FEDERAL TRADE COMMISSION**  
**Required Supplementary Information**  
**For the Years Ended September 30, 2004 and 2003**  
(Dollars in thousands)

**Intragovernmental Expenses:**

**Trading Partner:**

	<u>2004</u>	<u>2003</u>
General Services Administration	\$ 18,331	\$ 17,121
Office of Personnel Management	18,117	18,479
Social Security Administration	5,151	4,858
Department of the Interior	864	770
Department of Transportation	724	755
Government Printing Office	646	853
Department of Labor	258	183
Department of Health and Human Services	218	(87)
United States Postal Service	214	294
Department of Justice	107	31
National Archives and Records Administration	39	(6)
Veterans Administration	37	-
Department of State	33	28
Department of the Treasury	15	186
Other	1	30
<b>Total Intragovernmental Expenses</b>	<b><u>\$ 44,755</u></b>	<b><u>\$ 43,495</u></b>

**Mission:**

Maintaining Competition	\$ 19,692	\$ 20,443
Consumer Protection	25,063	23,052
<b>Total Intragovernmental Expenses</b>	<b><u>\$ 44,755</u></b>	<b><u>\$ 43,495</u></b>



## Notes to the Financial Statements

### NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### (a) *Reporting Entity*

The Federal Trade Commission (FTC) was created by the Federal Trade Commission Act of 1914. The FTC enforces a variety of federal antitrust and consumer protection laws. The FTC seeks to ensure that the nation's markets function competitively and are vigorous, efficient, and free of undue restrictions. The FTC also works to enhance the smooth operation of the marketplace by eliminating acts or practices that are unfair or deceptive. In general, the FTC's efforts are directed toward stopping actions that threaten consumers' opportunities to exercise informed choice. Finally, the FTC undertakes economic analysis to support its law enforcement efforts and to contribute to the policy deliberations of the Congress, the Executive Branch, other independent agencies, and state and local governments when requested.

#### (b) *Fund Accounting Structure*

The FTC's financial activities are accounted for by federal account symbol. They include the accounts for appropriated funds and other fund groups described below for which the FTC maintains financial records, and consumer redress accounts for which the agency has management oversight.

General Funds Consist of salaries and expense appropriation accounts used to fund agency operations and capital expenditures.

Deposit Funds Consist of monies held temporarily by the FTC as an agent for others.

Suspense Funds Represent receipts awaiting proper classification, or held in escrow, until ownership is established and proper distributions can be made.

Receipt Accounts Reflect civil penalties and other miscellaneous receipts that are collected but not retained by the FTC. Cash balances are automatically transferred to the general fund of the Treasury at the end of each fiscal year.

#### (c) *Basis of Accounting and Presentation*

The financial statements present the financial position, net cost of operations, changes in net position, budgetary resources, financing, and custodial activities of the FTC, in accordance with accounting principles generally accepted in the United States of America and the form and content requirements of OMB Bulletin 01-09. They have been prepared from the books and records of the FTC and include the accounts of all funds under the control of the FTC. Accounting

principles generally accepted in the United States of America encompass both accrual and budgetary transactions. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. The accompanying financial statements are prepared on the accrual basis of accounting.

In addition, the accompanying statements include information on the activities of the agency's consumer redress program. Independent agents are contracted to administer the program under the oversight of FTC program offices, which maintain the financial records for consumer redress activity.

**(d) Budget Authority**

Congress annually passes appropriations that provide the FTC with authority to obligate funds for necessary expenses to carry out mandated program activities. These funds are available until expended. The funds appropriated are subject to OMB apportionment of funds in addition to Congressional restrictions on the expenditure of funds. Also, the FTC places internal restrictions to ensure the efficient and proper use of all funds. Appropriated funding is derived from various revenues and financing sources.

**(e) Fund Balances with the U.S. Treasury**

With the exception of cash held in consumer redress custodial accounts by FTC's contracted agents, the FTC does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. Fund balances with Treasury consist of appropriated funds that are available to pay current liabilities and to finance authorized purchase commitments, and restricted funds, which include deposit and suspense funds. The FTC's fund balances with Treasury are carried forward until such time as goods or services are received and payment is made, or until the funds are returned to the U.S. Treasury.

**(f) Advances and Prepayments**

Payments in advance of the receipt of goods and services are recorded as advances and recognized as expenses when the related goods and services are received. Advances are principally advances to FTC employees for official travel.

**(g) Accounts Receivable**

Entity accounts receivable include amounts due from other federal entities and from current and former employees and vendors. Non-entity accounts receivable include civil monetary penalties imposed as a result of the FTC's enforcement activities, uncollected redress judgments, and amounts due from receivers. Since

the FTC does not retain these receipts, a corresponding liability is also recorded for non-entity accounts receivable.

