"Sunlight is said to be the best of disinfectants."

Louis Brandeis, 1913

Federal Election Commission
Performance and Accountability Report

Fiscal Year 2004

“Sunshine is said to be the best of disinfectants; electric light the best policeman,” Justice Louis Brandeis’ famous quote, orignially published in “What Publicity Can Do”, Harper’s Weekly Dec. 20, 1913: 10–13, was cited during the 1976 Supreme Court case Buckley v. Valeo upholding major provisions of the Federal Election Campaign Act of 1971, as amended.

About the quote:

In 1976, the Federal Election Campaign Act was tested in the landmark Supreme Court Case, Buckley v. Valeo. In the spirit of former Justice Brandeis’ famous quote, the court affirmed the importance of bringing campaign finance information into the “sunshine,” and upheld major provisions of the Act. The majority opinion concluded the public’s right to know overrides the right to privacy.

The Federal Election Campaign Act passed in 1971, in an era when public distrust of government was high. Vietnam was coming to an end and Watergate was foremost in the minds of the American public. By 1972, almost two-thirds of Americans believed that those in government were acting in their own self-interest rather than acting in the best interest of the country*. In response congress began to expand openness in government first with the Freedom of Information Act (FOIA) in 1966, then with the Federal Election Campaign Act, which led to the establishment of the Federal Election Commission in 1974.

*Statement of Senator Lawton Chiles, author of the sunshine legislation.

Federal Election Commission
Performance and Accountability Report

Fiscal Year 2004

October 1, 2003 – September 30, 2004

FEC Performance and Accountability Review FY 2004
Released December 2004
Written by Karen Shaffer, Cheryl Kelley and John O'Brien
Design and Layout by James Landon Jones

Contents

(cont.)

APPENDICES

List of Illustrations

A Message from the FEC Chairman

FEDERAL ELECTION COMMISSION
Washington, D.C. 20463

Office of the Chairman

December 16, 2004

I am pleased to present the Federal Election Commission's Performance and Accountability Report (PAR) for FY 2004, prepared under the guidance of the Office of Management and Budget's (OMB) Bulletin No. 01-09. This Performance and Accountability Report contains the Commission's financial statements, as required by the Accountability of Tax Dollars Act of 2002.

The Accountability of Tax Dollars Act of 2002 extended the requirements for the preparation of financial statements and for a full financial audit of the agency's financial management systems and internal management controls down to agencies the size of the Commission. The FEC requested and received a waiver from this requirement in FY 2003, as did most of the agencies newly required to undergo financial audits, to give the FEC time to prepare for the financial audit. Therefore, this report reflects the first year that the FEC was required to produce financial statements and undergo a full financial audit.

The Commission is pleased to report that the FEC received a fully unqualified (clean) opinion from the Independent Certified Public Accounting firm of Clifton Gunderson LLP, which was engaged by the FEC Office of Inspector General to audit the consolidated financial statements included in this report. The unqualified (clean) opinion indicates that the FEC's financial statements present fairly the financial position of the Federal Election Commission.

This achievement demonstrates both our continued dedication to sound financial management and the reliability of the financial data upon which we base our budget and financial decisions. The attainment of the clean opinion in our first year of the required preparation of financial statements and audits is a significant success and reflects the commitment of resources by the FEC to ensure that our financial systems and internal management controls are sound.

Bradley A. Smith
Chairman

The Federal Election Commission (FEC) At A Glance

Mission: To assure that the campaign finance process is fully disclosed and that the rules are effectively and fairly enforced, fostering the electorate's faith in the integrity of the nation's political process.

- Created by Congress in 1975 as an independent regulatory agency to administer and enforce the Federal Election Campaign Act (FECA), the statute that governs the financing of federal elections.
- The FEC has jurisdiction over the financing of campaigns for the U.S. House, the U.S. Senate, the Presidency, and the Vice Presidency.
- Responsibilities include disclosing campaign finance information, enforcing the provisions of the law such as the limits and prohibitions on contributions, and overseeing the public funding of Presidential elections.
- The FEC regulated the disbursement (spending) by federal candidates and committees estimated at approximately $5.1 billion for the 2004 Presidential and Congressional elections, an increase of over 1,400 percent over the $310 million spent by federal candidates and committees during the first publicly-funded elections in 1976.
- The public has full access to documents that trace the sources of campaign financing. There are approximately 3 million itemized transactions for the 2004 election cycle in the FEC's disclosure database.
- In FY 2004, there were 4.1 million visits and nearly 100 million "hits" on the FEC's website.

FEC accomplishes its mission at a cost of approximately 20 cents annually for each American. For less than a quarter per citizen each year, the FEC ensures full disclosure of campaign financing and fair and effective enforcement of election rules.

This report is available at www.fec.gov.

How To Use This Report

This Performance and Accountability Report (PAR) was produced to meet the requirements of the Accountability of Tax Dollars Act of 2002 and guidance from the Office of Management and Budget (OMB), which expanded the authorization granted under the Reports Consolidation Act of 2000 to require that agencies prepare a PAR annually. It provides the Federal Election Commission's (FEC) financial and performance information for FY 2004, enabling the President, the Congress, and the American people to assess the Commission's performance in meeting its statutory mission.

The FY 2004 PAR is organized into the following three major sections:

- **Management's Discussion and Analysis (MD&A)**, which provides an overview of the financial and performance information contained in the Performance and Financial Sections. It includes the Commission's assessment on the reliability and completeness of the information presented. MD&A offers an overview of the FEC organization, highlights of its most important goals and results, and addresses issues affecting the Commission's performance in the future.

- **Performance**, which provides a report on the FEC's accomplishments, and results in meeting its goals and objectives, as required by the Government Performance and Results Act (GPRA). This section provides results for all of the measures contained in FEC's FY 2004 performance plan.

- **Financial**, which contains the details on FEC's finances, including the Commission's financial statements, the auditor's report, and the Inspector General's assessment of the top management challenges facing the Commission.

In addition, three Appendices contain Management's Decision and Final Actions on Office of Inspector General (OIG) Audit Recommendations, a Glossary of Terms, and Additional Performance Data.

The Commission's *Strategic Plan*, FY 2004 – 2009, and its Annual Performance Plans, which form the basis for this report, are available on the FEC website at www.fec.gov.

FEC also prepares an *Annual Report* that covers the activities of each calendar year. Reports through 2003 are available in electronic form at http://www.fec.gov/pages/anreport.shtml. The report for 2004 will be published in June 2005.

About The FEC

A Brief History of the Federal Election Commission

As early as 1905, President Theodore Roosevelt recognized the need for campaign finance reform and called for legislation to ban corporate contributions for political purposes. In 1907, he proposed public funding of federal elections. In response, Congress enacted several statutes between 1907 and 1966 to:

- Limit the disproportionate influence of wealthy individuals and special interest groups on the outcome of federal elections;
- Regulate spending in campaigns for federal office; and
- Deter abuses by mandating public disclosure of campaign finances.

However, there was no real significant enforcement of campaign finance legislation for the most part until the post-Watergate period after the 1972 elections. In 1971, Congress did consolidate its earlier reform efforts in the Federal Election Campaign Act (FECA), instituting more stringent disclosure requirements for federal candidates, political parties and political action committees (PACs). It also set up the income tax check-off to provide for the financing of Presidential general election campaigns and national party conventions. Still, without a central administrative authority, the campaign finance laws were difficult to enforce. Authority was split between the General Accounting Office (now the Government Accountability Office) and offices in the Clerk of the House and the Secretary of the Senate, with criminal enforcement in the Department of Justice.

Following reports of serious financial abuses in the 1972 Presidential campaign, Congress amended the FECA in 1974 to set limits on contributions by individuals, political parties, and PACs. It established the FEC as an independent agency to enforce the law, facilitate disclosure and administer the public funding program. Amendments to the Internal Revenue Code that same year established the matching fund program for Presidential primary campaigns. Subsequent amendments in the late 1970's streamlined the disclosure process and expanded the role of political parties.

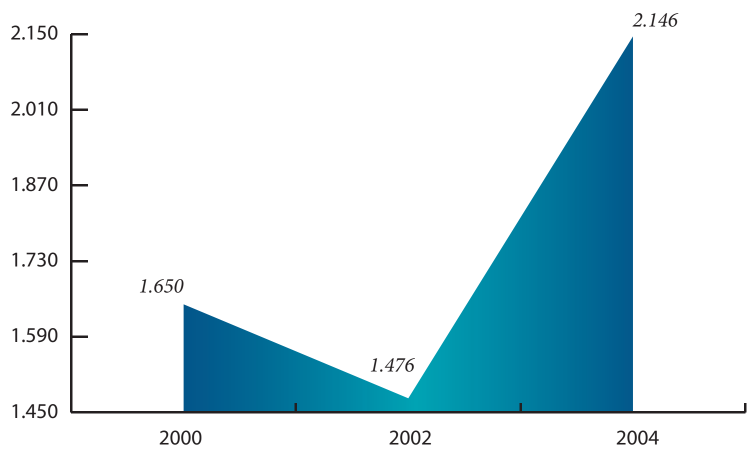
The Bipartisan Campaign Reform Act of 2002 (BCRA), sponsored by Senators John McCain and Russell Feingold, and Representatives Christopher Shays and Marty Meehan, amended the FECA further. It banned national parties from raising or spending nonfederal funds (often called "soft money"), restricted so-called issue ads, increased the contribution limits, and indexed certain limits for inflation.

What the FEC Does

The sanctity of the political process is key to public faith in the policy decisions made by the elected and executive branches of government. The FEC strives to provide the electorate with the capability to make educated, informed decisions in the political process as to where candidates for federal office derive their financial support, and with the confidence that those who disregard the laws regarding campaign financing and/or its requirements for public disclosure will suffer real and evenhanded consequences for noncompliance.

The Commission's disclosure database, which contains millions of transactions, is available through the FEC's website. Last year, the FEC redesigned its website to make it more user-friendly. Interested citizens can select a profile of a committee's financial activity for each election cycle. Citizens also can access information on contributions by using a variety of search elements (e.g., donor's name, recipient's name, date, amount, or geographic location).

Figure 1.1 Total Transactions Processed by Election Cycle Through 9/30 of Election Year (in millions)



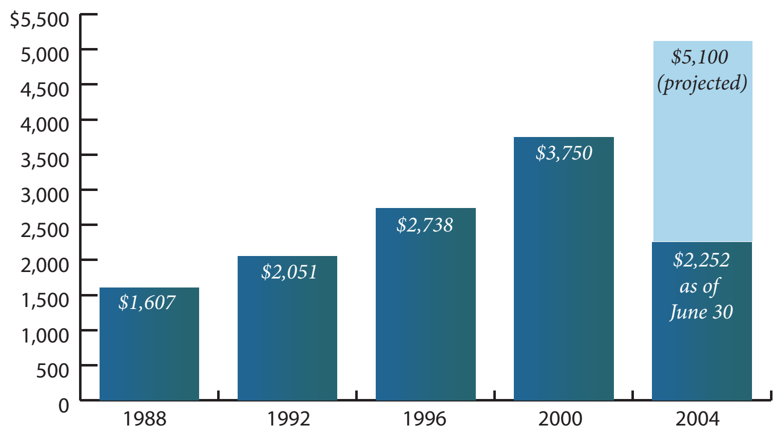
Total transactions increased dramatically between the 2000 and 2004 Presidential election cycles.

The sheer volume of data available to the public is staggering. The Commission defines its work in the context of election cycles, which include the preceding and actual election years, i.e., calendar years 2003 and 2004 constitute the 2004 election cycle. In any election cycle, nearly 8,000 committees file between 85,000 to 90,000 reports, which contain information concerning between 2.5 to 3.0 million itemized contributions, as well as millions of other itemized disbursements, receipts, and other payments previously not entered into Commission databases. These reports are now filed electronically, except for Senate reports and other committees with less than $50,000 in activity. At the same time, the FEC has the resources to audit less than 1 percent of the committees filing reports in any given cycle, and only has the capacity to actively pursue approximately 2 percent of total committees through its compliance (enforcement) process at any given time.

Campaign financing has skyrocketed since 1976, when the FEC regulated the disbursement by federal candidates and committees of $310 million in the first publicly-funded elections. For the 2004 Presidential and Congressional election, it is estimated that the FEC regulated the disbursement (spending) of approximately $5.1 billion—an increase of more than 1,400 percent in just eight Presidential election cycles.

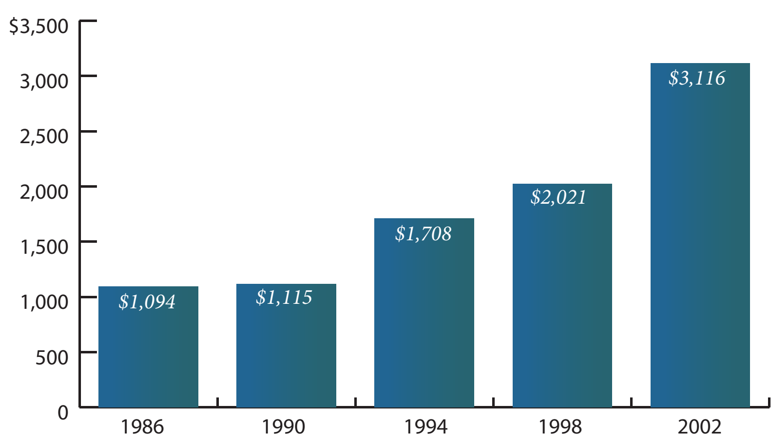
Total disbursements (spending) by federal committees and candidates in federal elections is the most significant measure of the total workload faced by the Commission. The figures below depicts total spending in recent federal Presidential and Congressional election cycles. Spending in Presidential cycles has more than tripled and in Congressional cycles it has nearly tripled. As of the June 30, 2004 reports processed by the FEC, over $2.2 billion had already been disclosed for the 2004 cycle.

Figure 1.2 Total Disbursements in Federal Elections, Presidential Cycles (in millions)



Disbursements (spending) in Presidential elections have more than tripled since 1988

Figure 1.3 Total Disbursements in Federal Elections,Congressional Cycles (in millions)



Disbursements (spending) in Congressional elections have nearly tripled since 1986

The FEC strives to foster and maintain an attitude of voluntary compliance with the rules of the campaign finance process through:

- facilitating public disclosure of campaign finance activity; providing information and policy guidance to the public, press, political committees, and elections officials on the law and Commission regulations;

- enforcing the FECA through audits, investigations, and civil litigation; and

- implementing the public funding programs for Presidential campaigns and conventions. This includes certification and audits of participating candidates and committees, and enforcement of public funding legislation.

How the FEC Accomplishes Its Mission

The FEC is structured to foster bipartisan decision making. Its work is directed by six members, who are appointed by the President and confirmed by the Senate. Each member serves a 6-year term, and two seats are subject to appointment every 2 years. By law, no more than three Commissioners can be members of the same political party, and at least four votes are required for any official Commission action. Chairmanship of the Commission rotates among the members each year, with no member serving as Chairman more than once during his or her term.

Commission Membership and Statutory Officers

The Commissioners serve full time and are responsible for administering and enforcing the Federal Election Campaign Act. They generally meet twice weekly, once in closed session to discuss matters that, by law, must remain confidential, and once in a meeting open to the public. At these meetings, they formulate policy and vote on significant legal and administrative matters.

In addition to the Commissioners, the Staff Director and General Counsel positions were created by the FECA in 1974. The Inspector General was established later under amendments to the Inspector General Act of 1978, and is independent and reports to both the Commission and the Congress under the provisions of the IG Act. The Staff Director functions as the Chief Operating Officer and is responsible for implementing agency policy and overseeing the Commission's public disclosure activities, audit program, outreach efforts, and review of reports. The Commission's work is supported by several staff offices, including the Administration Division, Office of Congressional, Legislative and Intergovernmental Affairs, Office of Equal Employment Opportunity and Special Programs, Office of Personnel and Labor Relations, Office of Planning and Management, and Press Office.

The Office of General Counsel (OGC) staff performs the following functions:

- Drafts advisory opinions and regulations as well as other legal memoranda interpreting the federal campaign finance law;

- Investigates alleged violations of the law, negotiates conciliation agreements, and recommends civil penalties for individuals and entities that have violated the Act;

- Handles all civil litigation arising out of any legal actions brought by or against the Commission. It is the exclusive representative of the Commission before the federal district and circuit courts, and the Supreme Court with respect to matters related to public financing of Presidential elections; and

- Processes all audit-related legal and repayment matters, and handles final legal actions for debt settlements, administrative terminations, and administrative fines matters.

Figure 1.4 FEC Members

FEC Members

Bradley A. Smith, Chairman

Ellen L. Weintraub, Vice Chair

David M. Mason, Commissioner

Danny L. McDonald, Commissioner

Scott E. Thomas, Commissioner

Michael E. Toner, Commissioner

Statutory Officers

James A. Pehrkon, Staff Director

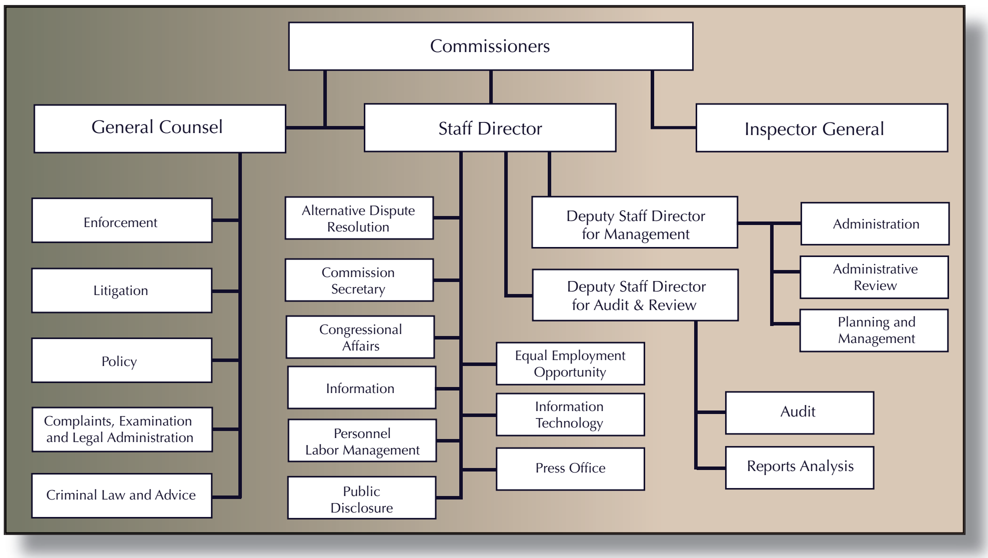
Lawrence H. Norton, General Counsel

Lynne A. McFarland, Inspector General

The Audit Division evaluates the matching fund submissions of Presidential primary candidates and determines the amount of contributions that may be matched with federal funds. As required by law, it audits all public funding recipients. It also audits those committees that, according to FEC determinations, have not met the threshold requirements for substantial compliance with the law. The division's resources are also used in the Commission's investigations of complaints.

The Information Division provides general educational assistance to candidates, committees, and others involved in elections through the Internet, e-mail, letters, telephone conversations, publications, and conferences. To foster voluntary compliance with the FECA, the FEC aggressively engages in outreach and educational efforts, such as seminars and prior notice mailings before each major filing period.

Figure 1.5 FEC Organization Chart



The Information Technology (IT) Division provides internal IT support, operates the electronic filing system, and enters information into the FEC database from all reports filed by political committees and other entities. IT is responsible for operating and maintaining the FEC website that is now the main source of information and disclosure of campaign finance data. The division is also responsible for the computer programs that sort and organize campaign finance data into indexes. These indexes permit a detailed analysis of campaign finance activity and provide a tool for monitoring contribution limits. The indexes are available on the website and online through the Direct Access Program (DAP), a subscriber service managed by the division. The division publishes the *Reports on Financial Activity* series of periodic studies on campaign finance and generates statistics for other publications.

The Office of Administrative Review (OAR) was established in 2000 after statutory amendments permitted the Commission to impose civil money penalties for violations of certain reporting requirements. Under the program, if the Commission finds "reason to believe" (RTB) that a committee failed to file a required report or notice, or filed it late, it will notify the committee of its finding and the amount of the proposed civil money penalty. Within 40 days, the committee may challenge the RTB finding. OAR reviews these challenges and may recommend that the Commission uphold the RTB finding and civil money penalty, uphold the RTB finding but modify or waive the civil money penalty, determine that no violation occurred, or terminate its proceedings. OAR also serves as the Commission's liaison with the U.S. Department of the Treasury on debt collection matters involving unpaid civil money penalties under this program.