Opening judgment receivable balances reflect the Federal Accounting Standards Advisory Board (FASAB) standard for the recognition of losses using the collection criterion of “more likely than not.” This criterion results in receivable balances that are more conservatively stated than those valued by the private sector under generally accepted accounting principles. The Board states that it is appropriate to recognize the nature of federal receivables, which, unlike trade accounts of private firms or loans made by banks, are not created through credit screening procedures. Rather, these receivables arise because of the assessment of fines from regulatory violations. In these circumstances, historical experience and economic factors indicate that these types of claims are frequently not fully collectible.

The FTC recognizes an allowance for uncollectible non-entity accounts receivable by individual account analysis based on the debtor’s ability and willingness to pay, and the probable recovery of amounts from secondary sources, including liens, garnishments, and other applicable collection tools. Entity accounts receivable are considered fully collectible, and therefore no allowance is recorded.

***(h) Property and Equipment***

Commercial vendors and the General Services Administration, which charges the FTC a Standard Level Users Charge (SLUC) that approximates the commercial rental rates for similar properties, provide the land and buildings in which the FTC operates.

Property and equipment consist of equipment, leasehold improvements, and software. All items with an acquisition value greater than \$100,000 and a useful life over two years are capitalized using the straight-line method. Service lives range from three to twenty years.

Internal use software development and acquisition costs of \$100,000 are capitalized as software development in progress until the development stage has been completed and the software successfully tested. Upon completion and testing, software development-in-progress costs are reclassified as internal use software costs and amortized using the straight-line method over the estimated useful life of three years. Purchased commercial software that does not meet the capitalization criteria is expensed.

***(i) Liabilities***

Liabilities represent the amount of monies or other resources that are likely to be paid as the result of a transaction or event that has already occurred. Liabilities classified as not covered by budgetary resources are liabilities for which

appropriations have not been enacted and liabilities resulting from the agency's custodial activities. See *Note 11*. Also, the Government, acting in its sovereign capacity, can abrogate FTC liabilities (other than contracts).

**(j) Undisbursed Premerger Filing Fees**

A liability is recorded for undisbursed filing fees collected under the Hart-Scott-Rodino (HSR) Antitrust Improvements Act of 1976, which are due to the Department of Justice in a subsequent period.

**(k) Federal Employees' Compensation Act (FECA) Actuarial Liability and Accrued FECA Claims**

The FTC records an estimated liability for future workers' compensation claims based on data provided from the Department of Labor (DOL). The FTC also records a liability for actual claims paid on its behalf by the DOL.

**(l) Accrued Leave**

A liability for annual leave is accrued as leave is earned and reduced when leave is taken. At year end, the balance in the accrued annual leave account is adjusted to reflect the liability at current pay rates and leave balances. Accrued annual leave is paid from future funding sources and, accordingly, is reflected as a liability not covered by budgetary resources. Sick and other leave is expensed as taken.

**(m) Employee Health Benefits and Life Insurance**

FTC employees are eligible to participate in the contributory Federal Employees Health Benefit Program (FEHBP) and the Federal Employees Group Life Insurance Program (FEGSIP). The FTC matches the employee contributions to each program to pay for current benefits.

**(n) Post-Retirement Health Benefits and Life Insurance**

FTC employees eligible to participate in the FEHBP and the FEGSIP may continue to participate in these programs after their retirement. The Office of Personnel Management (OPM) has provided the FTC with certain cost factors that estimate the true cost of providing the post-retirement benefit to current employees. The FTC recognizes a current cost for these and other retirement benefits (ORB) at the time the employee's services are rendered. The ORB expense is financed by OPM, and offset by the FTC through the recognition of an imputed financing source on the Statement of Financing. During fiscal years 2004 and 2003, the cost factors relating to FEHBP were \$4,420 and \$3,766, respectively, per employee enrolled. During fiscal years 2004 and 2003, the cost factor relating to FEGSIP was 0.02 percent of basic pay per employee enrolled. See *Note 9, Imputed Financing*.

**(o) Employee Retirement Benefits**

FTC employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Employees hired after December 31, 1983, are covered by FERS and Social Security, while employees hired prior to January 1, 1984, may elect to either join FERS or remain in CSRS. Approximately 27 percent of FTC employees participate in CSRS. For employees participating in CSRS, the FTC contributes 7 percent of the employee's gross earnings to the CSRS Retirement and Disability Fund. For employees participating in FERS, the FTC contributes 10.7 percent to the Federal Employees' Retirement Fund. Employees participating in FERS are covered under the Federal Insurance Contributions Act (FICA) for which the FTC contributes a matching amount to the Social Security Administration. FTC contributions are recognized as current operating expenses.

The Thrift Savings Plan (TSP) is a defined contribution retirement savings and investment plan for employees covered by either CSRS or FERS. CSRS participating employees may contribute up to 9 percent of earnings for 2004, 8 percent for 2003, to TSP, but do not receive a matching contribution from the FTC. FERS participating employees may contribute up to 14 percent and 13 percent of earnings for the years 2004 and 2003, respectively, to the TSP plan. For FERS employees, the FTC contributes 1 percent of the employee's gross pay to the TSP. The FTC also matches 100 percent of the first 3 percent contributed and 50 percent of the next 2 percent contributed. FTC contributions are recognized as current operating expenses. Although the FTC contributes a portion for pension benefits and makes the necessary payroll withholdings, it is not responsible for contribution refunds, employee's retirement benefits, or the retirement plan assets. Therefore, the FTC financial statements do not report CSRS and FERS assets, accumulated plan benefits, or unfunded liabilities, if any, which may be applicable to employees. Such reporting is the responsibility of OPM.