The Alternative Dispute Resolution (ADR) office provides parties in enforcement actions with an alternative method for resolving complaints that have been filed against them or for addressing issues identified in the course of an FEC audit. The program is designed to promote compliance with the federal campaign finance law and Commission regulations and to reduce the cost of processing complaints by encouraging settlements outside the agency's normal enforcement track.

The Public Disclosure Division processes incoming campaign finance reports from federal political committees and makes the reports available to the public in the Public Records Office as well as through fax lines and mail responses to requests for data and information.

The Reports Analysis Division (RAD) provides committee officials with technical assistance in complying with reporting requirements and conducts detailed examinations of the campaign finance reports filed by political committees. Due to limited resources in compliance, the review of reports represents the only full scrutiny of 100 percent of all committee filings. Each committee has a RAD analyst assigned, who assists the committee and seeks to voluntarily assure compliance with the law and full, accurate disclosure. RAD also performs the first part of the late and non-filing programs, referring committees to the OAR for final action, and refers debt settlement and administrative termination actions to the OGC for final legal action.

In mid-FY 2004, the FEC Office of Election Administration (OEA) was transferred to the new Election Assistance Commission (EAC), so limited funds and only 2.0 full-time equivalent (FTE) positions were devoted to it in FY 2004. Existing assets were transferred to the Election Assistance Commission in mid-FY 2004. The transfer was originally projected for FY 2003 but delays in appointing the new commissioners for the EAC delayed the establishment of the new commission and the transfer of the OEA.

Program Performance Overview: Highlights of FEC Performance in FY 2004

FEC's mission is to assure that the campaign finance process is fully disclosed and that the rules are effectively and fairly enforced. The sanctity of the political process is key to public faith in the policy decisions made by those who are elected. FEC's overarching goal is to provide the electorate with the capability to make educated, informed decisions in the political process as to where candidates for federal office derive their financial support, and with the confidence that those who disregard the federal election campaign laws will suffer real and evenhanded consequences for noncompliance. To attain this desired outcome, FEC strives to foster and maintain an attitude of voluntary compliance with the rules of the campaign finance process. Voluntary compliance and public confidence are necessary because limited budgetary resources preclude extensive efforts to enforce federal campaign laws.

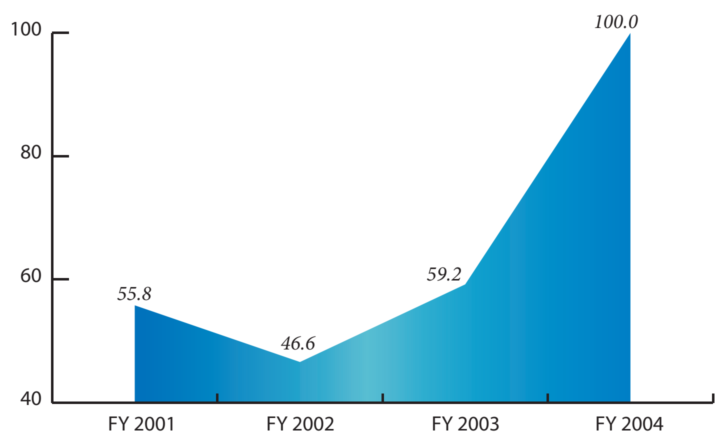
FEC's *Performance Plan* contains a number of measures and indicators that provide insight into how well the Commission is achieving its mission. These measures provide a basis for comparing actual program results with established program performance goals as required by the Government Performance and Results Act. This section highlights seven of the measures, using the stoplight grading scale reflected in the Executive Branch Management Scorecard, which is used to track progress on the President's Management Agenda initiatives. FEC's FY 2004 *Performance Report* is presented in Section II, with its additional statistical information provided in Appendix C.

During FY 2004, the Commission continued to implement the Bipartisan Campaign Reform Act of 2002 and respond to Constitutional challenges to the new Act. In December 2003, the Supreme Court upheld the two principle features of the BCRA: the control of soft money and the regulations of electioneering communications. The Court found unconstitutional the BCRA's ban on contributions from minors and the "choice provision," which provides that a party committee cannot make both coordinated and independent expenditures on behalf of a candidate after that candidate's general election nomination. The FEC issued new regulations, rules, and advisory opinions, including candidate travel regulations that established uniform payment rates for all federal election travel on either government or private aircraft and other conveyances. As an interim measure, the Commission approved a Statement of Policy Regarding Disclosure of Closed Enforcement and Related Files that identified the categories or records that will be released to the public once enforcement cases are closed. The Commission presented 12 legislative recommendations to the President and the Congress for improving campaign finance laws.

In December 2003, the Commission unveiled its Enforcement Query System (EQS), a web-based search tool that allows users to find and examine public documents regarding closed Matters Under Review (MUR). Previously, these documents were available only on paper or microfilm at FEC headquarters in Washington, DC.

The FEC redesigned its website to better meet the needs of the regulated community, researchers, and the general public. In FY 2004, it recorded almost 100 million "hits" and 4.1 million visits from the public, an increase over previous years. In FY 2003, there were only 59 million "hits" and 2 million visits.

Figure 1.6 Total Website Hits, Fiscal Year (in millions)



The traffic on FEC's redesigned website nearly doubled between FYs 2003 and 2004.

In FY 2004, the Audit Division completed a major effort to increase the number of non-Presidential committees audited in each election cycle. The goal was to complete 45-50 audits of committees or double the roughly 20-25 committees audited each election cycle in past years. In FY 2004, the division completed the last of 50 audits of these committees from the 2002 election cycle.

The Commission also continued to expand its enforcement presence and improve the timeliness of enforcement actions through the Alternative Dispute Resolution (ADR) and Administrative Fine (administered by OAR) programs. These programs streamline the process for late and non-filer enforcement and for cases that would otherwise be dismissed due to lack of enforcement resources. In addition, the programs allow the General Counsel to focus resources on the more significant compliance issues and cases, and to improve the timeliness of the resolution of those cases. This has allowed the FEC to close a higher percentage of cases with substantive action rather than dismissing them for staleness or lack of resources.

FEC's Workflow and Its Relationship to Strategic Plan and Annual Performance Plan

Performance Data Collection and Reporting

As a result of the pattern of campaign financing, not all data is collected or available on a fiscal year basis. Therefore, an assessment of FEC performance can best be determined by comparing annual trends from election cycle to election cycle. Assurance of the accuracy of performance data reported in Section II and in this section of the report is achieved through data verification processes inherent in the recurring use and updates of the data. FEC analysts, managers, and executives verify the data on an ongoing basis. The data receive a final review by budget and program branch chiefs with budget and performance responsibilities prior to submission and final review by the Staff Director. The Data Sources and Quality discussion in Section II of this report provides additional information about FEC's actions to ensure the accuracy of data, which are documented in the Data Verification and Validation sections of the FEC's annual Performance Plans and Reports.

The FEC is different from most agencies in that its natural workflow patterns do not begin and end neatly on October 1, the start of the new federal fiscal year when FEC receives its annual appropriation from the Congress. The Commission defines its work in the context of election cycles. An election cycle consists of the preceding and actual election years, i.e., calendar years 2003 and 2004 constitute the 2004 election cycle. An election cycle, therefore, spans three fiscal years (i.e., the 2004 cycle begins in FY 2003 and ends in FY 2005). The beginning of the new fiscal year (October 1) coincides with the peak pre-election period when the FEC experiences its heaviest workloads for many programs.

The flow of work for programs such as audits and enforcement actions is such that action on the referrals for audits and compliance actions from the 2004 election will not be finalized for three to four years after the election. This is particularly true for Presidential audits and enforcement cases arising from the public funding provisions of the FECA. As a result, work undertaken or completed in any fiscal year includes work that began in previous election cycles. The *Strategic Plan* outlines performance goals and workloads by election cycle, while the *Annual Performance Plan* relates the specific activities of FY 2004 to work from several election cycles. Goals for each core program area establish targets for the speed/timeliness in which an action should take place, and the volume of transactions that will be processed.

Goals and Objectives for FY 2004

To achieve its mission, the FEC has identified three major program areas– public disclosure, compliance, and public financing. The Commission uses a set of performance indicators to measure success in achieving improved public confidence in the political process. If FEC meets its performance targets for timely review and processing of reports, for resolving enforcement actions in a timely manner, and for informing and educating the public about campaign finance, it will achieve its desired outcome to fairly and effectively apply campaign finance rules and to promote disclosure, thereby enabling the electorate to make informed choices in the electoral process.

A fourth goal, which appeared in previous performance plans, was election administration. In FY 2004, the Office of Election Administration was transferred to the newly created Election Assistance Commission, so this goal was not included in the FY 2004 plan. The goals, objectives, and desired outcomes described in this report are tied to the remaining three core FEC programs:

1. Public Disclosure

Goal: Promote disclosure of campaign finance reports required to be filed for public view under the FECA to ensure full, accurate, and timely disclosure of campaign finance activity in federal elections, and to provide information and policy guidance on the FECA to the public, press, and those persons and entities required to comply with the FECA.

Success in this program will mean that:

- Sources of campaign funds in federal elections are accurately, fully, and timely disclosed to the public;
- The electorate can make informed decisions as to the sources of campaign funds for candidates for federal office;
- The electorate can readily obtain campaign finance information directly from the FEC in usable formats;
- The press and media can use FEC data to more widely disclose campaign finance information; and
- The public and the campaign finance community can easily obtain policy guidance and assistance in understanding and complying with the FECA.

2. Compliance

Goal: Enforce the disclosure and limitations provisions of the FECA to encourage and obtain voluntary compliance with the disclosure and limitations provisions of the FECA through enforcement of the Act in a timely, consistent, and comprehensive manner.

Any reported FECA violation may lead the General Counsel to classify it as a Matter Under Review. If the General Counsel determines there is a "reason to believe" that a violation has been committed, the respondents are notified and an investigation may begin.

Faced with a large number of complex cases, in 1993 the Commission developed the Enforcement Priority System (EPS) to provide a consistent and impartial ranking of cases based on the relative seriousness of the alleged violations. EPS enables the FEC to match the seriousness of a particular case to the resources available to undertake the investigation. EPS is used in conjunction with the case management system, which enables the Commission to measure performance with regard to the substantive resolution of cases by issue and to measure timeliness of enforcement actions. The increased level of civil penalties assessed by the Commission following implementation of the EPS has demonstrated the benefits of pursuing more substantive cases. Success in this program will mean that:

- The public has confidence that the FECA is fairly and swiftly enforced;
- The election community has a high level of confidence that the FECA is fairly enforced, resulting in a high level of voluntary compliance with the FECA;
- The election community believes that there are real, timely consequences for violation of the disclosure and limitation provisions of the FECA; and
- FEC enforcement resources are focused on the most salient and significant compliance concerns under the FECA.

3. Public Financing

Goal: Implement the Presidential election public funding provisions of the FECA and successfully administer the public funding provisions of the FECA for qualified candidates in Presidential elections.

In December 2003, seven Presidential candidates in the 2004 primary elections submitted matching fund requests totaling more than $15 million. Despite a brief shortfall in the Presidential fund all candidates received their full entitlement in February 2004, and the eligible national Presidential nominating conventions and general election committees were fully funded. The Department of the Treasury maintains the matching fund account, which is comprised of money derived from a taxpayer check-off system. Preparations are underway for audits of the seven candidates receiving matching funds, as well as the committees of the two general election candidate committees, the two host committees, and the two convention committees. These field audits will be completed by FY 2005, with all audit issues resolved in FY 2006, although compliance issues may take longer to resolve.

Success in this program will mean:

- The successful implementation of the public funding provisions of the FECA continues for each Presidential election;
- All federal funds disbursed in Presidential elections are properly certified and accounted for by eligible candidates;
- All audits and enforcement actions related to public funding are completed in a fair and timely fashion; and
- There are real and timely consequences for failure to comply with the FECA requirements.

How the FEC Achieves Its Goals

Improvements in productivity, aided by IT enhancements, generally have enabled the FEC to keep pace with the large increases in federal campaign finance activity during recent election cycles. This activity has nearly doubled in the last 12 years. Total candidate and committee disbursements (spending) for a non-Presidential election cycle have increased from $1.1 billion in 1986, to $3.1 billion for the 2002 congressional cycle, a more than 184 percent increase. In Presidential election cycles, spending exceeded an estimated $5.1 billion for the 2004 Presidential election cycle compared to $1.6 billion in the 1988 cycle.

The FEC receives information from approximately 8,000 committees filing over 90,000 reports and generating 2-3 million itemized transactions each cycle. Every election cycle since 1992 has seen a new record in total spending in federal elections for Congressional and Presidential elections. FEC's electronic filing system offers the capability of instantly updating the database and expanding the types of information collected. The average annual cost is about $1.5 million to maintain the electronic filing system. With the passage of mandatory electronic filing, FEC is beginning to see the benefits of timeliness and work process improvements such a sophisticated system affords. For example, since the institution of mandatory electronic filing, the median time to process all documents has improved from 11 days (2000 cycle) to 6 days (2002 cycle) to 2 days for the 2004 cycle as of September 30, 2004.

The Commission's key performance measures by major program are highlighted in Figure 1.7 below, with comparative results from FYs 2001, 2002, and 2003. The chart incorporates the color coding used in the Executive Branch Management Scorecards that track status and progress toward the goals of the President's Management Agenda. Green indicates that FEC met or exceeded the goal; yellow indicates that FEC came very close to meeting the goal: FEC is pleased that none of the scores are red for failing to meet the goal by a significant margin.

Figure 1.7 Key Performance Measures by Major Program

Measure	Goal	FY 2004	FY 2003	FY 2002	FY 2001
Reports filed with FEC will be available to the public within 48 hours	99% of reports are available within 48 hours	Green	Green	Green	Green
Review all reports and statements received	35,000 reports and 20,000 statements expected in 2004	Green	Green	Green	Green
Respond to data requests from press, public, and committees within 72 hours	100% of requests will receive a response within 72 hours	Green	Green	Yellow	Yellow
Committees will receive responses to requests for assistance within 72 hours	75% of committees receive a response within 72 hours	Green	Green*	Green*	Yellow*
Committees are referred for potential audit or enforcement actions	110 committees are referred for potential further actions (75 for audit; 35 for enforcement)	Green for Enforcement Green for Audit	Green for Audit Yellow for Enforcement	Yellow	Yellow
Half of FEC's cases are processed or closed with substantive action	200 cases are processed or closed; 100 with substantive action	Green for Substantive Yellow for Case Numbers	Green for Substantive Yellow for Case Numbers	Green for Substantive** Yellow for Case Numbers	Green for Substantive*** Yellow for Case Numbers
Maintain caseload with *50% active and 50% inactive cases.	175-200 cases are maintained; with 50% active and 50% inactive	Green	Green	Green	Green ***

* Goal was 100%
** Goal was 40% closed with substantive action
*** Goal was 40% active and 60% active for FY 2001

Future Challenges

The FEC has experienced a more than 1,400 percent increase in total campaign finance activity since 1976 (from $310 million in total disbursements in federal elections in 1976 to approximately $5.1 billion in the 2004 election.) This increase in total financial activity has led to a 27 percent increase in total documents filed in an election cycle since the 1984 cycle, as well as a 400 percent increase in itemized transactions entered into the disclosure databases since 1984. The Commission has met these increases with a relatively static level of staffing though the use of management initiatives, productivity increases, and the use of technological improvements.

External factors that affect the general application of the FECA pose the greatest challenge to the FEC's ability to achieve its mission. These factors are beyond the control of the Commission, and can include:

- Significant increases or decreases in the level of competition in federal election campaigns, the volume and intensity of fund-raising for federal campaigns, and the general political attitude, interest, and awareness of the public and the electorate, which can greatly influence the tone and competitiveness of elections;

- Amendments to FECA, which could either close present "loopholes" in the law and strengthen the FEC's enforcement and disclosure operations, or loosen the regulations regarding the limits and restrictions on fund-raising and reporting;

- Future Supreme Court rulings on contested elements of the FECA, e.g., the definition of "express advocacy," the legal determination of what activity by a group triggers registration as a committee (and thus reporting requirements and limitation provisions). The BCRA amendments to the FECA resolved some issues, left others still open, and created some potential new issues to be resolved; and

- The solvency of the Presidential Election Campaign Fund and, as a consequence, the determination of Presidential candidates to either opt in or out of the public funding programs.

All of these factors can influence the amount of money to be regulated by the FEC each election cycle, which affects FEC workload by variations in the number of reports filed and transactions to be processed, the volume of requests for information, data, and assistance, and the number of complaints filed with the Commission. The status of the Presidential fund may become an active factor in future elections, because of declining public support of the check-off and absent any legislative fix to index income into the fund.

FEC did not experience a major shortfall for the 2004 Presidential election because several major candidates decided not to take federal matching funds for the 2004 primaries; however, this may change in future elections. There was a brief shortfall, however, with the February 2004 primary matching payments for this election, which was restored with the February deposits to the fund. Shortfalls in 1996 and 2000 occurred for several reasons. First, the eligibility requirements for receiving matching funds have not been adjusted for inflation since 1974, thus allowing more candidates to qualify for matching funds. Second, the "front-loading" of the primary and caucus nominating process, which puts a premium on "early" fund-raising for Presidential candidates, resulted in a high volume of funds being raised in 1995 and 1999 that were eligible for matching payments in January of 1996 and 2000. Absent legislative action, the Public Funding program faces potential shortfalls because of declining participation in the check-off program, and the failure to index contributions to inflation while the payouts are indexed.

Authority for the Administrative Fine program will expire on December 31, 2005, unless action is taken to extend it.

To address these concerns, in May 2004 the FEC submitted to Congress and the President 12 legislative recommendations, four of which are considered a priority by the Commission.

- Allow use of federal campaign funds donations to State and local candidates and for any other lawful purpose;
- Increasing the amount that authorized committees may give to authorized committees of other candidates;
- Modifying terminology of "reason to believe" finding; and
- Require electronic filing of Senate reports.

Financial Performance Overview: Analysis of Financial Statements

The FEC notes that this is its first audited financial statement cycle, so comparative data is not available for prior years. The financial statements and accompanying notes begin on page 39 in Section III.

FEC's Consolidated Statement of Net Cost shows how the FEC used its resources in FY 2004. The Commission allocated its budget of $50,456,592 (including the OEA until the transfer of this office to the newly established EAC). The following pie charts reflect the FEC's total obligations of $50,388,416 for FY 2004. FEC allocated its resources to its three programs (disclosure, compliance, and public financing) based on the cost of the FTEs dedicated to each program. FTE figures were derived from the work hours entered by employees into the Management Information System (MIS). Costs for the offices and divisions that provided management and support services were allocated pro rata to the three programs. Imputed costs for future retirement and federal employees' health benefits also were allocated pro rata to the three programs.

During the past four fiscal years, the FEC spent the bulk of its resources on the two main programs: Disclosure and Compliance. Spending and FTE dedicated to Public Financing decreases as the presidential audits and the related compliance cases are completed each four-year cycle. As would be expected, the resources are allocated mostly to Compliance as the Audit and OGC staff shift over to non-presidential compliance activities.

The percentage of staff dedicated to Disclosure is higher than the percentage of dollars as the staff for these activities tends to be lower graded and less expensive than the lawyers and auditors dedicated to Compliance. However, more resources and higher level staff has been dedicated to Disclosure through the IT initiatives, as higher level programmers, systems analysts and other IT staff have been required to implement the IT initiatives and keep the more sophisticated databases, electronic filing, and the enhanced website running.