However, the FTC recognizes the full cost of providing future pension benefits to covered employees at the time the employees' services are rendered. OPM has provided the FTC with certain cost factors that estimate the true service cost of providing the pension benefits to covered employees. The cost factors used to arrive at the service cost are 25 percent of basic pay for CSRS-covered employees and 12 percent of basic pay for FERS-covered employees during fiscal years 2004 and 2003. The pension expense recognized in the financial statements equals this service cost to covered employees less amounts contributed by these employees. If the pension expense exceeds the amount contributed by the FTC as employer, the excess is recognized as an imputed financing cost. The excess total pension expense over the amount contributed by the agency must be financed by OPM and is recognized as an imputed financing source, non-exchange revenue.

**(p) Net Position**

The FTC's net position is composed of the following:

Unexpended appropriations include the amount of unobligated balances and undelivered orders. Unobligated balances are the amount of appropriations or other authority remaining after deducting the cumulative obligations from the amount available for obligation.

Cumulative results of operations represent the net results of operations since inception, the cumulative amount of prior period adjustments, the remaining book value of capitalized assets, and future funding requirements.

**(q) Exchange Revenues**

The Federal Accounting Standards Advisory Board defines exchange revenue as inflows of resources to a governmental entity that the entity has earned. They arise from exchange transactions that occur when each party to the transaction sacrifices value and receives value in return.

Exchange revenues are earned through the collection of fees under the Hart-Scott-Rodino Act. This Act, in part, requires the filing of premerger notifications with the FTC and the Antitrust Division of the Department of Justice (DOJ) and establishes a waiting period before certain acquisitions may be consummated. Mergers with transaction amounts over \$50 million require the acquiring party to pay a filing fee. The filing fees are based on the transaction amount and follow a three-tiered structure: \$45,000, \$125,000, and \$280,000. The FTC retains one-half of the HSR premerger filing fees collected. Revenue is recognized when all required documentation under the HSR Act has been received by the agency. Fees not retained by the FTC are maintained in a suspense fund until transferred to the DOJ and not reported as revenue to the FTC.

Exchange revenues are also earned through the collection of fees for the national Do Not Call Registry. This registry operates under Section 5 of the FTC Act, which enforces the Telemarketing Sales Rule (TSR). The Do Not Call Implementation Act, P.L. 108-010, gives the FTC authority to establish fees for fiscal years 2003 through 2007 sufficient to offset the implementation and enforcement of the provisions relating to the Do Not Call Registry. Fees collected over expenses are retained for use in other FTC missions. Authority to create the registry was ratified in Public Law 108-082. Consumers may register a preference not to receive telemarketing calls. Telemarketers are required to pay an annual subscription fee and download from the Do Not Call database a list of telephone numbers of consumers who do not wish to receive calls. Fees are based on the number of area codes downloaded. The minimum charge was \$25 for downloading one area code. The maximum charge was \$7,375 for all area codes within the United States. Effective September 1, 2004, the new minimum charge is \$40 and the maximum charge is \$11,000.

Exchange revenue is also earned for services provided to other Government agencies through reimbursable agreements. The FTC recovers the full cost of services, primarily salaries and related expenses. Revenue is earned at the time the expenditures are incurred against the reimbursable order. All exchange revenues are deducted from the full cost of the FTC's programs to arrive at net program cost.

**(r) Appropriations Used**

In addition to exchange revenue, the FTC receives financing sources through direct appropriation from the general fund of the Treasury to support its operations. A financing source, appropriations used, is recognized to the extent these appropriated funds have been consumed. In fiscal years 2004 and 2003, the FTC received a financing source in the form of a direct appropriation that represented approximately 46 percent and 63 percent of total revenues and financing sources realized.

**(s) Methodology for Assigning Cost**

Total costs were allocated to each mission based on two components: a) direct costs to each mission and b) indirect costs based on the percentage of direct FTE used by each mission.

**(t) Comparative Data**

Certain 2003 line items on the Statements of Net Cost have been reclassified to conform with the current year's presentation.

**NOTE 2 – FUND BALANCES WITH TREASURY**

Fund balances with Treasury consisted of the following at September 30, 2004 and 2003:

<u>(Dollars in thousands)</u>	Unobligated			2004	2003
	Obligated	Available	Not available	Total	Total
General Funds Entity	\$ 36,200	\$ 1,027	\$ 7,400	\$ 44,627	\$ 40,900
General Funds Non-Entity:					
Undisbursed Premerger Filing Fees	-	-	-	6,530	1,600
Deposit Funds - Redress	-	-	-	13,001	4,755
Total Non-Entity	-	-	-	19,531	6,355
<b>Total</b>	<b>\$ 36,200</b>	<b>\$ 1,027</b>	<b>\$ 7,400</b>	<b>\$ 64,158</b>	<b>\$ 47,255</b>

The obligated balance includes accounts payable and undelivered orders that have reduced unexpended appropriations but have not yet decreased the cash balance on hand.