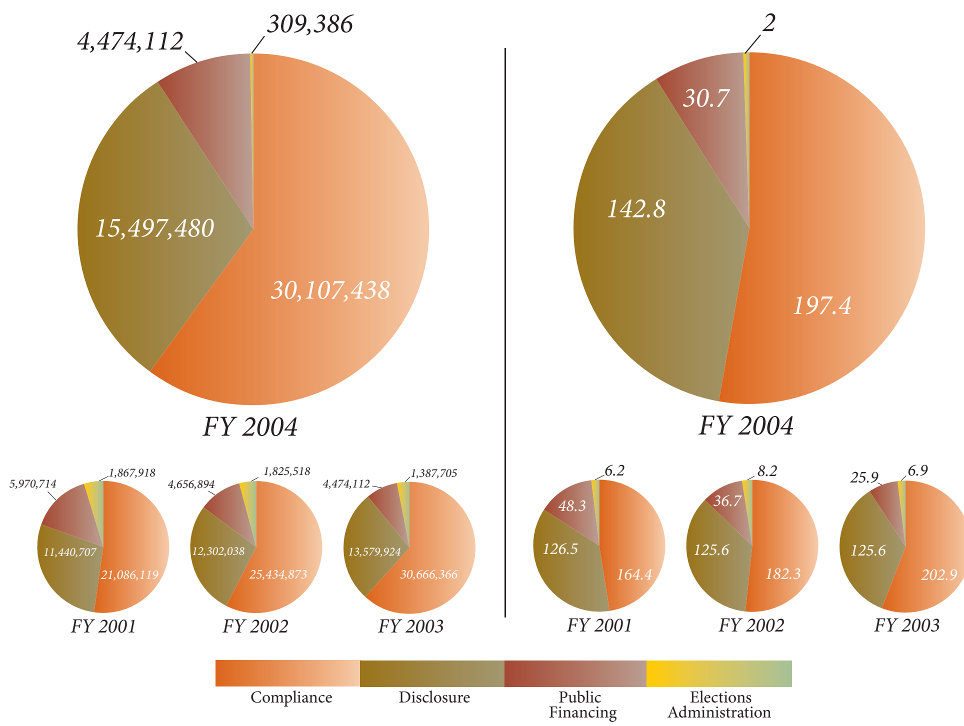
Resources and FTE dedicated to the OEA elections efforts declined as the relocation of the OEA staff and resources to the new EAC grew more imminent. The major accomplishments of the FEC in FY 2001-2004 were covered in the Management's Discussion and Analysis.

The pie charts in Figures 1.14 and 1.15 on page 20 show how dollars and FTEs were allocated organizationally among the three program areas for FY 2001–2004. These charts are based on total obligations for each fiscal year.

For comparison purposes, FTE and funds allocated for program areas in the past four fiscal years are presented below. Election administration became the responsibility of the new Office of Election Administration in mid-2004, so management and overhead costs were not allocated to OEA in the FY 2004 chart.

Figure 1.8 *Allocation (total obligations) by Major Program Area*

Figure 1.9 *FTEs by Major Program Area*

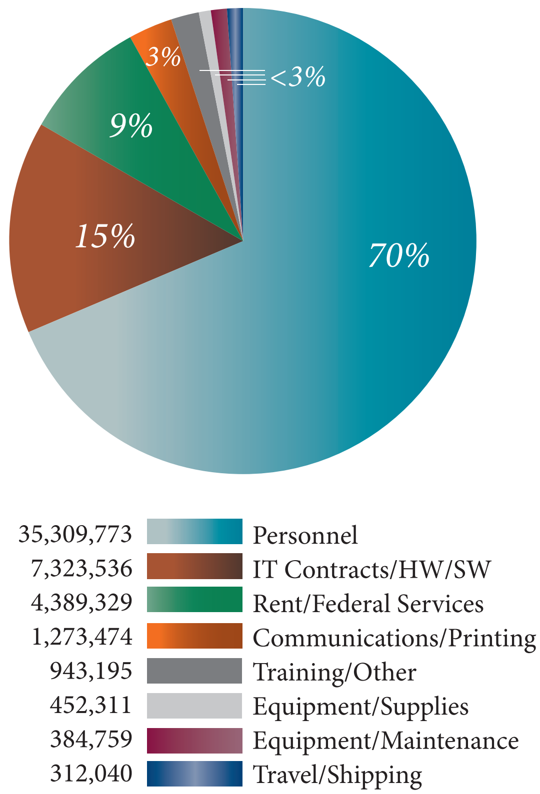


More than three-fourths of FEC's budget and staffing resources have been devoted to its compliance and disclosure programs.

The FEC did not allocate these costs until FY 2004, but for comparison purposes these costs were recalculated and allocated for FY 2001-2003 for the PAR.

The pie chart in Figure 1.10 on page 21 shows how the FEC utilized its budget (based on total obligations by object class) in FY 2004. FEC is a labor-intensive agency that does not provide grants; approximately 70-72 percent of the FEC's budget has been devoted to personnel expenses over the past 4 years. Costs are aggregated into several categories: (1) personnel; (2) travel and transportation; (3) space rental and federal agency services; (4) equipment rental and maintenance; (5) telephone/postage, printing and publications; (6) IT contracts, hardware and software; (7) equipment purchases and supplies; and (8) all other, including, training, depositions, and other contracts. Full details on FEC's FY 2004 budget may be found at www.fec.gov.

Figure 1.10 Dollar Allocation by Component, FY 2004



Nearly three-fourths of FEC's budget is devoted to personnel costs.

Debt Collection Improvement Act

FEC manages its delinquent debt pursuant to the Debt Collection Improvement Act (DCIA) of 1996. It refers delinquent debt greater than 90 days old to the Department of the Treasury (Treasury) for cross servicing and offset. In FY 2004, FEC's net receivables (delinquent debt) totaled $95,358.

Prompt Payment Act

The Prompt Pay Act requires federal agencies to make timely vendor payments and to pay interest penalties when payments are late. FEC's on-time payment rate for FY 2004 was effectively 100%.

Improper Payments Information Act

In accordance with OMB guidance, FEC reviewed all of its programs and activities to identify those, which may be susceptible for significant erroneous payments. FEC does not make grants, and its non-personnel expenses are approximately $15 million. FEC is confident that improper payments are immaterial.

Grants Management

FEC does not administer any grant programs.

Systems, Controls, and Legal Compliance

This section describes select systems that are critical to FEC management, and discusses FEC's capacity to comply with the federal laws and regulations that pertain to those systems and controls over its resources. While exempt from the Paperwork Reduction Act, FEC seeks to comply with the spirit and intent of a variety of federal financial management systems requirements, including those articulated by the Chief Financial Officers Act, Federal Managers' Financial Integrity Act (FMFIA), Government Management Results Act, Federal Financial Management Improvement Act, OMB Circular A-127, *Financial Management Systems*, and the Clinger-Cohen Act of 1996. FEC's goals for its financial management systems focus on ensuring effective internal controls, timely and reliable financial and performance data for reporting, and system integration. Its immediate priority is to address the two weaknesses identified by the auditors in the FY 2004 audit of FEC's financial statements. The auditors cited FEC's financial reporting process and FEC's information technology as material weaknesses. The auditors' report and management's responses are presented in their entirety in Section III; the auditors' findings and FEC's responses are summarized below:

- Financial Reporting: The auditors noted that FEC had to expend a tremendous amount of effort to "cleanup" its accounting records in order to prepare auditable financial statements as of and for the year ended September 30, 2004. They opined that weaknesses in four related areas (financial statement preparation; timely recording, reconciliation and analysis; General Ledger system setup and posting model definitions; and the lack of an integrated financial management system) constituted a material weakness. FEC believes that it took appropriate action before and during the audit period to address and mitigate the problems cited by the auditors to the extent that these issues do not constitute a material weakness.

- Information Technology: The auditors opined that weaknesses in four related information technology areas (entity-wide security program, controls to protect information, contingency plan, and software development and change controls), when viewed as a whole, constituted a material weakness. FEC acknowledges that the problems identified are reportable conditions, but does not believe that the collective weight of these issues rises to the level of a material weakness. Management recognized these issues (in some cases prior to the beginning of the financial statement audit) and has initiated corrective action. FEC maintains that it is not appropriate to find the existence of financial management material weaknesses for systems and applications that do not directly impact on the accuracy and security of information used in the FEC financial statements.

FEC Financial Management System

The FEC is actively moving toward an integrated financial system. The FEC has migrated to PeopleSoft financials and is currently upgrading the system to comply with Government Accountability Office standards and federal systems certification requirements. In FY 2004 and continuing into FY 2005, the FEC engaged in a legacy system "off-load" process to migrate legacy systems over to the new PeopleSoft compatible, Oracle IT platform. In addition, since late FY 2003 the FEC has been developing and implementing a budget preparation and MIS system that will be totally integrated with the financial system and all other Oracle-based IT systems.

Overview of Strategic Plan

FEC currently operates under its FY 2004 – 2009 *Strategic Plan*, developed in accordance with the Government Performance and Results Act. This Strategic Plan provides the framework for how FEC will use its resources to implement and enforce the campaign finance laws during the 2004 (FY 2004-2005), 2006 (FY 2006-2007) and 2008 (FY 2008-2009) election cycles.

As noted in the Management's Discussion and Analysis Section, the FEC is different from most agencies in that its natural workflow patterns do not begin and end neatly on October 1, the start of the new federal fiscal year. The flow of work for programs such as audits and enforcement actions can span two or three election cycles. As a result, work undertaken or completed in any fiscal year includes work that began in previous election cycles.

The FEC achieved several successes in FY 2004 and expects to continue these successes and build upon them in FY 2005. This is contingent on the FEC receiving the budget requested for FY 2005 of $52,159,000 and 391 FTE. In addition, the FEC requires this level of funding to continue to implement changes required by the BCRA amendments to the FECA and to cope with the implications of recent court proceedings and rulings with regard to FEC regulations promulgated to implement the BCRA.

The FEC funding for FY 2004 and 2005 as proposed includes the multi-year IT initiative funding for the overall improvements to the FEC IT programs, and activities that require long range funding and implementation. Reductions in the FY 2005 budget, whether programmatic or due to across-the-board general reductions will endanger the success of these multi-year initiatives. It is therefore crucial for the FEC to receive requested funding levels for FY 2005 to enable the Commission to continue to build upon recent successes in disclosure, compliance and public financing.

FY 2004 Performance Plan and Results

The FEC's Strategic Plan identifies performance goals by election cycle or other multi-year periods. The FY 2004 Performance Plan focuses on the results sought for only the fiscal year. While it is difficult to measure how the FEC ensures public faith in the political and campaign finance systems, FEC gauges its effectiveness through a series of performance indicators designed to measure performance in areas that promote confidence in the election finance process. The FEC Office of Election Administration was included in prior reports as a program area; it was transferred to the new Election Assistance Commission (EAC) in mid FY 2004, so it is not included in this year's report.

Disclosure

The desired outcome is that the public can make informed choices in the electoral process because of full disclosure of the sources of candidate campaign funding. Disclosure goals focus on timely responses to requests for information and speed in making information available to the public.

The table on page 30 summarizes FEC's performance on its disclosure goals for FYs 2001–2004. It uses the color coding used in the Executive Branch Management Scorecards that track status and progress toward the goals of the President's Management Agenda. Green indicates that FEC met or exceeded the goal; yellow indicates that FEC came very close to meeting the goal. Red would be used to indicate that the Commission failed to meet a goal by a significant margin. FEC is proud that none of its results received a "red" score.

The key to disclosure is timely and accurate disclosure of campaign finance information. Two of the Commission's key measures of this are the timeliness of data processed into the Commission disclosure database; and the timeliness of reviews of the reports to foster the voluntary improvement of the accuracy of the reports filed. The two timeliness measures for processing information are: the median days required to process the reports (days to place 50 percent of the reports and itemized data on the public record), as depicted in Figure 1.11 on page 28; and the days from receipt of report to completion of processing for 95 percent of all reports received, as depicted in Figure 1.12 also on page 28.

Figure 1.13 on page 29 depicts those measures and compares numbers of documents and itemized transactions processed as of September 30 of the election year for the 2000, 2002 and 2004 election cycles.

The only 100 percent scrutiny of all disclosure reports results from the review of the reports by the Reports Analysis Division (RAD). The record workloads incurred since the 1992 cycle impacted on the timeliness of the review of the reports. Significant backlogs of unreviewed reports developed, reaching over 30,000 reports at one point in the 2000 cycle. However, RAD made significant improvement in the timeliness of the review of reports in FY 2004 for the 2004 cycle. It should also be noted that RAD and IT are engaged in a project to

Figure 1.11 Median Days Required to Process Reports

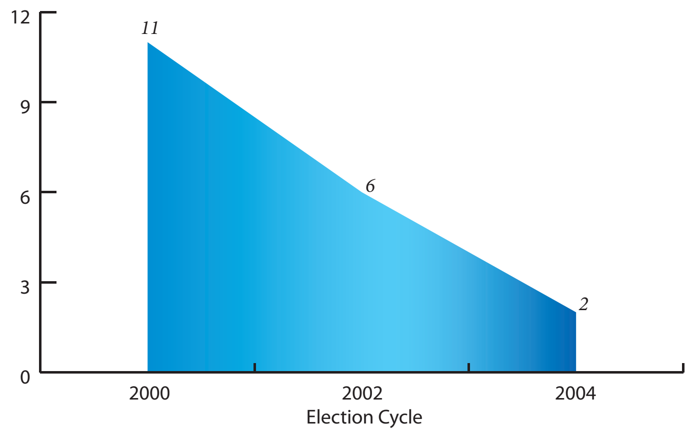
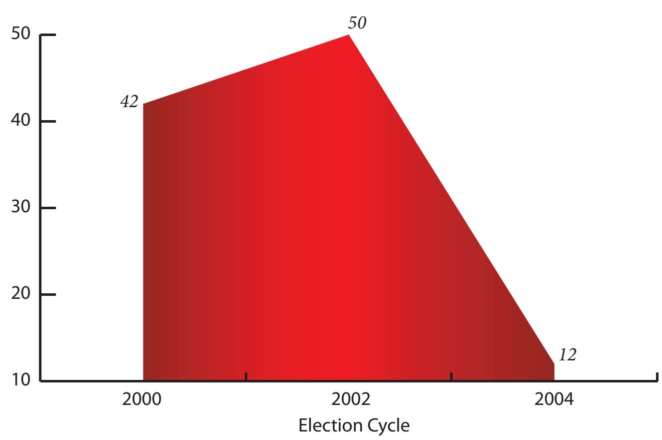


Figure 1.12 Days Needed to Complete Processing for 95% of Reports

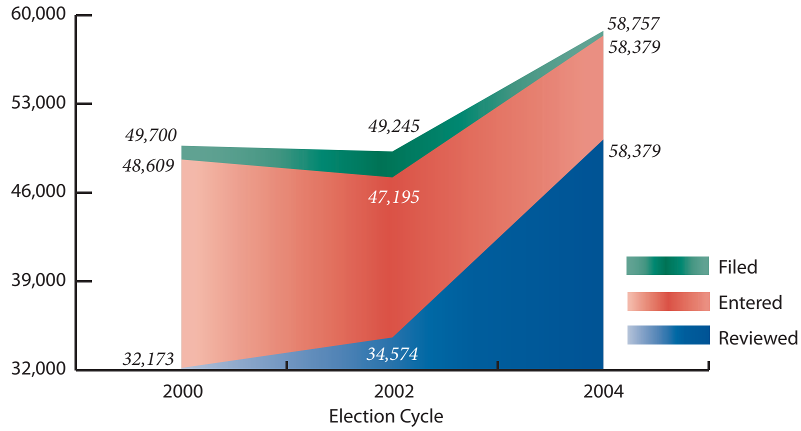


As Figures 1.11 and 1.12 illustrate, electronic filing and other initiatives dramatically decreased the time it takes to process reports.

develop and implement an automated review system that will greatly enhance the breadth and scope of reports review and should further improve the timeliness of review.

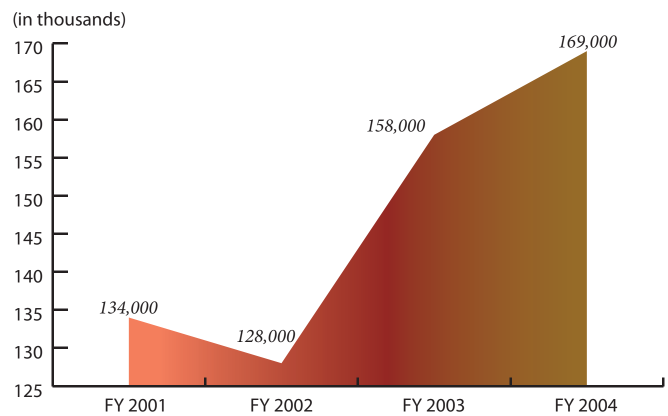
A review of workload and performance data for the data processing and reports review activities of the Commission reveals improvement in the processing of reports. In addition to the timelier processing of reports, the FEC is more efficient, with the coding of itemized transactions, reaching 169,000 per FTE in FY 2004 compared to 128,000 per FTE in FY 2002. This productivity increase is illustrated in Figure 1.14 on page 29. (Many of the FEC workloads vary in cycles including in odd and even fiscal year cycles due to the nature of when the election date falls in the fiscal year as noted previously.)

Figure 1.13 Document Volumes and Process Efficiency (through 9/30 of election year)



The numbers and timeliness of documents processed increased significantly from 2002 to 2004

Figure 1.14 Total Transactions Coded Per FTE, Fiscal Year



Electronic filing and IT increased productivity (number of transactions coded per employee)

Compliance

The desired outcomes are the perception by the regulated community that disclosure reports must be accurately and timely filed and the impartial and timely enforcement of the FECA. Compliance goals focus on primarily on the number of actions accomplished.

The table on page 31 summarizes FEC's performance on its compliance goals for FY 2001–2004. It uses the color coding used in the Executive Branch Management Scorecards that track status and progress toward the goals of the President's Management Agenda. Green indicates that FEC met or exceeded its goal; yellow indicates that FEC came very close to meeting the goal. Red would be used to indicate that the Commission failed to meet a goal by a significant margin. The FEC is proud that only one of its results received a "red" score.