Other Information Deposit and suspense funds stated above are not available to finance FTC activities and are classified as non-entity assets, and a corresponding liability is recorded.

### NOTE 3 -- CASH AND OTHER MONETARY ASSETS

Cash and other monetary assets held as non-entity assets consist of redress judgment amounts on deposit with the FTC's distribution agents, receivers and divestiture fund deposits. A corresponding liability is recorded for these assets.

Cash and other monetary assets consisted of the following as of September 30, 2004 and 2003:

<u>(Dollars in thousands)</u>	<u>2004</u>	<u>2003</u>
Non-Entity:		
Redress Contractors	\$ 70,113	\$ 60,199
Divestiture Fund (Note 11(d))	<u>41,376</u>	<u>41,192</u>
<b>Total Non-Entity</b>	<u><u>\$ 111,489</u></u>	<u><u>\$ 101,391</u></u>

### NOTE 4 -- ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following as of September 30, 2004 and 2003:

<u>(Dollars in thousands)</u>	<u>Currently Due</u>	<u>Allowance</u>	<u>2004 Net</u>	<u>2003 Net</u>
Entity Assets:				
Intragovernmental-				
<b>Accounts Receivable</b>	<u>\$ 121</u>	<u>\$ -</u>	<u>\$ 121</u>	<u>\$ 231</u>
Non-Entity Assets:				
Consumer Redress	\$ 501,187	\$ 439,293	\$ 61,894	\$ 239,790
Civil Penalties	<u>985</u>	<u>-</u>	<u>985</u>	<u>2,105</u>
<b>Total Non-Entity Assets</b>	<u><u>\$ 502,172</u></u>	<u><u>\$ 439,293</u></u>	<u><u>\$ 62,879</u></u>	<u><u>\$ 241,895</u></u>

For more detailed information on non-entity receivables, see Exhibit A.



## NOTE 5 -- PROPERTY, PLANT, AND EQUIPMENT, NET

Capitalized property and equipment, net of accumulated depreciation, consisted of the following as of September 30, 2004 and 2003:

<u>(Dollars in thousands)</u>					
<u>Asset Class</u>	<u>Service Life</u>	<u>Acquisition Value</u>	<u>Accumulated Depreciation</u>	<u>2004 Net Book Value</u>	<u>2003 Net Book Value</u>
Equipment & Furniture	5-20 yrs	\$ 5,433	\$ 2,592	\$ 2,841	\$ 3,329
Leasehold Improvements	10-15 yrs	4,683	715	3,968	3,116
Software	3 years	2,542	1,591	951	1,404
Software-in-Development		6,510	-	6,510	1,289
<b>Total</b>		<u>\$ 19,168</u>	<u>\$ 4,898</u>	<u>\$ 14,270</u>	<u>\$ 9,138</u>

Property and equipment are depreciated using the straight-line method. Depreciation expense was \$1.9 million and \$1.4 million for fiscal years ending September 30, 2004 and 2003, respectively and is contained in the accumulated depreciation.

## NOTE 6 -- LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Liabilities not covered by budgetary resources consisted of the following as of September 30, 2004 and 2003:

### (a) *Intragovernmental and With the Public*

<u>(Dollars in thousands)</u>	<u>2004</u>	<u>2003</u>
Intragovernmental		
Other Liabilities:		
Civil Penalty Collections Due	\$ 985	\$ 2,105
Accrued FECA Claims	395	433
<b>Total</b>	<u>\$ 1,380</u>	<u>\$ 2,538</u>
With the Public		
Undisbursed Redress	\$ 83,114	\$ 64,954
Divestiture Fund Due	41,376	41,192
Redress Net Collections Due	61,894	239,790
<b>Total</b>	<u>\$ 186,384</u>	<u>\$ 345,936</u>

**(b) Other Information**

Civil Penalty Collections Due represents the contra account for accounts receivable due for civil monetary penalties, which will be transferred to the general fund of the Treasury upon receipt.

Accrued FECA Claims consists of workers compensation claims payable to the Department of Labor (DOL), which will be funded in a future period.

Undisbursed Redress includes redress in FTC's Treasury deposit account, or with FTC redress contractors.

Divestiture Fund Due represents the contra account for the divestiture fund held by one of FTC's contractors until distribution of the funds is ordered per terms of the agreement.

Redress Net Collections Due represents the contra account for accounts receivable due from judgments obtained as a result of the agency's consumer redress litigation.