Figure 1.15 FY 2004 Performance Plan Results – Disclosure

Performance Measure/Responsible FEC Component	FY 2004 Volume and Results	FY 2003 Volume and Results	FY 2002 Volume and Results	FY 2001 Volume and Results
Make 99% of reports filed at FEC available for public review within 48 hours by processing reports and statements (scan, film, file, code, and enter summary data) (Public Disclosure/Data Systems)	GREEN 87,500 reports and statements	GREEN 90,500 reports and statements	GREEN 71,000 reports and statements	GREEN 81,100 reports and statements
Code and enter itemized data from disclosure reports filed, 95% complete within 45 days from the date the reports are received at the FEC; reduce backlog of unprocessed 2004 cycle reports to less than 2,000 (and all unprocessed reports to less than 3,000) (Data Systems)	GREEN 44,800 reports and 1,660,000 transactions 2004: Backlog 378 99% 17 days to 95% complete 2002: Backlog 34 99% YELLOW 71 days to 95% complete	GREEN 56,500 reports 1,457,000 transactions 2004: Backlog 101 99% 19 days to 95% complete 2002: Backlog 66 99% YELLOW 71 days to 95% complete	GREEN 39,000 reports 1,125,000 transactions 2002: Backlog 2100 96% YELLOW 50 days to 95% complete 2000: Backlog 175 99% 45 days to 95% complete	GREEN 49,000 reports 1,181,000 transactions 2002: Backlog 547 95% 18 days to 95% complete 2000: Backlog 312 99% 44 days to 95% complete
Respond to 75% of requests for assistance from committees in filing reports within 72 hours. (Reports Analysis)	GREEN 18,500 requests	GREEN 20,200 requests	GREEN 14,900 requests	GREEN 12,500 requests
Review 60% of all quarterly reports filed within 90 days of receipt at Commission (75% within 120 days), complete 100% review of all reports filed; reduce backlog of unreviewed 2004 cycle reports to less than 15,000, and less than 16,000 for all reports from all cycles (Reports Analysis)	GREEN 44,600 reports 2004: 8,600 Backlog 85% of reviews completed 2002: 505 Backlog 99% of reviews completed	GREEN 61,400 reports 2004: 7,300 Backlog 54% of reviews completed 2002: 424 Backlog 99% of reviews completed	GREEN/YELLOW 40,100 reports 2002: 14,700 Backlog 70% of reviews completed 2000: 1,300 Backlog 99% of reviews completed	GREEN/YELLOW 52,500 reports 2002: 10,700 Backlog 8.5% of reviews completed 2000: 4,300 Backlog 95% of reviews completed
Review 100% of all statements received	GREEN 14,300 statements	GREEN 14,300 statements	GREEN 14,300 statements	GREEN 14,300 statements
Prepare RFAI's for 100% of all committees' reports reviewed which require them, 60% within 90 days of receipt at Commission	GREEN 9,700 RFAI's	GREEN 11,300 RFAI's	YELLOW 8,800 RFAI's	YELLOW 11,500 RFAI's
Respond to 100% of all requests within 72 hours (Public Disclosure, Press Office, Information) Requests for general information on FEC and FECA (14 days for written requests) Calls and requests for copies of forms, the FECA and Regulations, and Commission brochures and guidelines	GREEN 23,000 Public Records 34,100 Printouts 51,400 Press/Information 14,800 Orders	GREEN 24,300 Public Records 37,800 Printouts 37,600 Press/Information 11,300 Orders	GREEN 22,000 Public Records 29,000 Printouts 37,900 Press/Information 4,100 Orders	GREEN 23,800 Public Records 30,300 Printouts 48,600 Press/Information 9,900 Orders
Comply with statutory deadlines for 95% of all FOIA requests and appeal received; respond to all requests for legal assistance from FOIA Officer (OGC)	GREEN 30 Requests YELLOW—need data on FOIA appeals and legal	GREEN 26 Requests YELLOW—need data on FOIA appeals and legal	GREEN 20 Requests YELLOW—need data on FOIA appeals and legal	GREEN 38 Requests YELLOW—need data on FOIA appeals and legal
Enable Commission to meet statutory deadlines for issuance or conclude action on Advisory Opinions for 95% of all 60 and 20 day deadlines, estimated 40 in FY 2002, and meet 45-60 day target for AO reconsiderations, 15 days for deficient request notices (OGC)	GREEN 47 Advisory Opinions	GREEN 28 Advisory Opinions	GREEN 18 Advisory Opinions	GREEN 28 Advisory Opinions
Maintain targets for completion of all rule-making petitions filed pursuant to 11 CFR Part 200, complete revisions to sections of Regulations in FY 2004 (OGC)	GREEN	GREEN Massive Effort on BCRA Implementation Deadlines	GREEN Massive Effort on BCRA Implementation Deadlines	GREEN
Notify all filers of upcoming reporting periods, and provide copies of forms as a pre-reporting notice; publish monthly FEC Record (Information)	GREEN	GREEN	GREEN	GREEN
Publish statutorily required Annual Report and publish the following: FEC Disclosure Forms, FECA (the Act), FEC Regulations and updates, 11 CFR, Campaign Guides/Brochures (Information)	GREEN	GREEN	GREEN	GREEN

Figure 1.16 FY 2004 Performance Plan Results – Compliance

Performance Measure/Responsible FEC Component	FY 2004 Volume and Results	FY 2003 Volume and Results	FY 2002 Volume and Results	FY 2001 Volume and Results
Refer committees for potential audits (RAD) 75 committees for potential audits from the 2002 election cycle in FY 2003-2004 (50 in FY 2003 and 25 in FY 2004)	GREEN/YELLOW 1 Referral—Total is one less than 75, but completed early; in FY 2003 rather than 2004.	GREEN 73 Referrals	YELLOW 1 Referral; Less than 75 per full 2000 Cycle	GREEN 52 Referrals
Refer committees for potential enforcement actions (RAD) 35 committees; complete all enforcement referrals within the second FY of the election cycle (all of 2004 cycle by close of FY 2005) (RAD)	GREEN 43 referrals	YELLOW 17 Referrals	YELLOW 15 Referrals	YELLOW 11 Referrals
Publish committees that fail to file reports (RAD) OAR—Admin Fines Program	GREEN	GREEN	GREEN	GREEN
Complete the expanded number of 438(b) audits (Audit) Expand from 20-25 to 40-45 per Election Cycl: 20-25 authorized committee audits and 20-25 unauthorized committee audits; initiate an estimated 45-50 total audits for the 2002 cycle; initiate all authorized committee audits within 6 months of the election	GREEN 32 Audits Completed Goal of 50 for 2002 Cycle Achieved	GREEN 21 Audits Completed Goal of 50 for 2002 Cycle Achieved	GREEN 17 Audits Completed Goal of 25 for 2000 Cycle Achieved	GREEN 15 Audits Completed Goal of 25 for 2000 Cycle Achieved
Maintain the Enforcement Priority System (EPS) to identify and assign the more significant enforcement cases, more rapidly dispose of less significant cases, and manage limited staff resources: (OGC) Process and close 200 cases in FY 2004, 50% with substantive Commission action Maintain monthly average total caseload of 175 to 200 cases, with average ratio of 50% active to 50% inactive cases (OGC)	GREEN Substantive and Active Cases 50% or better YELLOW Less than 100 cases closed	GREEN Substantive and Active Cases 50% or better YELLOW Less than 100 cases closed	GREEN Substantive and Active Cases 50% or better YELLOW Less than 100 cases closed	GREEN Substantive and Active Cases 50% or better GREEN 100 cases closed
Respond to RAD requests for review of debt settlement plans and administrative terminations, complete review of complex debt settlement plans; complete debt settlements and administrative terminations (OGC) Complete 25 debt settlements and 500 administrative terminations	GREEN/YELLOW 7 Debt Settlements 419 Admin Terminations	GREEN/YELLOW 12 Debt Settlements 462 Admin Terminations	GREEN/YELLOW 22 Debt Settlements 630 Admin Terminations	GREEN/YELLOW 36 Debt Settlements 60 Admin Terminations
File all litigation pleadings in district court for offensive litigation of Commission determination to file suit, and meet all other time limits for briefs and other pleadings imposed by the rule or order of the courts; estimated 10-15 defensive suits initiated. (OGC)	GREEN File pleadings within 90 days of Commission determination to file suit, Initiate 10-15 defensive suits	GREEN Massive efforts to meet BCRA Challenge Deadlines at SCOTUS	GREEN Massive efforts to meet BCRA Challenge Dead-lines at SCOTUS	GREEN
Make at least one attempt to initiate settlement prior to commencement of suit for each case early enough to permit consideration by Commission of any settlement proposal prior to target date of initiation of suit (OGC)	YELLOW Virtually no Offensive Suits Filed—but case can be made that successful efforts for conciliations avoided suits. See also measure below.	YELLOW Virtually no Offensive Suits Filed—but case can be made that successful efforts for conciliations avoided suits.	YELLOW Virtually no Offensive Suits Filed—but case can be made that successful efforts for conciliations avoided suits.	YELLOW Virtually no Offensive Suits Filed—but case can be made that successful efforts for conciliations avoided suits.
Ensure that all pleadings and briefs represent the Commission's positions persuasively, by reporting on status of each active litigation case once a month, and by maintaining a system to obtain satisfaction of all judgments imposing civil penalties (OGC)	GREEN Successful increase in civil penalties collected.	GREEN Successful increase in civil penalties collected.	GREEN Successful increase in civil penalties collected.	GREEN Successful increase in civil penalties collected.
Permits operation of the ADR and administrative fine programs with 3 FTE each o process non-and/or late-filer cases and less salient cases; frees enforcement staff in OGC to work on more complex, substantive cases for potential enforcement action (RAD and ADR, OAR)	GREEN 41 closed ADR Cases; 26 Substantive 137 Admin fines collected	GREEN 50 closed ADR Cases; 31 Substantive 394 Admin fines collected	GREEN 18 closed ADR Cases; 17 Substantive 117 Admin fines collected	GREEN 270 closed ADR Cases; 25 Substantive 361 Admin fines collected
Enhance automated review and data mining capabilities; full productivity and workload impacts not expected until 2006 cycle (RAD and Data)	YELLOW Developmental work on Automated Review Process and Data Mining	YELLOW Developmental work on Automated Review Process and Data Mining	YELLOW Developmental work on Automated Review Process and Data Mining	YELLOW Developmental work on Automated Review Process and Data Mining
Utilize additional staff in RAD and OGC acquired due to BCRA impacts to ensure that new provisions of the FECA amended by BCRA are complied with, properly reported, and enforced (RAD and OGC)	GREEN ITD, RAD, BCRA Staff hired RED OGC BCRA staff not filled	YELLOW ITD, RAD, BCRA Staff mostly hired RED OGC BCRA staff not filled	NO BCRA Staff Increment	NO BCRA Staff Increment

The FEC has engaged in efforts to improve its general compliance program to foster the image that the FECA is fairly, impartially, and timely enforced, and that there are real consequences to not complying with the law. The initiatives have included the expansion of the enforcement presence through the use of the Administrative Fine and ADR programs. These programs have generated more streamlined enforcement actions, produced substantive resolution to cases that would have been dismissed or never activated, and fostered compliance with the filing requirements and deadlines with regularized, real consequences for failing to file reports on time.

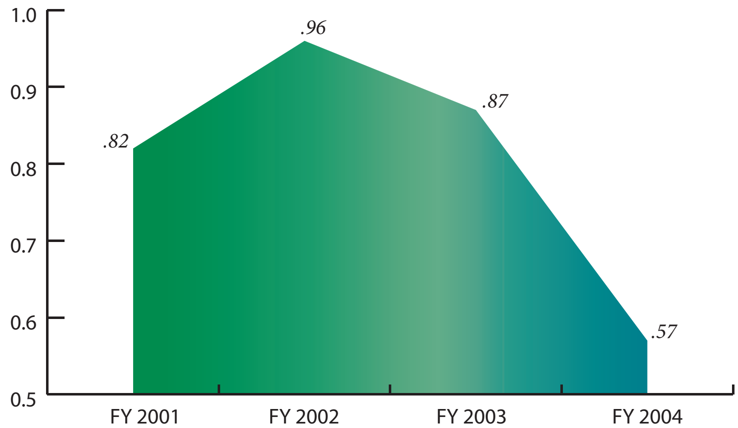
In addition, the two programs (Administrative Fine and ADR) have allowed OGC to focus its enforcement resources on more substantive cases, and improve the timeliness of cases closed. The measures of these initiatives include: the number of cases closed, the percentage of cases closed with substantive action rather than dismissed, the days elapsed to close cases, and the total and average amount of civil penalties and fines collected. The last measure is an attempt to quantify the substantive nature of cases, assuming that larger fines and penalties are indicative of more major violations of the FECA.

While the total cases closed has decreased for OGC, the percentage closed with substantive action has increased markedly, from an average of 45 percent in FYs 1995-2002 to 85 percent in FY 2004. The total cases closed decreased partially because some of the less substantive cases were transferred to the new Administrative Fine and ADR programs, allowing the Office of General Counsel to concentrate its resources on more salient cases.

Administrative fines and ADR cases are closed with significantly less time than for OGC cases. Administrative fines cases for late and non-filers take less time to complete, especially when measured from the date a Reason to Believe determination was made to the final determination date. The difficulties associated with the mail processing and delivery post-9/11 had a somewhat adverse impact on the processing of these cases. However, there is evidence that the program is improving filing timeliness and compliance, and that the cases are most likely to derive from the non-electronically filed reports (also the smaller committees in terms of dollar activity.) ADR cases have shown improvement in timeliness for those cases not dismissed and generally take less time to complete than traditional enforcement cases.

The RAD staff has utilized technology to reduce the time required to process requests for additional information, as shown in Figure 1.17 below.

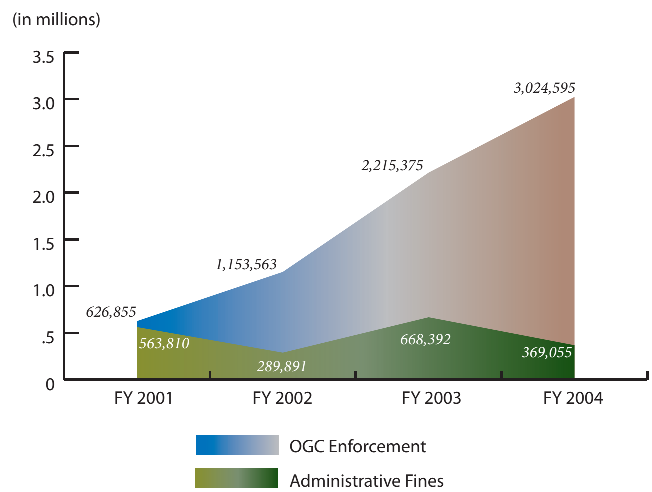
Figure 1.17 RAD FTE Hours Per RFAI, Fiscal Year



The RAD staff continued to decrease the time it takes to process Requests For Additional Information

Overall, civil monetary penalties have increased significantly from FY 2001 to FY 2004, as illustrated in Figure 1-18. Administrative Fine and ADR programs have allowed FEC to effectively process late and non-filing cases that in the past might not have received attention.

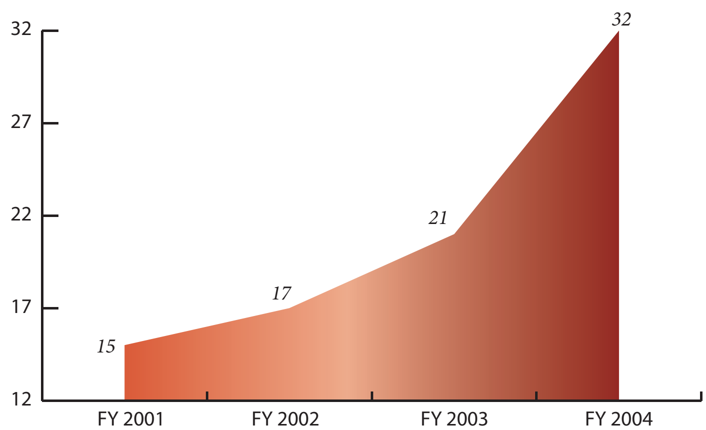
Figure 1.18 Fines and Penalties Assessed, Fiscal Year



By focusing on more salient cases, FEC has dramatically increased the civil penalties assessed

The FEC has increased the number of non-Presidential audits, known as Title 2 audits, from 20-25 per election cycle to 45-50 per cycle in the 2002 cycle. These results were evident in FYs 2003–2004, when the number of Title 2 audits more than doubled from FYs 2001–2002.

Figure 1.19 Number of Title 2 Audits Completed, Fiscal Year



The number of audits completed has doubled since FY 2001

Public Financing

The desired outcomes of the public funding program are to process timely and accurately requests for federal funds to qualified presidential candidates and to ensure impartial and timely enforcement of the FECA.

Due to the timing of the election cycle, the FEC's goals for FY 2004 in this area were limited. The Commission reviewed all matching fund requests and certified for payment within required time frames. It also met its earlier goal of completing by December 2003 all repayment matters within three years of general election for the 2000 election.

Results from FYs 2001- 2003

The FEC achieved its goals for public financing in accordance with the following time frames established in the Commission's *Strategic Plan*.

Within two years of each Presidential general election, complete the certification of payments to and audits of publicly funded candidates in Presidential elections:

- Process monthly certification requests for federal matching funds (estimated 10-12 candidates in a Presidential election with an incumbent, 15-17 candidates in an "open" Presidential election);

- Audit primary candidates receiving federal matching funds (same criteria for number of candidates);

- Audit at least four (major) national party convention and host committees receiving federal funds for nominating conventions, and any eligible minor party convention committees; and

- Audit general election candidate committees of two major parties (and any eligible minor parties).

Within three years of each Presidential general election, complete legal review of Presidential audits:

- Review legal issues arising from primary audits, at least four convention audits, and two or three general election audits;

- Resolve repayment questions for committees receiving federal funds (always meeting three year statute of limitations);

- Initiate enforcement cases involving Presidential committees referred through internal referral process or complaint; and

- Provide Congress with a report on the public funding programs.

Within four years of each Presidential general election, complete initial actions on enforcement cases involving Presidential committees referred through internal process or complaint.

All 2000 cycle Presidential audits were completed by the close of 2002; the FEC target is two years from the date of the general election. The FEC goal will be FY 2006 for the 2004 cycle audits.

All 2004 certifications for matching funds were processed in a timely manner.

As noted, the FEC has warned in the A-123 process that the Presidential funds are incurring shortfalls due to lack of indexing of contributions into the fund for inflation, while the payments are indexed for inflation. In addition, public support for the check-off fund has been eroding. The FEC has requested educational program funding to explain the check-off and has made several legislative recommendations to "fix" the program in the past but has not received any of the requested funding. The program will require legislative changes to avoid significant shortfalls in future elections; all shortfalls to date have been confined to the primary matching fund program and have been made good reasonably soon in the cycle. Future shortfalls could impact on the general election and/or on the primary program in a major fashion.

Other FY 2004 Performance Results

IT development and enhancements assist the FEC in meeting its objectives and goals. The two major on-going initiatives are the IT Enhancements and the Electronic Filing projects. During FY 2004, the Commission continued to provide point of entry for filing House disclosure documents at the FEC; scan all documents and transmit images to House Office in usable format for that office; work with Senate Office in making Senate documents available for disclosure; and enhance and upgrade FEC imaging system and all web-based disclosure applications. FEC also continued its multiyear enhancement and upgrade of IT systems for all Commission Offices and Divisions; migration to client/server environment; and implementation of document management system; and maintained its new finance and accounting system. The Commission developed a Data Mining program to take advantage of the enhanced disclosure system and to enhance the automated review process in RAD.

The Commissioner and management staff continued to comply with government-wide laws and regulations for budget, planning, personnel, Equal Employment Opportunity, and other issues affecting federal agencies; and to provide guidance and support to the staff in meeting the FEC mission and achieving agency objectives and goals.

The Department of Agriculture, which performs the payroll function for FEC, underwent a Statement of Auditing Standards (SAS) 70 system review, which noted several reportable conditions that did not affect FEC. These audits, completed under the guidelines of the American Institute of Certified Public Accountants' SAS Number 70, Service Organizations, provide an opinion on the internal controls placed in operation and include tests of operating effectiveness.

Program Assessment Rating Tool (PART) Reviews

During FY 2004, FEC participated in one PART review by OMB. FEC's Compliance-Enforcement program received an overall rating of "Results Not Demonstrated." OMB found that the program's purpose is clear and addresses a specific public need. The program's annual performance measures demonstrate progress toward meeting FEC's strategic goals, and it annually meets goals designed to promote voluntary compliance. OMB noted that the program lacks long-term performance measures, does not have a history of regular, independent evaluations, and needs to better link its budget and performance goals. The Commission is working to address these concerns.

Data Sources and Quality

The FEC has a planning and budgeting system based on a detailed Management Information System (MIS), and is driven by program-based workloads and activity data, outputs, and productivity measures. In an ongoing evaluation process, the monthly MIS reports and fiscal year-based productivity measures are used to evaluate program efficiency and effectiveness. The FEC has also married the A-123 and A-127 processes, under the Federal Managers' Financial Integrity Act, to ongoing program management activities, and relates the annual A-123 reports to the FEC budget requests.

The evaluation of program resources, mainly staff resources, and the resulting program outputs and productivity measures are used in the internal planning and budget formulation processes. Commission management plans and budget requests are workload-driven, and related to resource levels and expected program activity levels.

As a personnel-intensive agency, about 70 percent of the Commission's resources are staff costs, and the remaining 30 percent represents mainly rent and other direct support for that staff. Using the MIS and summary MIS reports, both produced on a monthly basis, all workloads, program outputs, productivity, and effectiveness and efficiency are being monitored, in monthly management reports. Several other tracking systems monitor the status of reports processing (filing, filming, data coding and entry, and reports review), enforcement and litigation activities, Advisory Opinions and regulatory rule making, and audit progress. The Enforcement Priority System continually adjusts active enforcement case loads to match available resources.

A major, multiyear effort to institute a case management system for OGC to track enforcement cases resulted in the system becoming fully operational in FY 2003. This system monitors case status and tracks staff time by case for all OGC programs, not just enforcement. The implementation of the case management system provides a significant tool for the FEC to monitor resource usage and case progress.

FEC's performance goals are tied directly to the Commission's workload and activity measures and the level of funding requested. The ongoing program activity monitoring and output measurement efforts enable the Commission to determine if its performance goals are being achieved. This provides the basis for future evaluation efforts.

Message from the CFO

The FEC is pleased to present the Federal Election Commission's Performance and Accountability Report (PAR) for FY 2004, prepared under the guidance of the Office of Management and Budget's (OMB) Bulletin No. 01-09. This Performance and Accountability Report contains the Commission's financial statements, as required by the Accountability of Tax Dollars Act of 2002; a section of performance information, and a report on the Commission's material weaknesses as identified in the audit report.

The Accountability of Tax Dollars Act of 2002 extended the requirements for the preparation of financial statements and for a full financial audit of the agency's financial management systems and internal management controls down to agencies the size of the Commission. The FEC requested and received a waiver from this requirement in FY 2003, as did most of the agencies newly required to undergo financial audits, to give the FEC time to prepare for the financial audit. Therefore, this report reflects the first year that the FEC was required to produce financial statements and undergo a full financial audit.