**NOTE 7 -- NET POSITION**

Net position consisted of the following as of September 30, 2004 and 2003:

<u>(Dollars in thousands)</u>	<u>2004</u>	<u>2003</u>
Unexpended Appropriations:		
Unobligated - Available	\$ 20	\$ 113
Undelivered Orders	16	29
Total Unexpended Appropriations	<u>36</u>	<u>142</u>
Cumulative Results of Operations:		
Invested Capital	14,270	9,138
Retained Fees:		
Unobligated - Available	1,027	444
Unobligated - Unavailable	7,380	8,085
Undelivered Orders	22,658	19,948
Future Funding Requirements	<u>(9,839)</u>	<u>(9,705)</u>
Total Cumulative Results of Operations	<u>35,496</u>	<u>27,910</u>
<b>Total Net Position</b>	<u>\$ 35,532</u>	<u>\$ 28,052</u>

## **NOTE 8 -- COMMITMENTS AND CONTINGENCIES**

Commitments The FTC is committed under obligations for goods and services that have been ordered but not yet received (undelivered orders) at fiscal year end. Undelivered orders were \$22.7 million and \$20.0 million as of September 30, 2004 and 2003, respectively.

Contingencies The FTC is a party in various administrative proceedings, legal actions, and claims brought by or against it. In the opinion of FTC management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or the results of operation of the FTC.

On November 14, 2002, the Court of Federal Claims granted the plaintiffs' motion for a summary judgment in a case brought by Department of Justice (DOJ) trial attorneys seeking overtime pay. The ruling indicated the attorneys were entitled to additional overtime pay, but did not establish either an amount of damages or methodology for calculating such an amount. On January 17, 2003, the court granted the DOJ's motion to stay the proceedings and allow an interlocutory appeal under 28 U.S.C. Sec. 1292 to the United States Court of Appeals for the Federal Circuit. A three-judge panel at the Federal Circuit found that the DOJ attorneys were not entitled to overtime pay. The DOJ attorneys have filed a petition for a rehearing of the case by the full Federal Circuit.

According to the FTC's General Counsel, the circumstances underlying the DOJ case differ significantly from the circumstances for attorneys and other FLSA-exempt employees at the FTC, and the FTC's ultimate potential exposure in such a case would be limited and in any event would turn on individual, not class action, claims.

Leases The FTC rents approximately 568,000 square feet of space in both commercial and government-owned properties for use as offices, storage and parking. Space leases for government-owned property are made with the General Services Administration (GSA).

Leases of commercial property are made through and managed by GSA. The Commission has leases on 4 government-owned properties and 10 commercial properties. The FTC's current leases expire at various dates through 2012. Two leases provide for tenant improvement allowances totaling \$7.1 million, and provide that these costs be amortized over the length of the leases. Under the terms of the leases, the FTC agrees to reimburse the landlord for the principal balance of the unamortized portion of the tenant improvement allowance in the event the agency vacates the space before lease expiration. The leases expire in 2005 and 2012.

Rent expenditures for the years ended September 30, 2004 and 2003, were approximately \$17.1 million and \$16.8, respectively. The \$16.8 million of rent

expenditures is net of a GSA credit of approximately \$1.9 million for fiscal year 2003, relating to the main headquarters building. In fiscal year 2004 GSA discontinued the rent discount program that it provided to federal agencies.

Future minimum lease payments due under leases of government-owned property as of September 30, 2004, are as follows:

**(Dollars in thousands)**

Fiscal Year	
2005	\$ 6,275
2006	1,618
2007	1,193
2008	1,133
2009	<u>589</u>
<b>Total Future Minimum Lease Payments</b>	<b><u>\$ 10,808</u></b>

Future minimum lease payments under leases of commercial property due as of September 30, 2004 are as follows:

**(Dollars in thousands)**

Fiscal Year	
2005	\$ 11,226
2006	10,678
2007	10,825
2008	11,025
2009	11,032
Thereafter	<u>22,095</u>
<b>Total Future Minimum Lease Payments</b>	<b><u>\$ 76,881</u></b>

**NOTE 9 -- IMPUTED FINANCING**

Imputed financing recognizes actual costs of future benefits, which include the FEHBP, FEGLI, and pension benefits that are paid by other federal entities. Imputed financing was composed of the following:

<u>(Dollars in thousands)</u>	<u>2004</u>	<u>2003</u>
FEHBP	\$ 4,049	\$ 3,439
FEGLIP	13	13
Pension Benefits	<u>2,915</u>	<u>2,893</u>
<b>Total Imputed Costs</b>	<b><u>\$ 6,977</u></b>	<b><u>\$ 6,345</u></b>

## NOTE 10 -- PENSION EXPENSE

Pension expenses in 2004 and 2003 consisted of the following:

<u>(Dollars in thousands)</u>	Employer Contributions	Imputed Costs	2004 Total Pension Expense	2003 Total Pension Expense
Civil Service Retirement System	\$ 1,906	\$ 2,785	\$ 4,691	\$ 4,697
Federal Employee Retirement System	7,217	130	7,347	6,771
Thrift Savings Plan	<u>2,998</u>	<u>-</u>	<u>2,998</u>	<u>2,761</u>
<b>Total</b>	<b><u>\$ 12,121</u></b>	<b><u>\$ 2,915</u></b>	<b><u>\$ 15,036</u></b>	<b><u>\$ 14,229</u></b>

## NOTE 11 -- CUSTODIAL ACTIVITIES

The FTC functions in a custodial capacity with respect to revenue transferred or transferable to recipient government entities or the public. These amounts are not reported as revenue to the FTC. The major components of the FTC's custodial activities are discussed below.

### **(a) Premerger Filing Fees**

All Hart-Scott-Rodino (HSR) premerger filing fees are collected by the FTC pursuant to section 605 of P.L. 101-162, as amended, and are divided evenly between the FTC and the Department of Justice (DOJ). The collected amounts are then credited to the appropriations accounts of the two agencies (FTC's "Salaries and Expenses" and DOJ's "Salaries and Expenses, Antitrust Division"). During fiscal years 2004 and 2003, respectively, FTC collected \$167.4 million and \$113.4 million in HSR fees. Total collections in the amount of \$83.6 million were retained for distribution, of which \$77.3 million was transferred to DOJ in 2004 and \$56.0 million in 2003. As of September 30, 2004 the undistributed collections remaining in the amount of \$6.5 million represent amounts to be transferred to DOJ in a future period.

**(b) Civil Penalties and Fines**

Civil penalties collected in connection with the settlement or litigation of the FTC's administrative or federal court cases are collected by either the FTC or DOJ as provided for by law. DOJ assesses a fee equivalent to 3 percent of amounts collected before remitting them to the FTC. The FTC then deposits these collections into the U.S. Treasury. Civil penalties collected also include amounts collected for undecided civil penalty cases held in suspense until final disposition of the case.

**(c) Redress**

The FTC obtains consumer redress in connection with the settlement or litigation of both its administrative and its federal court cases. The FTC attempts to distribute funds thus obtained to consumers whenever possible. If consumer redress is not practical, the funds are paid (disgorged) to the U. S. Treasury, or on occasion, other alternatives, such as consumer education, are explored. Major components of the program include eligibility determination, disbursing redress to claimants, and accounting for the disposition of these funds. Collections made against court-ordered judgments totaled \$337.6 million and \$101.8 million during fiscal years 2004 and 2003, respectively.

The sources of these collections are as follows:

<u>(Dollars in thousands)</u>	<u>2004</u>	<u>2003</u>
Contractors	\$ 259,031	\$ 71,428
Receivers	1,085	6,291
FTC	<u>77,469</u>	<u>24,049</u>
<b>Total</b>	<u><u>\$ 337,585</u></u>	<u><u>\$ 101,768</u></u>

**(d) Divestiture Fund**

One judgment obtained by the FTC on behalf of its Maintaining Competition mission stipulates the divestiture of assets by the defendants into an interest-bearing account to be monitored by the agency. The balance of the account represents principal and related interest held in one of the FTC's contractor accounts as stipulated in the judgment. A corresponding liability is recorded.

Divestiture Fund activity in fiscal years 2004 and 2003 consisted of the following:

<u>(Dollars in thousands)</u>	2004	2003
Beginning Balance	\$ 41,192	\$ 40,975
Interest	261	341
Expense	(77)	(124)
<b>Ending Balance</b>	<b>\$ 41,376</b>	<b>\$ 41,192</b>

**(e) Accrual Adjustments**

These adjustments represent the difference between the agency's opening and closing accounts receivable balances. Accounts receivable are the funds owed to the agency (as a custodian) and ultimately to consumers or other entities. See Exhibit A for computation of accrual adjustments to the Statement of Custodial Activity.

**(f) Receivers**

This amount represents the funds forwarded to receivers during the year for distribution to consumers. The agency recorded an asset, Due from Receivers, and a corresponding liability, Receivers Distributions Due, for the amount of funds forwarded. These balances are reduced as the distributions to consumers are confirmed.

**(g) Redress to Claimants**

Redress to claimants consists of amounts distributed to consumers by the FTC, one of its contracted agents, the court appointed receiver, or the defendant. In fiscal year 2004 a total of \$294.1 million was distributed to consumers: \$293.0 million was paid by the FTC and its contracted agents, and \$1.1 million was paid by receivers. In fiscal year 2003, a total of \$69.6 million was distributed to consumers: \$63.3 million was paid by the FTC and its contracted agents, and \$6.3 million was distributed by receivers.

**(h) Contractor Fees Net of Interest Earned**

Collections against monetary judgments are often deposited with one of the agency's two redress contractors until distributions to consumers occur. Funds are deposited in interest-bearing accounts, and the interest earnings are used to fund administrative expenses. Contractor expenses for the administration of redress activities and funds management amounted to \$8.0 million and \$5.3 million during the years ended September 30, 2004 and 2003, respectively. The significant increase in expense is due to one case in which approximately 2

million claims notifications were sent and 846,000 consumer checks were issued. Expense also includes costs for a consumer education campaign in lieu of distributions to consumers for one redress case. Interest earned was \$367,000 and \$354,000 during fiscal years 2004 and 2003, respectively, with the difference of \$7.6 million and \$4.9 million representing net expense.