The Commission is pleased that the FEC received a fully unqualified (clean) opinion from the Independent Certified Public Accounting firm of Clifton Gunderson LLP, which was engaged by the FEC Office of Inspector General to audit the consolidated financial statements included in this report. The unqualified opinion indicates that the FEC's financial statements present fairly the financial position of the Federal Election Commission.

The FEC committed significant resources to improving our financial systems and preparing for the first year audit. We acquired the services of an accounting firm to review our FY 2003 financial systems and statements, and to prepare for the FY 2004 audit and the preparation of full financial statements. The accounting firm also assisted Commission staff in their successful achievement of an unqualified audit opinion in the first year of full financial audits.

The FEC is also engaged in ongoing efforts to more fully integrate our financial management systems and to upgrade our financial accounting system, which was acquired and installed over the previous fiscal years. The past and on-going commitment of resources to enhance and improve the FEC financial management systems is proof of the agency's continuing efforts to ensure that the Commission has sound and effective financial management controls systems.

This report also contains a discussion of key performance measures that depict the Commission's processing of record levels of campaign finance reports and data from those reports in the most recent election cycles. New records of total campaign spending have been set each election cycle since the 1992 election. The FEC has managed to improve our timeliness of data processing and review of reports, and to expand and improve our disclosure of reports and data in the face of these record levels of campaign finance activity. The FEC has improved our compliance programs by expanding our enforcement presence and increasing the number of cases closed with substantive actions.

The Commission has also successfully implemented the recent major amendments to the Federal Election Campaign Act (FECA), the Bipartisan Campaign Reform Act (BCRA). The FEC met stringent deadlines both for promulgating implementing regulations and preparing for legal reviews of the substance of the legislation. The legal ramifications of these rule-making efforts and court cases extended into FY 2004 and will continue to require a significant commitment of resources.

The FEC has achieved these successes with limited increases in staff and resources through management initiatives to improve performance, enhanced use of IT resources, and the implementation of electronic filing of campaign finance disclosure reports. We have also instituted an administrative fine program to improve timely filing.

While the audit did report some material weaknesses and reportable conditions, the FEC is engaged in efforts to correct any weaknesses and improve our financial management systems. The FEC also notes that our financial management controls generally comply with the FMFIA and that there are no weaknesses that we believe place our overall system of management controls at serious risk of jeopardizing the soundness of our financial statements.

FEC managers are required to include concern for internal management controls in their on-going management duties and responsibilities, and to annually report any potential vulnerabilities or weaknesses through a process of risk assessment of their programs. In keeping with OMB circulars and directives, the FEC has emphasized integrating management controls concerns with general management responsibilities.

This report reflects the results of the audit of the financial statements, our performance in meeting our mission and our objectives for our major programs, and our concern for sound financial and program management. Taken as a whole, these efforts reflect the Commission's goal to effectively and efficiently meet our mission responsibilities, and the FEC's efforts to maintain, and enhance and improve, sound financial management controls.

We are pleased to report that the FEC's system of management controls, taken as a whole, are in compliance with the FMFIA and the Accountability Act, and provide reasonable assurance against waste, fraud, and abuse of agency resources. They also provide reasonable assurance that the Commission is using resources effectively and efficiently in meeting our mission responsibilities. This report reflects the FEC's continual commitment to improving and enhancing our management controls systems.

John C. O'Brien
Acting Deputy Staff Director for Management
Acting Chief Financial Officer

Independent Auditor's Report

FEDERAL ELECTION COMMISSION
Washington, D.C. 20463

Office of Inspector General

MEMORANDUM

TO: The Commission

FROM: Inspector General

SUBJECT: Audit of the Federal Election Commission's Fiscal Year 2004 Financial Statements

DATE: December 16, 2004

This letter transmits the final audit report of the Federal Election Commission's (FEC) fiscal year (FY) 2004 financial statements. In accordance with the Accountability of Tax Dollars Act of 2002, the FEC prepared financial statements in accordance with Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, as amended, and subjected them to audit.

The Chief Financial Officers Act of 1990 (Public Law 101-576, commonly referred to as the "CFO Act"), as amended, requires the FEC Office of Inspector General (OIG), or an independent external auditor as determined by the Inspector General, to audit the agency financial statements. Under a contract monitored by the OIG, Clifton Gunderson LLP (CG-LLP), an independent certified public accounting firm, performed the audit of the FEC's FY 2004 financial statements.

In the report dated December 8, 2004, CG-LLP issued an unqualified opinion on the FEC's financial statements. The OIG commends the FEC for the noteworthy accomplishment of receiving an unqualified opinion, the first year the FEC was subject to the requirements of the Accountability of Tax Dollars Act of 2002. Although the OIG recognizes this significant accomplishment, it is important to recognize that a tremendous amount of effort by FEC management, staff, and consultants was necessary to achieve the unqualified opinion. In addition, the auditor report on internal control includes both reportable conditions and material weaknesses, and numerous audit recommendations that must be addressed by management.

Audit Process

CG-LLP conducted the audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended. The results of the financial statement audit are detailed in three reports: report on compliance with laws and regulations; report on internal control; and the opinion on the financial statements.

Report on Compliance with Laws and Regulations

FEC management is responsible for complying with laws and regulations applicable to the agency. To obtain reasonable assurance about whether FEC's financial statements are free of material misstatements, CG-LLP performed tests of compliance with certain provisions of laws and regulations, non-compliance with which could have a direct and material effect on the determination of financial statement amounts, and certain laws and regulations specified in OMB Bulletin No. 01-02, such as the Anti-Deficiency Act and the Prompt Payment Act.

The results of CG-LLP's tests of compliance with laws and regulations described in the audit report disclosed no instances of noncompliance with the laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Report on Internal Control

CG-LLP's planning and performance of the audit included consideration of the FEC's internal control over financial reporting. The CG-LLP auditors obtained an understanding of the FEC's internal control; determined whether internal controls had been placed in operation; assessed control risk; and performed tests of controls in order to determine auditing procedures for the purpose of expressing an opinion on the financial statements. The auditors limited their internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and consequently CG-LLP did not provide an opinion on internal control.

Internal control as it relates to the financial statements, is a process, affected by agency's management and other personnel, designed to provide reasonable assurance of the following: (1) transactions are properly recorded, processed, and summarized to permit preparation of the financial statements and assets are safeguarded against loss from unauthorized acquisition, use or disposition; (2) transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations identified by OMB; and (3) transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

In performing the testing of internal control necessary to achieve the objectives in OMB Bulletin No. 01-02, the auditors identified matters relating to significant deficiencies in the design or operation of FEC's internal control. The testing of internal control identified both reportable conditions and material weaknesses. The American Institute of Certified Public Accountants (AICPA) categorizes reportable conditions as matters relating to significant deficiencies in the design or operation of the internal control, which in the judgment of the auditor, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the 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.

CG-LLP identified material weaknesses in the areas of:

- Financial Reporting
- Information Technology

CG-LLP identified reportable conditions, not considered to be material weaknesses, which include the following:

- Cost Accounting System and Processes
- General Property and Equipment
- Payroll

Opinion on the Financial Statements

CG-LLP audited the balance sheet of the FEC as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the year then ended. In the report dated December 8, 2004, CG-LLP issued an unqualified opinion on the FEC's financial statements.

The audit included an examination, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also included assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall principal statements' presentation.

Audit Follow-up

The report on internal control contains numerous recommendations to address weaknesses found by the auditors. Management was provided a draft copy of the audit report for comment and CG-LLP reviewed management's comments. Although CG-LLP stands by the report and the weaknesses detailed, the OIG and CG-LLP intend to work with management through the follow-up and audit process to ensure the weaknesses are addressed satisfactorily. In accordance with OMB Circular No. A-50, *Audit Followup*, revised, and based on an agreement with the Offices of the Staff Director and General Counsel, the Staff Director or designee shall develop an action plan for corrective action of the recommendations. The action plan is to set forth specific action planned to implement the recommendations and the schedule for implementation.

<u>OIG Evaluation of Clifton Gunderson LLP's Audit Performance</u>
In connection with the OIG's contract with CG-LLP, the OIG reviewed CG-LLP's reports and related documentation and inquired of its representatives. Specifically, we performed the following: (1) reviewed CG-LLP's approach and planning of the audit; (2) evaluated the qualifications and independence of the auditors; (3) monitored the work of the auditors throughout the audit; (4) examined audit documents and audit reports to ensure compliance with *Government Auditing Standards* and OMB Bulletin No. 01-02; and (5) performed other procedures we deemed necessary.

The OIG's review of CG-LLP's work, as differentiated from an audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States, was not intended to enable us to express an opinion on the FEC's financial statements; provide conclusions about the effectiveness of internal control; or reach conclusions on whether FEC's management substantially complied with laws and regulations related to the audit. CG-LLP is responsible for the opinion and conclusions reached in the attached reports dated December 8, 2004. The OIG review disclosed no instances where CG-LLP did not comply, in all material respects, with *Government Auditing Standards*.

If you should have any questions, please contact my office on (202) 694-1015. We appreciate the courtesies and cooperation extended to Clifton Gunderson LLP and the OIG staff during the conduct of the audit.

Lynne A. McFarland
Lynne A. McFarland
Inspector General

Attachments

Cc: Staff Director
Acting Chief Financial Officer
Accounting Officer
Information Technology Director
Deputy Staff Director for Audit and Review

4

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To the Inspector General of the
Federal Election Commission

We have audited the balance sheet of the Federal Election Commission (FEC) as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the year then ended. These financial statements are the responsibility of FEC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements,* as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall principal statements' presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of FEC as of September 30, 2004, and its net cost, changes in net position, custodial activity, budgetary resources and reconciliation of net cost to budgetary obligations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our reports dated December 8, 2004 on our consideration of FEC's internal control over financial reporting, and on our tests of FEC's compliance with certain provisions of laws and regulations. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of our audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

Offices in 15 states and Washington, DC

Member of HLB International

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management Discussion and Analysis and Required Supplementary Information are not a required part of the basic financial statements, but are supplementary information required by OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures to such information, which consisted principally of inquiries of FEC management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Clifton Gunderson LLP

Calverton, Maryland
December 8, 2004

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Internal Control

To the Inspector General of the
Federal Election Commission

We have audited the financial statements of the Federal Election Commission (FEC) as of and for the year ended September 30, 2004, and have issued our report dated December 8, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered FEC's internal control over financial reporting by obtaining an understanding of FEC'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. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act (FMFIA) (31 U.S.C. 3512), 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.

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 agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the 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 certain matters discussed in the following paragraphs involving the internal control and its operation that we consider to be reportable conditions and material weaknesses.

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

Finally, with respect to internal control related to performance measures reported in FEC's Performance and Accountability Report, 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, as amended. 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.

****

MATERIAL WEAKNESSES

I. Financial Reporting

The Accountability of Tax Dollars Act of 2002 extends to FEC a requirement to prepare and submit to the Congress and the Director of the OMB an audited financial statement. Fiscal year 2004 is the first year FEC is preparing and submitting audited financial statements.

FEC has attained a major achievement by having its financial statements audited for the first time. FEC, however, had to expend a tremendous amount of effort to "cleanup" its accounting records in order to prepare auditable financial statements as of and for the year ended September 30, 2004.

The weaknesses identified below collectively resulted in a material weakness in FEC's financial reporting process.

A. Financial Statement Preparation

Our audit of the interim financial statements disclosed several misstatements and/or misclassifications resulting from ineffective or lack of adequate quality and supervisory reviews and internal controls over the financial statement preparation and reporting process. These errors or omissions, some illustrated below, have consumed significant FEC resources in researching and correcting. The resources expended could have been devoted to the normal daily business operations of FEC.

- FEC downloads the trial balance from the general ledger (GL) system to a spreadsheet to generate its financial statements. The unadjusted trial balance used in preparing the March 31, 2004 financial statements did not agree to the balances in the GL system for most of its financial statement line items such as fund balance with treasury (FBWT), accounts payable (AP), net position and related accounts. Accordingly, the financial statements submitted to OMB did not have the correct balances because the errors were identified by both the FEC and the auditors only after the financial statements were submitted.
- The March 31, 2004 financial statements did not properly report the appropriation received and the status of budgetary resources.

2 of 16

- Software-in-development was not reported in the interim financial statements because FEC was still compiling the data.
- Certain on-top financial statement adjustments were posted incorrectly and key account relationships did not always agree.
- The interim financial statements did not reflect the current accounting activities for certain areas and only partially met the guidance in OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*.

In addition, "catch-up" journal vouchers and significant past activities detected during this "clean-up" process were recorded for the first time as adjusting journal entries or "on-top" financial statement adjustments.

Moreover, OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements,* states that preparation of the annual financial statements is the responsibility of the agency's management. In carrying out this responsibility, each agency chief financial officer should prepare a policy bulletin or guidance memorandum that guides the agency's fiscal and management personnel in the preparation of the annual financial statements. FEC does not have formal plans, methodology, or procedures to guide the financial statement preparation and reporting process.

Two of the five standards for internal control as stated in the Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government* are (1) information and communications, and (2) control activities.

(1) Information should be recorded and communicated to management and others within the entity who need it and in a form and within a timeframe that enables them to carry out their internal control and other responsibilities.

(2) Examples of control activities are: Reviews by management at the functional or activity level, proper execution of transactions and events, and accurate and timely recording of transactions and events.

B. Timely Recording, Reconciliation and Analysis

A major objective of internal control is to ensure the integrity of the underlying accounting data supporting the financial statements. An important control in this regard is the reconciliation of accounting records. An adequate reconciliation provides the assurance that processed transactions are properly and timely recorded in the accounting records and financial statements, which then allows management the ability to analyze its financial condition and results of operations on a routine basis.

The FEC has not performed many of the periodic account reconciliations and analyses necessary during the year. Account reconciliations not performed included certain FBWT reports from the Department of Treasury, budgetary accounts such as obligations, intragovernmental activities, and general property and equipment, among others. In addition, reconciliations that were performed were often not completed in a timely manner and certain account reconciliations contained reconciling items that have long been outstanding. Moreover, certain assets, such as software-in-development, were not reported in the interim financial statements because FEC was still compiling the data.

Furthermore, due to FEC's delay in submitting the June 30, 2004 accounting data in the Treasury's Federal Agencies' Centralized Trial-Balance System (FACTS II), FEC was prevented by the system to submit the data. Thus, FEC did not submit its June 30, 2004 accounting data. The accounting data includes mostly budgetary information that is required for the Report on Budget Execution and Budgetary Resources (SF 133), and the Year-End Closing Statement (FMS 2108).

C. GL System Setup and Posting Model Definitions

The GL system setup and posting model definitions do not fully comply with the transactions posting models consistent with the United States Standard General Ledger (USSGL) guidance and policies when recording and classifying certain transactions. As a result, certain proprietary accounts and budgetary accounts do not agree, and certain trial balance accounts do not trace to the USSGL crosswalk.

FEC is aware of the inherent limitations of the GL system and has attempted to upgrade the GL system during fiscal year 2004 to correct weaknesses identified. However, due to the enormous resources consumed in testing and monitoring the system upgrade and the problems arising from the upgrade process and the audit of the financial statements, FEC has decided to postpone its upgrade until fiscal year 2005.

D. Integrated Financial Management System

A single, integrated financial management system is a unified set of financial systems linked together electronically in an efficient and effective manner to provide agency-wide financial system support. Integration means that the user is able to have one view into systems such that, at whatever level the individual is using the system, he or she can obtain needed information efficiently and effectively through electronic means. It does not necessarily mean having only one software application covering all financial management system needs within an agency. Interfaces are acceptable as long as the supporting details are maintained and accessible to managers. Interface linkages must be electronic unless the number of transactions is so small that it is not cost beneficial to automate the interface. Easy reconciliation between systems, where interface linkages are appropriate, must be maintained to ensure data accuracy.

FEC does not have an integrated financial management system. Significant financial management systems such as the "cost system" and the property and equipment system are not interfaced with the GL system.

Recommendations:

1. Establish written policy and procedures to formalize plans, methods and procedures to guide the financial statement preparation and reporting process.

2. Prepare and analyze monthly reconciliations of subsidiary and summary account balances. Consider a "formal closing" of all accounts at an interim date(s), which will reduce the level of accounting activity and analysis required at year-end. This "formal closing" entails ensuring that all transactions are recorded in the proper period through the month-end. With complete and timely transaction recording, analysis of all major accounts can be performed effectively.

3. Ensure that supervisory reviews are applied to the financial statements and its supporting documentation, and the reviews are documented.

4. Ensure that upgrades to the financial management system comply with the posting model definitions in the USSGL.

5. Evaluate the functional requirements to integrate the financial reporting, property and equipment and the cost systems with the GL system; assess the degree of integration necessary to have a single, unified financial management system.

II. Information Technology (IT)

The reportable conditions below, when evaluated together, make the IT area a material weakness.

A. Entity-Wide Security Program

Effective information security management is critical to FEC's ability to ensure the reliability, availability, and confidentiality of its information assets, and thus its ability to perform its mission. If effective information security practices are not in place, FEC's data and systems are at risk of inadvertent or deliberate misuse, fraud, improper disclosure, or destruction—possibly without detection.

GAO's research of public and private sector organizations, recognized as having strong information security programs, shows that their programs include (1) establishing a central focal point with appropriate resources, (2) continually assessing business risks, (3) implementing and maintaining policies and controls, (4) promoting awareness, and (5) monitoring and evaluating policy and control effectiveness. (U.S. Government Accountability Office, *Executive Guide: Information Security*

Management, Learning From Leading Organizations, GAO/AIMD-98-68 [Washington, D.C.: May 1998]), and (GAO's *Information Security Risk Assessment: Practices of Leading Organizations, A Supplement to GAO's May 1998 Executive Guide on Information Security Management*, GAO/AIMD-00-33 [Washington, D.C.: November 1999]).

FEC has taken important steps to establish an effective information security program, but much remains to be done. In January 2004, FEC revised the Computer Security Officer position description to further strengthen the Commission's computer security program. In April 2004, FEC issued an Interim Final "Information System Security Program Policy", Policy Number 58A. Policy Number 58A was issued to "manage the risk to information rather than just systems". The FEC approved Policy Number 58A and supplements to Policy Number 58A in September 2004.

Current weaknesses that exist in the FEC's information security program include the following:

- FEC did not finalize its Information System Security Policy until September 2004. This policy was not fully implemented in fiscal year 2004;
- A framework of policies and standards to mitigate risks associated with the management of information resources has not yet been implemented;
- Risk assessments, as part of FEC's overall strategy to mitigate risks associated with its information technology environment, have not been conducted for more than three years. The FEC conducted a risk assessment in March of 2000, with several recommendations for strengthening its information technology environment. We noted that the FEC has not implemented many of the recommendations. Furthermore, the FEC has not updated its risk assessment since March of 2000 to ensure that its strategy to mitigate risk reflects changes in its information technology environment;
- There was no documented and approved entity-wide security program plan. FEC has indicated that it is in the process of documenting its entity-wide security program plan. The FEC has just established in September 2004 policy guidelines which it will use in the development and implementation of an entity-wide security program plan;
- The FEC completed the identification of its major application and mission critical general support systems in September 2004, as part of its risk mitigation strategy. Thus, the FEC has not completed the development of security plans for these applications and systems;
- Major applications and mission critical general support systems have not been certified to ensure that they are operating according to FEC's security requirements;
- A program for the continuous monitoring and evaluation of FEC's policy and controls to ensure operating effectiveness has not been established; and
- There is no periodic security awareness training. Training is only provided to new employees and contractors. The FEC did conduct a baseline awareness

training program, but does not have a process in place to provide security awareness training on an annual basis.

Recommendations:

6. Implement a framework of policies and standards to mitigate risks associated with the information resources management.

7. Conduct risk assessments at least every three years as part of an overall strategy to mitigate risks associated with its information technology environment.

8. Complete the documentation, approval and implementation of an entity-wide security program plan.

9. Develop, and implement security plans for major applications and mission critical general support systems as part of a risk mitigation strategy.

10. Certify that the major applications and mission critical general support systems are operating according to FEC's security requirements.

11. Establish a program for the continuous monitoring and evaluation of the computer security policy and control effectiveness.