Attorney fees of \$3.2 million related to three cases during fiscal year 2004 and \$11.1 million related to one case during fiscal year 2003.

**(i) Change in Liability Accounts**

Liability accounts contain funds that are in the custody of the agency or its agents, and are owed to others (consumers, receivers for fees, and/or the Department of Justice). See Exhibit B for the computation of liability account changes.

**(j) Current Year Judgments**

A judgment is a formal decision handed down by a court. Redress judgments include amounts that defendants have agreed, or are ordered, to pay for the purpose of making restitution to consumers deemed to have been harmed by the actions of the defendant(s) in the case. For purposes of presentation in Exhibit A, redress judgments include cases in which the FTC, or one of its agents, is directly involved in the collection or distribution of consumer redress. In fiscal years 2004 and 2003, the agency obtained and reported in Exhibit A monetary redress judgments against defendants totaling \$445.5 million and \$379.8 million, respectively.

The FTC does not include in the presentation of Exhibit A current redress judgment cases in which the FTC, or one of its agents, is not directly involved with the collection or distribution of consumer redress. These are cases in which the defendant, or other third party, has been ordered to pay redress directly to the consumers. There were five such cases in fiscal year 2004, of which judgments totaled \$626,000. In most of these cases, the judgment has ordered redress in the form of refunds or credits.

The agency also obtained civil penalty judgments of \$6.0 million and \$9.3 million in fiscal years 2004 and 2003, respectively.

**(k) Treasury Referrals and Prior Year Recoveries**

Monetary judgments six months or more past due are referred to the Department of Treasury for follow-up collection efforts in keeping with the Debt Collection Improvement Act of 1996 (DCIA). Treasury's Debt Management Services (DMS) administers the program, and deducts 18 percent from amounts ultimately collected for its fee. Collections, net of fees, are returned to the FTC for distribution to either consumers, in the form of redress, or to the general fund of



the Treasury as disgorged amounts. In fiscal years 2004 and 2003, \$41,000 and \$88,000 (net of fees) were collected based on FTC referrals and are reported as collections on the Statements of Custodial Activity. The FTC refers to DMS only those cases as defined in DCIA. This excludes cases that are in receivership, or bankruptcy or foreign debt. During 2004 and 2003, \$2.0 million and \$5.9 million were referred to the DMS for collection.

Prior year recoveries include amounts collected on cases that were written off in a previous year. In fiscal years 2004 and 2003, \$914,000 and \$10.2 million were collected, which includes the DMS collections.

**(l) Adjustments to the Allowance**

Adjustments to the allowance for redress, totaling \$286.7 million represent amounts formally written off during the year in the amount of \$3.7 million and adjustments to the provision for uncollectible amounts of \$283.0 million.

**NOTE 12 -- EARNED REVENUES**

Earned revenue with the public consisted of the following:

<u>(Dollars in thousands)</u>	<u>2004</u>	<u>2003</u>
HSR Premerger filing fees	\$ 83,598	\$ 56,015
Do Not Call Registry fees	<u>13,984</u>	<u>5,239</u>
<b>Total</b>	<u>\$ 97,582</u>	<u>\$ 61,254</u>

HSR premerger filing fees earned represent one-half of fees collected under the provisions of the Hart-Scott-Rodino Act. See Note 1 (q), Exchange Revenues. Revenue is recognized when earned; i.e., all required documentation under the HSR Act has been received by the agency.

Do Not Call Registry fees represent collections of subscription fees paid by telemarketers under the Do Not Call Implementation Act, P. L. 108-010. See Note 1 (q), Exchange Revenues. Revenue is recognized when collected and the Telemarketer is given access to download data from the Do Not Call database. The Do Not Call Registry was implemented during fiscal year 2003 and began operations in September 2003.

**NOTE 13 -- STATEMENT OF NET COST**

The Statements of Net Cost are consolidated for the FTC using a Budget Functional Classification (BFC) code. BFC codes are used to classify budget resources presented in the Budget of the United States Government per OMB. FTC is categorized under BFC code 376 – Other Advancement of Commerce. Gross cost and earned revenue for the FTC fall under this code, regardless of whether the fees are intragovernmental or with the public.

(Dollars in thousands)

Gross Cost and Earned Revenue:

	<u>BFC Code</u>	<u>Gross Cost</u>	<u>Earned Revenue</u>	<u>Net Cost</u>
FY 2004	376	\$ 185,853	\$ (98,390)	\$ 87,463
FY 2003	376	\$ 174,746	\$ (62,413)	\$ 112,333

Intragovernmental Gross Cost and Earned Revenue:

	<u>BFC Code</u>	<u>Gross Cost</u>	<u>Earned Revenue</u>	<u>Net Cost</u>
FY 2004	376	\$ 44,755	\$ (808)	\$ 43,947
FY 2003	376	\$ 43,495	\$ (1,159)	\$ 42,336

## NOTE 14 -- STATUS OF BUDGETARY RESOURCES

### (a) *Apportionment Categories of Obligations Incurred*

Obligations incurred reported on the Statement of Budgetary Resources in 2004 and 2003 consisted of the following:

<u>(Dollars in thousands)</u>	<u>2004</u>	<u>2003</u>
Direct Obligations:		
Category A	<u>\$ 89,213</u>	<u>\$ 106,257</u>
Reimbursable Obligations:		
Category A	98,856	70,201
Category B	<u>848</u>	<u>797</u>
Total Reimbursable Obligations	<u>99,704</u>	<u>70,998</u>
<b>Total</b>	<u><u>\$ 188,917</u></u>	<u><u>\$ 177,255</u></u>

### (b) *Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the United States Government*

The Budget of the United States Government with actual amounts for the year ended September 30, 2004, has not been published as of the issue date of these financial statements. This document will be available in December 2004.

## NOTE 15 – CHANGE IN ACCOUNTING ESTIMATES

In fiscal year 2003, the FTC changed the percentages estimated for development costs for software expenditures. Accounting standards require that the effects of a change in estimate should be reported in the period of change and subsequent periods. The net effect of this change in estimate for fiscal year 2003 was a \$758,403 charge to expense. This was the result of the reclassification from capitalized software to software maintenance expense. The depreciation expense recognized had this change in estimate not been recorded would have been \$252,801 in each of fiscal years 2003, 2004 and 2005. See Note 5 – *Property and Equipment, Net*.

FEDERAL TRADE COMMISSION  
Notes to the Statements of Custodial Activity  
Accrual Adjustments  
September 30, 2004 and 2003  
(Dollars in thousands)

Exhibit A

Part 1	<u>MC Mission Civil Penalty</u>	<u>Civil Penalty</u>	<u>CP Mission Redress</u>	<u>Subtotal CP</u>	<u>2004 Total</u>	<u>2003 Total</u>
Judgments Receivable - Net Beginning	\$ -	\$ 2,105	\$ 239,790	\$ 241,895	\$ 241,895	\$ 94,830
Add:						
Current Year Judgments (Note 11j)	756	5,194	445,517	450,711	451,467	389,219
Prior Year Recoveries (Note 11k)	-	-	914	914	914	10,232
Less:						
Collections by FTC/Contractors Receivers	(756)	(5,786)	(337,585)	(343,371)	(344,127)	(110,275)
Collections by DOJ for Litigation Fees/Other	-	(178)	-	(178)	(178)	(262)
Less:						
Adjustments to Allowance (Note 11 l)	-	(350)	(286,742)	(287,092)	(287,092)	(141,849)
<b>Judgments Receivable - Net, Ending</b>	<u>\$ -</u>	<u>\$ 985</u>	<u>\$ 61,894</u>	<u>\$ 62,879</u>	<u>\$ 62,879</u>	<u>\$ 241,895</u>
<b>Part 2</b>						
Judgments Receivable - Net Ending	\$ -	\$ 985	\$ 61,894	\$ 62,879	\$ 62,879	\$ 241,895
Judgments Receivable - Net Beginning	-	2,105	239,790	241,895	241,895	94,830
<b>Accrual Adjustment</b>	<u>\$ -</u>	<u>\$ (1,120)</u>	<u>\$ (177,896)</u>	<u>\$ (179,016)</u>	<u>\$ (179,016)</u>	<u>\$ 147,065</u>

FEDERAL TRADE COMMISSION  
Notes to the Statements of Custodial Activity  
Change in Liability Accounts  
September 30, 2004 and 2003  
(Dollars in thousands)

Exhibit B

	MC Mission				CP Mission			Total
	Pre-Merger	Divestiture	Civil Penalty	Subtotal MC	Civil Penalty	Redress	Subtotal-CP	
Liabilities @ 09/30/04	\$ 6,530	\$ 41,376	\$ -	\$ 47,906	\$ 985	\$ 145,008	\$ 145,993	\$ 193,899
Liabilities @ 09/30/03	\$ 1,600	\$ 41,191	\$ -	\$ 42,791	\$ 2,105	\$ 304,744	\$ 306,849	\$ 349,640
<b>Change in Liability Accounts</b>	<u>\$ 4,930</u>	<u>\$ 185</u>	<u>\$ -</u>	<u>\$ 5,115</u>	<u>\$ (1,120)</u>	<u>\$ (159,736)</u>	<u>\$ (160,856)</u>	<u>\$ (155,741)</u>

	MC Mission				CP Mission			Total
	Pre-Merger	Divestiture	Civil Penalty	Subtotal MC	Civil Penalty	Redress	Subtotal-CP	
Liabilities @ 09/30/03	\$ 1,600	\$ 41,191	\$ -	\$ 42,791	\$ 2,105	\$ 304,744	\$ 306,849	\$ 349,640
Liabilities @ 09/30/02	1,683	40,975	-	42,658	1,809	155,942	157,751	200,409
<b>Change in Liability Accounts</b>	<u>\$ (83)</u>	<u>\$ 216</u>	<u>\$ -</u>	<u>\$ 133</u>	<u>\$ 296</u>	<u>\$ 148,802</u>	<u>\$ 149,098</u>	<u>\$ 149,232</u>