12. Provide periodic computer security awareness training to all employees and contractors (i.e. contractors granted access to the FEC's network).

B. Controls to Protect Information

For a computerized organization like FEC, achieving an adequate level of information protection is highly dependent upon maintaining consistently effective access controls and system software controls. Access controls limit and monitor access to computer resources (i.e., data files, application programs, and computer-related facilities and equipment) to the extent necessary to provide reasonable assurance that these resources are protected against waste, loss, unauthorized modification, disclosure, or misappropriation. Access controls include logical/technical controls such as designing security software programs to prevent or detect unauthorized access to sensitive data. Similarly, system software controls limit and monitor access to powerful programs and sensitive files that control computer processing and secure the application and data supported by the system.

Our limited testing of internal controls identified information protection related weaknesses in FEC's information systems environment. Impacted areas included the local area and wide area networks as well as its midrange computer systems (e.g. servers). These vulnerabilities expose FEC and its computer systems to risks of external and internal intrusion, and subject sensitive information related to its major applications to potential unauthorized access, modification, and/or disclosure.

FEC has not assessed the risk of inadequate protection for its sensitive and mission critical files. No written criteria have been established to guide security personnel in monitoring and restricting access to production data and program files.

Current weaknesses in access controls include the following:

- No documentation or verification that the vulnerabilities identified in the February 2004 network penetration scan have been addressed;
- Visitor (individuals that do not have approved daily access) logs for data center access were not maintained and no compensating controls to monitor and record visitor access to the data center have been implemented;
- Password controls are weak:
  - There is no password lifetime set on the local area network (LAN);
  - There are no technical controls to enforce password changes on the LAN and the GL system;
  - Some passwords on the FEC LAN have not been changed since 1997;
  - The password policy cannot be updated or changed in the current version of the GL system;
  - The GL system passwords do not expire;
  - There is no limitation on the number of GL system password attempts (i.e. no lock-out policy);
  - There is no policy on the GL system composition of passwords; and
  - There are no controls on password length for the GL system.
- There are no records of access requests granted to remote users. The FEC was unable to provide access request approval documentation to support the access of all dial-up and Virtual Private Network (VPN) users that we sampled for our review. In addition, there was no evidence of periodic re-validations of these users;
- GL system access requests are not properly documented or reviewed. The FEC was only able to provide us original access matrices for eight of the 33 current GL system users. Additionally, the FEC does not periodically perform revalidations of GL system access;
- The principle of "least privilege" is not consistently applied in the GL system application. A high level IT official has similar access rights and privileges in the GL system application as the Accounting Officer;
- Data center access is not adequately documented or reviewed:
  - Four employees have their names misspelled on the cardholder report;
  - One of the individuals with access to the data center was terminated recently, but his access key is still active and the physical location of the key could not be determined; and
  - FEC could not identify one user who has access to the data center or justify why the individual has access to the data center.

- The FEC is not in compliance with its auditing policy because it does not automatically log the network activity described in the *Audit Event Standards*, even though it has the capability to do so.

Recommendations:

13. Establish a program to document corrective actions and verify that weaknesses identified have been addressed. Ensure and document that recommendations from the most recent network security review have been implemented.

14. Monitor and record visitor access to the data center.

15. Strengthen the password controls for the FEC's network and major applications, including the GL system.

16. Document and periodically revalidate VPN and dial-up access rights and privileges.

17. Document access requests and approvals for the GL system. Perform periodic revalidation of access granted to the GL system.

18. Ensure that the principle of "least privilege" is enforced. Ensure access in the GL system is granted according to job function and responsibility.

19. Disable the active access keys of users not requiring access to the data center. Correct the misspelled names on the cardholder report.

20. Use access request forms to document user access rights and periodically review the access for appropriateness.

21. Automatically log network activity as required by the *Audit Events Standards*.

C. Contingency Plan

Losing the capability to process and protect information maintained on FEC's computer systems can significantly impact FEC's ability to accomplish its mission to serve the public. The purpose of service continuity controls is to ensure that, when unexpected events occur, critical operations continue without interruption or are promptly resumed.

To achieve this objective, FEC should have procedures in place to protect information resources and minimize the risk of unplanned interruptions and a plan to recover critical operations should interruptions occur. These plans should consider activities performed at FEC's general support facilities (e.g. FEC's LAN, wide area network (WAN), and telecommunications facilities), as well as the activities performed by users of specific applications. To determine whether the disaster recovery plans will work as intended, FEC should establish and periodically test the capability to perform its functions in disaster simulation exercises.

Our review of the service continuity controls identified deficiencies that could affect FEC's ability to respond to a disruption in business operations as a result of a disaster or other long-term emergency. The deficiencies were as follows:

- FEC has not formally identified and prioritized all critical data and operations on its major applications and the resources needed to recover them if there is a major interruption or disaster. In addition, we could not determine whether FEC had established emergency processing priorities that will help manage disaster situations more effectively for the network;
- FEC does not have alternative processing sites for most of its operations in the event of a disaster, including its general ledger system;
- The FEC Disclosure Database is replicated at an off-site location as a web-enabled read-only database the public can access. In the event that data cannot be updated at the FEC and then replicated at the off-site location, there is no operational mechanism to update the Disclosure Database replicated at the offsite location;
- FEC does not have adequate capacity for most of its back-up tapes in its fireproof safe; hence, back-up tapes are not kept in a fireproof safe. Back-up tapes, however, are rotated on a weekly basis to an off-site facility;
- FEC data center is fully exposed to a wet pipe sprinkler system, with no compensating controls to avert inadvertent water damage to critical hardware and magnetic media in the case of a malfunction or false alarm; and
- FEC has not developed and documented a comprehensive contingency of operations plan of its data centers, networks and telecommunication facilities.

Recommendations:

22. Formally identify and prioritize all critical data and operations on FEC's networks and the resources needed to recover them if there is a major interruption or disaster. Ensure that emergency processing priorities are established to assist in managing disaster situations more effectively for the network.

23. Establish alternative processing sites for FEC's operations in the event of a disaster.

24. Establish operational mechanisms to update the Disclosure Database in the event the FEC database is unavailable to replicate the Disclosure Database resident at the offsite location.

25. Procure an additional fireproof safe(s) for back-up tapes.

26. Investigate and document options for compensating controls to avoid inadvertent water damage to critical hardware and magnetic media in the case of a malfunction or false alarm from the wet pipe sprinkler system.

27. Develop and document a comprehensive contingency of operations plan of FEC's data centers, networks and telecommunication facilities.

D. Software Development and Change Controls

Establishing controls over the modification of application software programs helps to ensure that only authorized programs and authorized modifications are implemented. This is accomplished by instituting policies, procedures, and techniques that help make sure all programs and program modifications are properly authorized, tested, and approved and that access to and distribution of programs is carefully controlled. Without proper controls, there is a risk that security features could be inadvertently or deliberately omitted or "turned off" or that processing irregularities or malicious code could be introduced.

Weaknesses that currently exist in the FEC's controls over modification of application programs include the following:

- System Development Life Cycle Methodology has not been finalized and implemented;
- No written policy has been created to manage software libraries;
- Written procedures to modify, test, approve or release software for any of its applications, including the GL system, have not been documented;
- Emergency change procedures and procedures for installing patches are not documented; and
- Certain software code changes for the GL system were not reviewed before being implemented.

Recommendations:

28. Finalize and implement the System Development Life Cycle Methodology.

29. Create a written policy to manage software libraries.

30. Document written procedures to modify, test, approve or release software for any of its applications.

31. Document written emergency change procedures for installing patches.

32. Establish policies and procedures to ensure that the software code is reviewed prior to moving the modified code into production.

REPORTABLE CONDITIONS

III. Cost Accounting System and Processes

A. Cost Allocation Methodology

FEC does not have a cost accounting system that is integrated with the GL system. The current cost accounting system is not adequate to produce the cost data for the Statement of Next Cost (SNC) in an efficient manner. Accordingly, the cost data presented on the SNC is compiled from three systems' raw data, which is then gathered and analyzed in an elaborate, complex, and manually intensive spreadsheet. Raw data used in the allocation of costs, such as payroll, is sometimes based on estimates due to the timing of the availability of the data. Expenses on the budget execution report, another source of raw data, are not reconciled with the general ledger balances.

FEC summarizes employee hours in a spreadsheet based on an office's program numbers, which is generated by a system. The program numbers represent the type of work performed by an employee and the hours are assigned directly or allocated to FEC's three major programs. FEC could not provide crosswalk documentation or definitions supporting the basis of assignment or allocation. The data accumulation and analysis is performed by one person and not subjected to a second review.

In addition, the FEC did not have a formal comprehensive policy and procedures for the program cost allocation. Although a written procedures document was provided to us, the document was written in response to our audit request and did not include a comprehensive set of procedures.

The manually intensive and elaborate cost allocation process dictates the need for a formal comprehensive policy and procedures. Moreover, the heavy reliance on a single person to carry out this process could impair FEC's ability to generate a timely and accurate report when the person becomes unavailable.

A control activity in the GAO *Standards for Internal Control in the Federal Government* is appropriate documentation of transactions and internal control. Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals. All documentation and records should be properly managed and maintained.

Recommendations:

33. Establish formal and comprehensive cost allocation methodology and related policy and procedures.

34. Cross-train employees to minimize the risks of major interruptions in normal business operations.

35. Establish a review process wherein a person, other than the preparer, reviews the work performed to ensure accuracy and propriety.

B. Managerial Cost Accounting

Statement of Federal Financial Standard No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government,* requires reporting components to perform a minimum-level of cost accounting and provide basic information necessary to accomplish the many objectives associated with planning, decision-making, and reporting. This minimum-level of cost accounting includes, among others: providing information for performance measurement; integrating both cost accounting and general financial accounting by using the USSGL; providing useful information; and accommodating management's special cost information needs or any other needs that may arise due to unusual or special situations or circumstances. The present FEC cost accounting system does not provide the minimum-level identified above.

FEC management notified us that it is in the process of developing a new cost accounting system.

Recommendation:

36. Evaluate the functional requirements for the new cost accounting system to ensure that at least, the minimum level of cost accounting required in SFFAS No. 4 is attained.

IV. General Property and Equipment (Property)

FEC's accounting for property involves a time-consuming effort that increases the risk of errors due to its process of expensing its property at the time of acquisition and preparing a journal voucher to reclassify the expense to an asset for reporting purposes.

Our audit disclosed deficiencies, errors or omissions that questioned the effectiveness of FEC's internal control on property. Some examples are noted below:

- Depreciation expense and accumulated depreciation reported on the depreciation report were not correct. We were informed that although the property management system calculates depreciation correctly, when the data is converted into another system to generate the depreciation report, the calculation gets corrupted. This error was identified during the audit and was subsequently adjusted.
- Software-in-development was not adequately tracked and was not reported until the September 30, 2004 financial statements. There was one instance of software-in-

development being reported as completed software in the property management system; therefore, the asset was being improperly depreciated. Another instance was completed software that was not recorded. These errors were only identified during the audit process.

- Several assets were recorded using the purchase order amount, instead of the actual cost.
- For the 45 sample items we tested, we noted that 45 receiving reports were not completed properly, that is, they were either not signed, did not have the date of receipt, did not have a description of the goods or services received, or lacked a reference to the invoice to be paid. Although only 6 of the 45 items pertained to acquisitions in fiscal year 2004, this deficiency persisted throughout fiscal year 2004.

One of the five standards for internal control in GAO *Standards for Internal Control in the Federal Government* is control activities. Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records, which provide evidence of execution of these activities as well as appropriate documentation.

Recommendations:

37. Enforce current procedures to require documentation of approvals and certifications for procurement and disbursements transactions.

38. Formally communicate to all appropriate personnel to ensure compliance and consistent application of the policies and procedures.

V. Payroll

We identified the following weaknesses related to the 45 items tested for payroll:

- Twelve employees' leave and/or credit hour balances reported on the time & attendance (T&A) reports did not agree with comparable data on the Statement of Earnings and Leave from the payroll service provider;
- FEC's policy requires timekeepers to perform a monthly reconciliation between the leave balances in FEC's records and the payroll service provider. The timekeepers are to forward leave balance certifications to the finance office indicating whether balances agree or disagree. Nine leave balance certification forms were either not completed or not submitted by the timekeepers to the finance office;
- Forty one documents supporting payroll activities such as requests for leave, approved absence forms, and certain payroll deduction elections forms were not available for review; and
- Changes made to some T&A reports were not authorized or properly authorized. In addition, the T&A reports of two employees were already approved by the certifying officer even though the pay period has not yet ended.

OMB Circular A-123, *Management Accountability and Control* (Revised June 21, 1995), requires that "the documentation for transactions, management controls and other significant events must be clear and readily available for examination." GAO *Standards for Internal Control in the Federal Government* states that transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use or commit resources and other events are initiated or entered into."

Recommendations:

39. Implement procedures to ensure that payroll deduction elections are authorized by maintaining adequate supporting documentation or an ability to query the service provider systems to verify these deductions if initiated by an employee without the FEC's intervention. Consider training/re-training payroll employees on the proper procedures for obtaining and retaining support documents for payroll elections.

40. Ensure that timekeepers perform a monthly reconciliation of leave balances reported in its records and the service provider records and submit the leave balance certification to the finance office monthly.

41. Implement procedures for ensuring hours recorded on the T&A reports are properly supported and authorized. Consider further automating payroll processing to decrease the risk of errors.

42. Implement procedures for ensuring all payroll and personnel documents are properly completed and authorized before payroll data is transmitted to the payroll service provider for processing.

OTHER MATTERS

Federal Managers' Financial Integrity Act (31 U.S.C. 3512) (Integrity Act) Compliance and Reporting

OMB Circular No. A-123 provides the reporting guidance for the Integrity Act. OMB Circular A-123 states that annually, by December 31, the head of each executive agency submit to the President and the Congress (i) a statement on whether there is reasonable assurance that the agency's controls are achieving their intended objectives; (ii) a report on material weaknesses in the agency's controls, and (iii) whether the agency's financial management systems conform with government-wide requirements.

OMB Bulletin No. 01-02 requires that we compare the material weaknesses in the agency's controls and material non-conformances on the agency's financial management systems in the FEC's Integrity Act report to our report on internal control dated December 8, 2004. Since the

Integrity Act report is due by December 31, 2004, FEC has not started and does not intend to start the process of accumulating the information required for its report until November 2004. Accordingly, since the Integrity Act report has not been completed, the comparison of reports could not be performed.

****

In addition to the material weaknesses and reportable conditions described above, we noted certain matters involving internal control and its operation that we reported to the management of FEC in a separate letter dated December 8, 2004.

This report is intended solely for the information and use of the management of FEC, FEC Office of Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
December 8, 2004

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Compliance with Laws and Regulations

To the Inspector General of the
Federal Election Commission

We have audited the financial statements of the Federal Election Commission (FEC) as of and for the year ended September 30, 2004, and have issued our report thereon dated December 8, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements,* as amended.

The management of FEC is responsible for complying with laws and regulations applicable to FEC. As part of obtaining reasonable assurance about whether FEC's financial statements are free of material misstatements, we performed tests of its 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. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to FEC.

The results of our tests of compliance with laws and regulations described in the preceding paragraph disclosed no instances of noncompliance with the laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

We noted certain immaterial instances of noncompliance that we have reported to management of FEC in a separate letter dated December 8, 2004.

This report is intended solely for the information and use of the management of FEC, FEC Office of Inspector General, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
December 8, 2004

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710
www.cliftoncpa.com

Offices in 15 states and Washington, DC

Member of HLB International

FEDERAL ELECTION COMMISSION
Washington, D.C. 20463

December 14, 2004

MEMORANDUM

To: Lynne A. McFarland
Inspector General

From: John C. O'Brien
Acting Deputy Staff Director for Management
Acting CFO

Through: James A. Pehrkon
Staff Director

SUBJECT: Comments on Draft Reports on Compliance with Laws and Regulations and Internal Control

Attached are FEC Management's responses to and comments on the draft reports on compliance with laws and regulations and internal control. The FEC is pleased to find that the review conducted by the independent public accounting firm of Clifton Gunderson LLP (CG), under the auspices of the FEC's Office of Inspector General, rendered an unqualified opinion of the FEC's FY 2004 Financial Reports. We also note that the FEC's financial statements are fairly presented. This is a noteworthy achievement for a first year audit.

We are also pleased to find that the FEC was not in violation of any law or regulation to which the FEC was subject. We are working within the attached responses to eliminate or at least reduce the number and/or scope of reportable conditions and the potential for any material weaknesses. The FEC's goal is to receive an unqualified opinion with no material weaknesses or reportable conditions each year.

It is important to FEC Management that the audit of the FEC's financial statements as of and for the year ended September 30, 2004 indicated that the FEC financial systems are in general accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended.

Thank you for the opportunity extended by you, your staff and CG to respond to the draft audit report. Everyone involved in the audit process worked extremely hard to ensure a successful conclusion to the audit. The FEC views the unqualified opinion as a success although it required an extensive commitment of staff and contract resources, and a large amount of staff time that could have been committed to other activities and on-going operations.

We will use CG's report as an opportunity to continue to improve the FEC's financial management systems, policies and procedures. The FEC viewed a previous review several years ago of the overall operations of the Commission by Pricewaterhouse-Coopers (PwC) in a similar fashion and used the results of their review to improve and enhance FEC programs where appropriate. The FEC takes such recommendations seriously and will study them to seek ways to implement appropriate proposals to enable us to serve the public better and to more effectively and efficiently meet our mission to administer and enforce the campaign finance disclosure laws.

Attachments

MATERIAL WEAKNESSES

I. Financial Reporting

The Accountability of Tax Dollars Act of 2002 extends to FEC a requirement to prepare and submit to the Congress and the Director of the OMB an audited financial statement. Fiscal year 2004 is the first year FEC is preparing and submitting audited financial statements. FEC has attained a major achievement by having its financial statements audited for the first time. FEC, however, had to expend a tremendous amount of effort to "cleanup" its accounting records in order to prepare auditable financial statements as of and for the year ended September 30, 2004.

The weaknesses identified below collectively resulted in a material weakness in FEC's financial reporting process.

A. Financial Statement Preparation

Our audit of the interim financial statements disclosed several misstatements and/or misclassifications resulting from ineffective or lack of adequate quality and supervisory reviews and internal controls over the financial statement preparation and reporting process. These errors or omissions, some illustrated below, have consumed significant FEC resources in researching and correcting. The resources expended could have been devoted to the normal daily business operations of FEC.

FEC Response: FEC acknowledges that there were misstatements in its March 31, 2004 financial reports, but does not agree that the controls surrounding its quarterly and annual financial statement preparation process is so ineffective to warrant the classification of this finding as a material weakness in FEC's financial reporting function. During the audit, we have made significant improvements to our supervisory controls. Though we are continuing to identify ways to improve further, we believe our current processes have improved to the point that they are no longer a material weakness.

Fiscal Year 2003 was the first year for which FEC was required to compile a full set of financial statements to comply with the provisions of the Accountability of Tax Dollars Act of 2002. Although FEC was waived from the requirement to submit such statements to the Office of Management and Budget (OMB), it endeavored to conduct an internal evaluation of its fiscal year 2003 financial data and financial reporting risks to ensure that its annual and quarterly financial statements were materially accurate. Additionally, in fiscal year 2002, FEC replaced its accounting system and converted its financial information from the "old" system to the "new" accounting system. As part of its internal evaluation, FEC sought to analyze and correct any inconsistencies resulting from the data conversion, and identify and correct any misstatements and/or relationship discrepancies related to its general ledger accounts.

The agency made great strides in its commitment to present a complete set of financial statements, which not only appropriately reflect current year activities, but also reflect accurate historical financial information. "Catch-up" journal vouchers and "on top" adjustments to FEC's accounting records for fiscal year 2003 and the first and second quarters of fiscal year 2004 were necessary to achieve its commitment. The misstatement found in the March 31, 2004 financial statements was due to human error. However, FEC has since prepared accurate financial statements for the third and fourth quarter of fiscal year 2004.

In light of FEC's implementation of compensating management controls (i.e., extensive data analysis to appropriately reflect account balances) and given that the error found in the second quarter of the fiscal year 2004 financial statements was not a persistent problem in FEC's financial statements compilation process, FEC does not concur with this material weakness. FEC believes that the process for the latter half of the fiscal year was vastly improved (better controls) and the risk of misstatement to the financial statements was effectively mitigated.

Improper reporting of the appropriation received and the status of budgetary resources in the March 31, 2004 statements was cited by the auditors. At the time the appropriation received amount was recorded, FEC was under a Continuing Resolution. FEC's efforts to solicit the guidance from OMB as to how the Appropriations should be reported, given the Continuing Resolution, were unsuccessful, as information received from OMB was not received timely (before the financials statements submission due date).

FY 2004 was the first year FEC had to file quarterly financial statements with OMB. Many agencies use spreadsheet models supplied by CPA firms to compile the complex quarterly and annual statements. It is common to download ledger information into these models.

B. Timely Recording, Reconciliation and Analysis

A major objective of internal control is to ensure the integrity of the underlying accounting data supporting the financial statements. An important control in this regard is the reconciliation of accounting records. An adequate reconciliation provides the assurance that processed transactions are properly and timely recorded in the accounting records and financial statements, which then allows management the ability to analyze its financial condition and results of operations on a routine basis.

The FEC has not performed many of the periodic account reconciliations necessary during the year. Account reconciliations not performed included certain FBWT reports from the Department of Treasury, budgetary accounts, intragovernmental activities, and general property and equipment, among others. In addition, reconciliations that were performed were often not completed in a timely manner and certain account reconciliations contained reconciling items that have long been outstanding. Moreover, certain assets, such as software-in-development, were not reported in the interim financial statements because FEC was still compiling the data.

Furthermore, due to FEC's delay in submitting the June 30, 2004 accounting data in the Treasury's Federal Agencies' Centralized Trial-Balance System (FACTS II), FEC was prevented by the system to submit the data. Thus, FEC did not submit its June 30, 2004 accounting data. The accounting data includes mostly budgetary information that is required for the Report on Budget Execution and Budgetary Resources (SF 133), and the Year-End Closing Statement (FMS 2108).

FEC Response: FEC understands the critical role that reconciliations play in internal control and acknowledges the lack of routine reconciliations during the first half of the fiscal year. However, we do not concur with the classification of this finding as a material weakness in FEC's financial reporting function. We have taken steps to implement an appropriate reconciliation schedule in the future

As a result of its internal evaluation of the fiscal year 2003 financial data and financial reporting process, FEC identified the need to acquire additional personnel resources to assist with the preparation of periodic reconciliations, in order to mitigate the risk of material misstatements to its financial statements. As such, FEC engaged contractors who have expended considerable effort to bring reconciliations up to date in fiscal year 2004. Though these reconciliations lagged for the first and second quarters of fiscal year 2004, they were completed prior to the completion of the audit and have revealed insignificant reconciling items related to FBWT accounts. All other reconciliations for major accounts (i.e. fixed assets) were performed on time and provided to the auditors.

Additionally, with assistance from contractors, FEC is currently performing routine reconciliations of its subsidiary records to the general ledger balances and is committed to this effort for fiscal year 2005. With respect to the submission of FEC's financial information to Treasury, when FEC tried to log on to submit the June 30, 2004 reports by the due date, the Treasury computer system was not operational. Since Treasury did not extend the deadline to agencies for FACTs submissions, FEC's accounting data was not submitted by the due date. All first, second and fourth quarter reports were submitted to Treasury and OMB on time. To date, Clifton Gunderson has had no adjustments to the reports except minor reclassifications.

Finally, FEC concurs with the matters pertaining to the compilation of software-in-development financial data. FEC has revised the data-gathering procedures and methodology for accounting for software-in-development.

C. GL System Setup and Posting Model Definitions

The GL system setup and posting model definitions do not fully comply with the transactions posting models consistent with the United States Standard General Ledger (USSGL) guidance and policies when recording and classifying certain transactions. As a result, certain proprietary accounts and budgetary accounts do not agree, and certain trial balance accounts do not trace to the USSGL crosswalk.

FEC is aware of the inherent limitations of the GL system and has attempted to upgrade the GL system during fiscal year 2004 to correct weaknesses identified. However, due to the enormous resources consumed in testing and monitoring the system upgrade and the problems arising from the upgrade process and the audit of the financial statements, FEC has decided to postpone its upgrade until fiscal year 2005.

FEC Response: FEC does not concur with this finding as a material weakness. FEC was fully aware of the posting model shortcomings and adequately considered the risk of misstatements in the financial reports. As such, FEC reengaged the implementer of the accounting system to upgrade the system and correct posting model shortcomings. However, the upgrade was postponed to dedicate resources and attention to the audit. FEC adequately compensated for the posting model shortcomings with extensive reconciliations and analyses. Relationships between proprietary and budgetary accounts were tested on a monthly basis and were provided to the auditors throughout the audit. FEC expects the upgrade of its financial system to be completed in FY 2005 but will continue the reconciliation of the accounts impacted by the posting model shortcomings. The upgraded financial system will be fully compliant with the USSGL.

D. Integrated Financial Management System

A single, integrated financial management system is a unified set of financial systems linked together electronically in an efficient and effective manner to provide agency-wide financial system support. Integration means that the user is able to have one view into systems such that, at whatever level the individual is using the system, he or she can obtain needed information efficiently and effectively through electronic means. It does not necessarily mean having only one software application covering all financial management system needs within an agency. Interfaces are acceptable as long as the supporting details are maintained and accessible to managers. Interface linkages must be electronic unless the number of transactions is so small that it is not cost beneficial to automate the interface. Easy reconciliation between systems, where interface linkages are appropriate, must be maintained to ensure data accuracy.

FEC does not have an integrated financial management system. Significant financial management systems such as the "cost system" and the property and equipment system are not interfaced with the GL system.

FEC Response: FEC disagrees with this finding and its classification as a material weakness. The FEC made a decision based on acceptable risk and on a cost benefit basis that the MIS, budget projection, and other performance reporting processes would be migrated after other priority commission programs were migrated to the new environment. This process is on-going: in FY 2004 and now in FY 2005 the FEC is engaged in a legacy system off-load process to migrate legacy systems over to the new IT platform. In addition, the FEC has been engaged since late FY 2003 in developing and implementing a budget preparation and MIS system that will be totally integrated with the financial system and all other oracle based IT systems.

The OMB guidance and GAO standards do not require agencies to have totally integrated financial management systems with all other agency systems. OMB Circulars A-127 and A-123 and the GAO standards, as well as the CFO Act, were designed to make agencies modernize, automate, and integrate outdated and disparate accounting systems. In addition the goal was to make sure all agency accounting systems were compliant with GAO standards and OMB circulars and directives. These initiatives do not require all agency systems to be totally integrated—they must use the same information in preparing performance and cost allocation reports and data. The FEC does this. The FEC budget projection process uses the same pay information from the service provider as the accounting system does, and both use the same HR information from the FEC Personnel system. In that regard, they are integrated.

The A-123 and A-127 Circulars and the GAO standards provide for agencies to make decisions on a cost-benefit basis with regard to management controls. The FEC determined that limited funds and staff resources available for the FEC IT initiatives mandated a priority for the main Disclosure database and other major disclosure and compliance programs. In addition, funds were allocated to acquire a financial and accounting system that was compliant with GAO standards and was JFMIP certified. The migration of other systems such as the MIS, budget projection, and other performance reporting processes to the new oracle based client server platform was given a lower priority.

The FEC also made decisions not to acquire vendor produced COTS HR packages due to costs and general reports from other agencies about the performance of these systems. A similar decision was made with regard to the procurement and property systems. The determination was made to not incur additional costs until the financial system upgrade to a newer version was completed. At that time a determination would be made on a cost benefits and potential risk analysis basis on whether it was worth the costs to totally integrate the procurement, property and financial systems. Currently the FEC is comfortable with the acceptable risks with the two systems not totally integrated, but will instead continue to provide personnel resources to perform reconciliations and analyses to ensure the accuracy of the financial statements..

Recommendations:

1. Establish written policy and procedures to formalize plans, methods and procedures to guide the financial statement preparation and reporting process.

2. Prepare and analyze monthly reconciliations of subsidiary and summary account balances. Consider a "formal closing" of all accounts at an interim date(s), which will reduce the level of accounting activity and analysis required at year-end. This "formal closing" entails ensuring that all transactions are recorded in the proper period through the month-end. With complete and timely transaction recording, analysis of all major accounts can be performed effectively.

3. Ensure that supervisory reviews are applied to the financial statements and its supporting documentation, and the reviews are documented.

4. Ensure that upgrades to the financial management system comply with the posting model definitions in the USSGL.

5. Evaluate the functional requirements to integrate the financial reporting, property and equipment and the cost systems with the GL system; assess the degree of integration necessary to have a single, unified financial management system.

FEC Response: Per the discussion above, the FEC will continue to evaluate the acceptable risk levels and the costs and benefits of integrating the accounting system with the other financial management systems (i.e. procurement and property systems); as noted the MIS and Budget systems are in the process of being upgraded and enhanced, including integrating them further with the service provider payroll and FEC accounting systems.

The FEC IT Strategic Plan provides for the future evaluation of the costs and benefits of further integrating the HR and other systems with the FEC financial system. Decisions to proceed will be based on Commission priorities and available resources and funds.

Finally, with respect to formalizing plans for the financial statement preparation process, a formal plan for monthly closing, reconciliation review and statement analysis will be prepared and implemented in FY 2005.

II. Information Technology (IT)

The reportable conditions below, when evaluated together, make the IT area a material weakness.

FEC General Response: The FEC does not agree that the reportable conditions in the IT area reach the level of a material weakness. In conjunction with the Financial Statements Audit of the FEC, four areas of Information Technology were examined for material weaknesses. The outcome of the audit in IT revealed a number of reportable conditions, none of which, individually, rise to the level of material weakness. FEC Management is also of the opinion that the collective "weight" of these reportable conditions does not together result in a material weakness. The reason for this position is that reportable conditions have been recognized and corrective actions have been and are being taken. The cost benefits test may be used for portions of these conditions, but for the majority the FEC has initiated corrective actions, some of which pre-date the audit.

FEC Management has also indicated our position on the FEC exemption from the Paperwork Reduction Act, which also exempts the FEC from many of the related and underlying statutes and regulations. We agree that best practices and sound management controls justify the use of some of the recommendations made during the audit in the area of IT control (many of which the FEC as implemented already). However, the FEC strongly believes that these recommendations, either singularly or collectively, do not rise to the level of material weaknesses. In addition, the FEC maintains that the agency can not be held to guidance and criteria identified in studies and analyses as if these were standards that are required to be adhered to.

Finally, the FEC continues to maintain that it is not appropriate to find the existence of financial management material weaknesses for systems and applications that do not directly impact on the accuracy and security of information used in the FEC financial statements.

The audit for IT support of financial statements was broken down into four areas: (1) Entity-wide Security Program, (2) Controls to Protect Information, (3) Contingency Plan and (4) Software Development and Change Controls.

Entity-wide Security Program:

It was noted in the draft report that the "FEC has taken important steps to establish an effective information security program, but much remains to be done." The references cited in the audit report, provide general guidance and are not audit standards. The FEC, in strengthening and building upon its security policy, has implemented the level of security that is commensurate with the FEC mission, best practices, budget and available resources. The resulting updated and modernized security program demonstrates the FEC's commitment to information security and a continuing pursuit of a balanced security program and costs to the agency.

Controls to Protect Information:

The FEC has installed an automated key entry system to all sensitive areas, such as the data center and hub rooms, in addition to the general building entry security processes. The access to the general areas where data is stored are further protected via password protection systems installed on each server and all personal computers. In an effort to follow the NIST guidance and protect to the level required by overall agency mission, the methodology employed by the FEC for physical security of the IT systems and data is in keeping with GSA, GAO and NIST standards and best practices.

Contingency Plan:

The FEC has taken reasonable precautions in preserving data in the event of a catastrophe. All FEC information and data is backed up daily, weekly and monthly and stored at an off-site facility. The main disclosure data base is retained at an acceptable level of redundancy in order to reproduce it in the event of catastrophe. Although the FEC identified a potential budget request for FY 2006 of over $15 million to fully replicate the FEC IT systems and provide a staffed continuity of operations back-up site, there is no interest at either OMB or our oversight and appropriation committees for such and expenditure. The existing spending and resulting level of risk in this area is at an acceptable level, based on the costs benefits test.

Software Development and Change Controls:

The FEC has established a System Development Life Cycle Plan that reflects the existing development environment of the FEC. That environment consists of purchased application software that is in compliance with existing certifications, and set-up and adapted for specific, particular FEC mission requirements. There is very little, if any, homegrown software that is developed solely by FEC personnel at this time. The level of controls over the modification and implementation of application systems are adequate for the size and single location of the agency. The use of system modification logs has been an effective method of control, yet use of this methodology was not acknowledged in the report. The agency has established an IT Quality Assurance Office, in an effort to incorporate the latest best practices in software application control.

A. Entity-wide Security Program

- FEC did not finalize its Information System Security Policy until September 2004. This policy was not fully implemented in fiscal year 2004;

FEC Response: In November 1997, the FEC established Directive 58, outlining the Commission policy on the control of commission software, and the use of agency computers. This directive formed the basis of the agency's computer security program. This directive has been enhanced and expanded incorporating the latest guidance and best practices provided by NIST in detail, and issued in policy 58A. The updating of Directive 58 was begun in December 2001 with the establishment of an agency Information Systems Security Officer, and followed with the establishment of an interim Information System Security Program Policy 58A dated April 2004. This interim policy became final in September 2004 as approved by the agency's Chief Technology Officer (CTO).

- A framework of policies and standards to mitigate risks associated with the management of information resources has not yet been implemented;

FEC Response: As a vital component of the Information Systems Security Program Policy (ISSPP) 58A, the FEC has developed and approved sub-policy 58-2.1: Risk Management policy. This policy establishes a framework of procedures and standards to mitigate risks associated with the management of information resources. The FEC is in the early stages of implementing this new policy.

- Risk assessments, as part of FEC's overall strategy to mitigate risks associated with its information technology environment, have not been conducted for more than three years. The FEC conducted a risk assessment in March of 2000, with several recommendations for strengthening its information technology environment. We noted that the FEC has not implemented many of the recommendations. Furthermore, the FEC has not updated its risk assessment since March of 2000 to ensure that its strategy to mitigate risk reflects changes in its information technology environment;

FEC Response: The FEC Risk Management policy specifies a risk assessment of its major applications and general supports systems every 3 years. The FEC has addressed many of the recommendations outlined in the March 2000 risk assessment; greater detail is required from the auditors as to which specific recommendations they believe have not been met. The FEC has updated its risk assessment program by developing and implementing 58A Information System Security Program Policy and 58-2.1 Risk Management. A risk assessment was conducted February 24, 2004 in the form of a Security Audit, the purpose of which was to identify any vulnerabilities in the IT infrastructure and to identify the risks associated with those vulnerabilities.

- There was no documented and approved entity-wide security program plan. FEC has indicated that it is in the process of documenting its entity-wide security program plan. The FEC has just established in September 2004 policy guidelines which it will use in the development and implementation of an entity-wide security program plan;

FEC Response: This issue is addressed in the response to the first bullet above.

- The FEC completed the identification of its major application and mission critical general support systems in September 2004, as part of its risk mitigation strategy. Thus, the FEC has not completed the development of security plans for these applications and systems;

FEC Response: The FEC identified its major applications, mission critical in May 2004. The lone General Support System was identified in March 2000, when the development of the security plan was completed for that system. These documents have been provided to the audit team.

- Major applications and mission critical general support systems have not been certified to ensure that they are operating according to FEC's security requirements;

FEC Response: The FEC has a policy that provides for the certification and accreditation of major applications and mission critical systems. That policy is 58-2.4: Certification and Accreditation Policy. The agency Security Officer attended an Accreditation and Certification workshop sponsored by NIST in order to apply the NIST guidelines that may be appropriate to the FEC, in June 2004.

- A program for the continuous monitoring and evaluation of FEC's policy and controls to ensure operating effectiveness has not been established; and

FEC Response: The FEC has established the position of Information Systems Security Officer. This is a full-time management position, and as indicated in the position description, has the responsibility for continuously monitoring the overall policies and controls. This position description has been provided to the audit team.

- There is no periodic security awareness training. Training is only provided to new employees and contractors. The FEC did conduct a baseline awareness training program, but does not have a process in place to provide security awareness training on an annual basis.

FEC Response: The FEC has finalized and approved a Security Awareness training policy which provides initial and ongoing training for all current and new employees, as well as contractors. This training has been in place during the past year and-a-half. The FEC has a security awareness program in place and documented, this documentation was provided to the audit team. All new employees and contractors undergo this training upon arrival at the FEC. Security awareness is emphasized in all FEC training classes as it pertains to the particular lesson being taught. Security awareness is re-enforced by the help desk personnel as problems are reported, and each time a help mission is launched. Information concerning virus protection, new viruses reported in trade journals and as reported through our support contracts are disseminated on a regular basis by the FEC security team, Help Desk personnel and trainers. Since the Security Awareness Training Program has only been established for a short period of time, an appropriate periodic training refresh period has yet to be established.

B. Controls to Protect Information

- No documentation or verification that the vulnerabilities identified in the February 2004 network penetration scan have been addressed;

FEC Response: The FEC has addressed and verified that the vulnerabilities pinpointed by the Nessus scan have been addressed. We are in the process of fully documenting all corrective actions.

- Visitor (individuals that do not have approved daily access) logs for data center access were not maintained and no compensating controls to monitor and record visitor access to the data center have been implemented;

FEC Response: The FEC does, in fact, maintain an electronic log which is the Kastle Key system. Each time a person enters the room the date and time is recorded. The only way to access the data center is with a Kastle key. Only individuals with Kastle Key access privileges for the data center are allowed entry.

- Password controls are weak:
  - There is no password lifetime set on the local area network (LAN);
  - There are no technical controls to enforce password changes on the LAN and the GL system;
  - Some passwords on the FEC LAN have not been changed since 1997;
  - The password policy cannot be updated or changed in the current version of the GL system;
  - The GL system passwords do not expire;
  - There is no limitation on the number of GL system password attempts (i.e. no
  - lock-out policy);
  - There is no policy on the GL system composition of passwords; and
  - There are no controls on password length for the GL system.

FEC Response: The FEC is in the process of implementing the recommendations to provide stronger password controls. Users will be forced through system control to change their password periodically. Below is the implementation of the agency's password policy, as outlined in policy 58A:

As many of you are aware, the Federal government has increased its focus on computer security. Agencies that process sensitive but unclassified information are required to enforce more stringent access control policies. One stipulation of these policies is that we enhance our identification/authentication methods. Due to this increased focus and recently initiated audit by the Office of Inspector General, the Commission is implementing a formal password policy. The policy (58-3.1 Logical Access Policy) and its derived FEC password standard can be found in \NTSRV1\FEC-WIDE\ FEC IT Policies and Standards. Please take the time to review them both.

This password standard requires a change of passwords no less than every 180 days. In order to ensure that every one has changed their Network, Lotus Notes and other logon passwords, current passwords will expire at midnight (12:00 AM) December 13, 2004. In order to logon after that time you will need to change your password. As usual, any questions should be addressed to the Helpdesk.

Summary of FEC IT Security Password and Standard

Passwords must contain a minimum of eight (8) characters.
Passwords must consist of a mix of upper and lower case letters, numbers, and special characters.
Passwords must not contain any word found in any dictionary in any language, or be based on any word or character in literature.
Passwords must not be based on user IDs, or related to personal information.
Passwords must be changed no less than once every 180 days.
Passwords will not be allowed to be repeated for at least five generations.
Users passwords must not be related to one another such that compromise of one makes others easier to guess; e.g., "abCdefg1", "abCdefg2", "abCdefg3".
User IDs will be disabled or revoked following five (5) consecutive failed login attempts.

Please note, we highly recommend our employees use Pass Phrases such as *SeeU2morrow!* or **CU2morrow*.

10

Again, please be aware that these password standards **are effective as of December 13, 2004** and apply to all FEC Information Systems that require a password including;

Windows(your network account)
Lotus Notes
PeopleSoft
FEC (Keaterm)
Comprizon.buy

To assist you in implementing these standards the ITD HelpDesk has created instructions on changing passwords to meet these criteria. These instructions are located in **\\Ntsrv1\FEC-WIDE\Help Desk Information\Password Information & Instructions.** As always, the HelpDesk can be reached at X1255 or via email.

- There are no records of access requests granted to remote users. The FEC was unable to provide access request approval documentation to support the access of all dial-up and Virtual Private Network (VPN) users that we sampled for our review. In addition, there was no evidence of periodic re-validations of these users;

FEC Response: There is a record of those individuals that have been granted access through the use of the VPN. The individuals on the access list have been approved by the CTO. The list is maintained by the Systems Branch. The list is periodically reviewed by the CTO. It is FEC policy that all FEC employees may access the network via dialup connection. Many FEC personnel have been provided with FEC laptops so that dial-up access may be available at home.

- GL system access requests are not properly documented or reviewed. The FEC was only able to provide us original access matrices for eight of the 33 current GL system users. Additionally, the FEC does not periodically perform revalidations of GL system access;

FEC Response: GL user matrix has been provided to the audit team. Supervisors request access for people that require access to the GL system either directly to the administrator or report them via the GL system Lotus notes database that is used to record all administrator activity. For example, log number 159 is a request for access rights.

- The principle of "least privilege" is not consistently applied in the GL system application. A high level IT official has similar access rights and privileges in the GL system application as the Accounting Officer;

FEC Response: The privileges for the high level IT official, were modified to allow the appropriate level necessary to perform the functions of the position, at the time it was identified by the audit team. This was complete months ago.

- Data center access is not adequately documented or reviewed:
  - Four employees have their names misspelled on the cardholder report;
  - One of the individuals with access to the data center was terminated recently, but his access key is still active and the physical location of the key could not be determined; and
  - FEC could not identify one user who has access to the data center or justify why the individual has access to the data center.

11

FEC Response: Data Center is adequately documented and reviewed through the use of the automated Kastle Key secure entry system. Kastle is under contract to monitor access 24-7 to the building as well as the data center. On occasion, since names are entered manually by the administrative division, spelling errors may occur and go undetected, due to the reviewers may be unaware of the correct spelling.

The individual in question in the second sub-bullet above, was not terminated, but in fact passed away. His Kastle Key was in his possession at the time of death and was unrecoverable at the time. Lost key procedures were instituted and his access was revoked during August 2004. He passed away on July 21, 2004. When personnel are terminated, or they leave the employ of the FEC voluntarily, their key is collected in accordance with personnel check out policy.

The individual that could not be identified was unknown to the Systems Branch Manager when asked. It is not expected of the Systems Branch manager to know each person on an access list. The person was a contract employee with proper credentials to be on the access list.

- The FEC is not in compliance with its auditing policy because it does not automatically log the network activity described in the *Audit Event Standards*, even though it has the capability to do so.

FEC Response: 58-3.3: Auditing and Monitor Policy and the Audit Event Standards are recently approved policies and standards, they were developed just prior to the audit. All of the FEC Information Systems have not yet come under their purview. The accounting system is scheduled for compliance soon.

C. Contingency Plan

- FEC has not formally identified and prioritized all critical data and operations on its major applications and the resources needed to recover them if there is a major interruption or disaster. In addition, we could not determine whether FEC had established emergency processing priorities that will help manage disaster situations more effectively for the network.

FEC Response: The FEC Mission Critical, General Support Systems, and Major Applications have been identified. The resources and data necessary to recover those entities in the event of a major interruption or disaster will be identified when the FEC completes its disaster recovery plans and procedures which is in process.

- FEC does not have alternative processing sites for most of its operations in the event of a disaster, including its general ledger system

FEC Response: the FEC does not have the budget or the mission criticality to justify the expense of establishing an alternative site. The FEC has the appropriate level of data processing that is consistent with its mission.

- The FEC Disclosure Database is replicated at an off-site location as a web-enabled read-only database the public can access. In the event that data cannot be updated at the FEC and then replicated at off-site location, there is no operational mechanism to update the Disclosure Database replicated at the off-site location.

FEC Response: the FEC does not have the budget or the mission criticality to justify the expense of establishing an alternative site. The FEC has the appropriate level of data processing that is consistent with its mission.

- FEC does not have adequate capacity for most of its back-up tapes in its fireproof safe; hence backup tapes are not kept in a fireproof safe.

FEC Response: The FEC will look into the expenses involved in expanding its fireproof safe capacities. In the interim, the off-site storage facility picks up tapes on a weekly basis, in the event of a catastrophe in the FEC Data Center, the maximum loss of data would be one week. At this time this is considered acceptable risk

- FEC data center is fully exposed to a wet pipe sprinkler system, with no compensating controls to avert inadvertent water damage to critical hardware and magnetic media in the case of a malfunction or false alarm.

FEC Response: In accordance with the NIST Computer Security Handbook chapter 15 Physical and Environmental Security, page 171, Water sprinkler systems are the preferred fire extinguishing systems. See below extract:

Fire Extinguishment. A fire will burn until it consumes all of the fuel in the building or until it is extinguished. Fire extinguishment may be automatic, as with an automatic sprinkler system or a HALON discharge system, or it may be performed by people using portable extinguishers, cooling the fire site with a stream of water, by limiting the supply of oxygen with a blanket of foam or powder, or by breaking the combustion chemical reaction chain.

> Halons have been identified as harmful to the Earth's protective ozone layer. So, under an international agreement (known as the Montreal Protocol), production of halons ended January 1, 1994. In September 1992, the General Services Administration issued a moratorium on halon use by federal agencies.

When properly installed, maintained, and provided with an adequate supply of water, automatic sprinkler systems are highly effective in protecting buildings and their contents. Nonetheless, one often hears uninformed persons speak of the *water damage* done by sprinkler systems as a disadvantage. *Fires that trigger sprinkler systems* cause the water damage. In short, sprinkler systems reduce fire damage, protect the lives of building occupants, and limit the fire damage to the building itself. All these factors contribute to more rapid recovery of systems following a fire.

Each of these factors is important when estimating the occurrence rate of fires and the amount of damage that will result. The objective of a fire-safety program is to optimize these factors to minimize the risk of fire.

- FEC has not developed and documented a comprehensive contingency of operations plan of its data centers, networks and telecommunication facilities.

FEC Response: The FEC is in process of developing a disaster recovery plan that will address these issues.

D. Software Development and Change Controls

- System Development Life Cycle (SDLC) Methodology has not been finalized and implemented.

FEC Response: The overall agency SDLC has been drafted and the policies and procedures are written. The implementation will take place with the establishment of the Quality Assurance Branch within the IT Division, as soon as the IT organization plan takes effect. There is a Quality Assurance Manager on board and he has taken steps to begin the establishment of appropriate QA controls.

- No written policy has been created to manage software libraries.

FEC Response: See the SDLC that was provided. The management of software libraries is addressed in the SDLC.

- Written procedures to modify, test, approve or release software for any of its applications, including the GL system have not been documented.

FEC Response: See the SDLC. In addition to the procedures in the SDLC, the procedures and flow are depicted in graphic form with the key players identified in the diagram for each system supported by the IT Division. The key players are identified as the business owners, the IT owners with the hardware and OS identified. See sample of the major systems diagram.

- Emergency change procedures and procedures for installing patches are not documented.

FEC Response: See SDLC

- Software code changes were not reviewed before being implemented.

FEC Response: All changes to the GL system are recorded in the Lotus Data Base set up to provide a log of all activity in the GL system. The changes are documented in this log, and acceptance is verified by the business owner of the GL system. As far as code changes are concerned, the FEC does not own source code to any purchased software, and therefore is not capable of making any code changes. We do, however maintain and modify as requested, via the log any changes to application scripts developed in house pertaining to the specific applications requirements of the FEC.

REPORTABLE CONDITIONS

III. Cost Accounting System and Processes

A. Cost Allocation Methodology

FEC does not have a cost accounting system that is integrated with the GL system. The current cost accounting system is not adequate to produce the cost data for the Statement of Net Cost (SNC) in an efficient manner. Accordingly, the cost data presented on the SNC is compiled from three systems' raw data, which is then gathered and analyzed in an elaborate, complex, and manually intensive spreadsheet.

FEC Overall Response: FEC acknowledges the benefits that can be enjoyed from the use of a fully integrated financial management system. However, as pointed out in previous responses, FEC's management has evaluated the cost versus the benefit of integrating all of its financial systems and believes that the cost should not outweigh the benefit of integration. FEC believes that its current systems are adequately configured to meet its mission. Also, FEC believes that given its size and the fact that payroll constitutes the majority of its costs, at this time the process for compiling and allocation its costs is adequate and, in our opinion, not complex. Therefore, FEC does not concur with the classification of this finding as a reportable condition.

FEC Response: The FEC prepares its cost allocation based on the budget reporting system's (MIS)data, and data from the accounting system as reported on the Budget Execution Report (BER). Our costs are based on data that is meaningful to OMB and our oversight committees in the presentation of budget requests and appropriation justifications: actual FTE allocated to programs and activities, and Budget Authority (BA), obligations, and final expenditures. These are the data that they are interested in reviewing in the context of the budget and appropriation processes. Both the OMB and congressional offices have commented on the quality and usability of FEC budget presentations in recent years, and the proof is that the FEC has attained a 3.5% increase in its budget for FY 2005 and a recommended 5.5% increase for FY 2006 when the budgets for many domestic agencies and programs have been frozen or even reduce in recent years.

Raw data used in the allocation of costs, such as payroll, is sometimes based on estimates due to the timing of the availability of the data.

FEC Response: Payroll costs constitute the large majority of FEC's costs. As previously communicated to Clifton Gunderson during the audit in responses to requests for information, use of data from the actual service provider and FEC payroll process necessarily requires the use of projections from actual data due to compressed time frames mandated by the Accountability of Tax Dollars Act and OMB regulations. Depending upon when the end of the last month of a quarter falls, there is a built in 10 day to two week processing time lag from when payroll data is collected and reported to the service provider and the payroll information is reported back to the FEC. This necessarily requires the use of projections to meet quarterly timeframes for reporting. These "estimates" are projections based on actual year to date data as available when the reporting time frame falls.

FEC could not provide crosswalk documentation or definitions supporting the basis of assignment or allocation. The data accumulation and analysis is performed by one person and not subjected to a second review. In addition, the FEC did not have a formal comprehensive policy and procedures for the program cost allocation. Although a written procedures document was provided to us, the document was written in response to our audit request and did not include a comprehensive set of procedures. The manually intensive and elaborate cost allocation process dictates the need for a formal comprehensive policy and procedures. Moreover, the heavy reliance on a single person to carry out this process could impair FEC's ability to generate a timely and accurate report when the person becomes unavailable.

FEC Response: Definitions of the three major programs are provided in the FEC Strategic Plan, Performance Plans, and FEC Mission Statement. A document describing the allocation process and additional documentation and explanation were provided in both written and verbal form in meetings to describe the new allocation process (see below). The document in question was written prior to the audit in preparation for the audit—documenting procedures in the normal course of preparing for an audit. The FEC noted that comprehensive procedures were not required due to the limited scope of the allocation process at the FEC. The FEC is a small agency with over 70% of its costs dedicated to payroll expenses, and it is our opinion that the process for compiling and allocating such costs is adequate under the costs benefits test.

Recommendations:

35. Establish formal and comprehensive cost allocation methodology and related policy and procedures.

FEC Response: The FEC has formally documented the cost allocation procedures; prior to the FY 2002, Act the FEC did not allocate management and overhead costs to the three major programs but reported them separately. The FEC does not see a cost effective need for "comprehensive" detailed procedures carried out solely by the budget office, particularly when as noted the system is being replaced by a new budget preparation and reporting system, automated and more fully integrated with the FEC financial system. In response to the 2002 Act the FEC added requirements to the new system to automate the allocation process in the new system which will be fully documented.

36. Cross-train employees to minimize the risks of major interruptions in normal business operations.

FEC Response: The FEC will train several employees to use the new automated budget preparation and reporting system which will be fully documented.

37. Establish a review process wherein a person, other than the preparer, reviews the work performed to ensure accuracy and propriety.

FEC Response: The FEC notes again that at some point in a small agency with limited staff the costs benefits test requires that officials perform their tasks responsibly and effectively. There is a limit to what tasks can be double-checked with a two person budget office. In addition, the new automated system will provide a built in check as a compensating measure of control.

B. Managerial Cost Accounting

Statement of Federal Financial Standard No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, requires reporting components to perform a minimum-level of cost accounting and provide basic information necessary to accomplish the many objectives associated with planning, decision making, and reporting...The present FEC cost accounting system does not provide the minimum-level identified above. FEC management notified us that it is in the process of developing a new cost accounting system.

Recommendations:

38. Evaluate the functional requirements for the new cost accounting system to ensure that at least, the minimum level of cost accounting required in SFFAS No. 4 is attained.

FEC Response: The FEC does not concur with this finding or its classification as a reportable condition. SFFAS No. 4 is a very general standard which gives agencies the flexibility of devising methods or techniques for allocating costs in a reliable and consistent manner. The FEC believes that the current methods and techniques for allocating costs are adequate given its size, mission and the nature of costs incurred (i.e. mostly payroll costs). FEC's current methods allow for satisfaction of the following "minimum" level of costs as prescribed in SFFAS No. 4:

- Capturing costs by major programs (i.e., responsibility segments)
- Capturing its full cost of operations
- Using a consistent costing methodology
- Using cost data to assist in measurement of performance
- Reporting cost information consistently
- Combining the standard general ledger data in the costing process
- Determining a reasonable and useful level of data precision
- Accommodating special information needs of management
- Documenting the costing techniques/methods

In that vein, the FEC believes that the current budget reporting and other financial management and reporting systems provide beneficial and useful high level management information, and make even more detailed information available to division and office managers. It is FEC's position that while its costing process is adequate, it will be improved upon implementation of its new budget reporting system, which will contain an automated cost allocation setup.

IV. General Property and Equipment (Property)

FEC's accounting for property involves a time-consuming effort that increases the risk of errors due to its process of expensing its property at the time of acquisition and preparing a journal voucher to reclassify the expense to an asset for reporting purposes.
Our audit disclosed deficiencies, errors or omissions that questioned the effectiveness of FEC's internal control on property. Some examples are noted below:

- Depreciation expense and accumulated depreciation reported on the depreciation report were not correct. We were informed that although the property management system calculates depreciation correctly, when the data is converted into another system to generate the depreciation report, the calculation gets corrupted. This error was identified during the audit and was subsequently adjusted.

- Software-in-development was not adequately tracked and was not reported until the September 30, 2004 financial statements. There was one instance of software-in- development being reported as completed software in the property management system; therefore, the asset was being improperly depreciated. Another instance was completed software that was not recorded. These errors were only identified during the audit process.

- Several assets were recorded using the purchase order amount, instead of the actual cost.

- For the 45 sample items we tested, we noted that 45 receiving reports were not completed properly, that is, they were either not signed, did not have the date of receipt, did not have a description of the goods or services received, or lacked a reference to the invoice to be paid. Although only 6 of the 45 items pertained to acquisitions in fiscal year 2004, this deficiency persisted throughout fiscal year 2004.

One of the five standards for internal control in GAO ***Standards for Internal Control in the Federal Government*** is control activities. Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records, which provide evidence of execution of these activities as well as appropriate documentation.

Recommendations:

37. Enforce current procedures to require documentation of approvals and certifications for procurement and disbursements transactions.

38. Formally communicate to all appropriate personnel to ensure compliance and consistent application of the policies and procedures.

FEC Response: FEC agrees with these findings. In FY 2003 and in preparation for the audit, FEC needed to establish asset values for prior year purchases. Detailed records were not always available. Federal accounting standards allow for the use of estimates where detailed records are not available. In some cases that meant using reports and estimates (purchase orders) from as far back as FY 1997. Thus, not all receiving reports were available. FEC provided the audit team with invoices, purchase orders and receiving reports for FY 2004 purchases. FEC will modify its stated requirement on receiving reports to delete the provision requiring a description of goods and services received. Since this information is on the purchase order and invoice, it is not necessary to require it on the receiving report. Instead, FEC will add an invoice number field to the receiving report. This will tie the approval to the goods or services received.

The error in the spreadsheet calculation of depreciation expense was caught and corrected by FEC in its regular review of the financial statements. Software in Progress was a new account added in FY 2004 and will be tracked quarterly in FY 2005.

18

Current procedures will be enforced. Late in FY 2004 some minor procedures changed (e.,g., Software in Progress). These changes will be documented and communicated to appropriate staff in early FY 2005.

V. Payroll

Recommendations:

39. Implement procedures to ensure that payroll deduction elections are authorized by maintaining adequate supporting documentation or an ability to query the service provider systems to verify these deductions if initiated by an employee without the FEC's intervention. Consider training/re-training payroll employees on the proper procedures for obtaining and retaining support documents for payroll elections.

40. Ensure that timekeepers perform a monthly reconciliation of leave balances reported in its records and the service provider records and submit the leave balance certification to the finance office monthly.

41. Implement procedures for ensuring hours recorded on the T&A reports are properly supported and authorized. Consider further automating payroll processing to decrease the risk of errors.

42. Implement procedures for ensuring all payroll and personnel documents are properly completed and authorized before payroll data is transmitted to the payroll service provider for processing.

FEC response: FEC's payroll is processed by a service provider. Seventy percent of FEC's annual budget is for payroll. We were pleased that after an extensive audit, Clifton Gunderson found no incorrect payments or leave balances and had only minor suggestions on improvements. .

The official record of an employee's leave balance is the earnings and leave statement, not the manually prepared timesheets.

FEC agrees it is responsible for obtaining original documents (tax forms, health deductions, etc.) when employees are hired. However, FEC employees may use OPM's Employee Express to change certain deductions. In some cases changes are made by the service provider employees (TSP loan repayments) or an authorized contractor such as for enrollment in the Flex Fund HCA Program. Thus, there is not necessarily a form in FEC's files for every change to an employee's deductions. Of the 41 documents the auditors state were not in FEC's files, Payroll personnel were able to produce alternative evidence showing the changes were made either by the employee through Employee Express, the service provider, or an authorized FEC employee or contractor.

FEC recognizes there are some situations (i.e., holidays, travel) where timesheets may be approved before the end of the pay period. Both cases noted by the auditors during the audit were around holiday time, when many employees are off. Supervisors remain responsible for hours worked by their employees. There is no indication this is widespread problem or anyone was paid incorrectly as a result of the advanced approval of the timesheets.

Timekeepers and supervisors will be reminded of the proper procedures for approving leave, correcting timesheets to minimize potential errors and submitting leave verifications to payroll each pay period.

OTHER MATTERS

Federal Managers' Financial Integrity Act (31 U.S.C. 3512) (Integrity Act) Compliance and Reporting

OMB Circular No. A-123 provides the reporting guidance for the Integrity Act. OMB Circular A-123 states that annually, by December 31, the head of each executive agency submit to the President and the Congress (i) a statement on whether there is reasonable assurance that the agency's controls are achieving their intended objectives; (ii) a report on material weaknesses in the agency's controls, and (iii) whether the agency's financial management systems conform with government-wide requirements. OMB Bulletin No. 01-02 required that we compare the material weaknesses in the agency's controls and material non-conformances on the agency's financial management systems in the FEC's Integrity Act report to our report on internal control dated November 1, 2004. Since the Integrity Act report is due by December 31, 2004, FEC has not started and does not intend to start the process of accumulating the information required for its report until November 2004. Accordingly, the comparison of reports could not be performed.

FEC Response: The FEC noted to Clifton Gunderson that the A-123 annual statement process is an annual one based on calendar years, not fiscal years, and is due to the President December 31, 2004, not by September 30, 2004. Given the heavy workload faced by FEC managers during an election year (2004), FEC management stated that we would not require division and office managers to prepare their statements prior to September 30, 2004. The FEC notes that Clifton Gunderson was made aware that the A-123 process at the FEC requires all managers to integrate concern for management controls into the on-going managerial and supervisory duties they perform on a continuing basis. This conforms to the last OMB revision of the A-123 process designed to integrate management controls and A-123 into the overall management processes of federal agencies.

It is therefore incorrect to state that the process has not been started. It is a process that is on-going on a regular basis. The process of preparing and submitting the annual statements to the Staff Director will not have been started by September 30. 2004.

FEC management did note that the 2003 statement indicated that managers had discovered no major potential weaknesses or potential vulnerabilities in their self assessment process. The FEC notes that the A-127 financial systems management controls review process can be more than covered by the extensive self-assessment the FEC performed, with the help of a contractor, for FY 2003 processes in preparation for the FY 2004 audit. It should also be noted that the review and evaluation process covered by the audit is more extensive than any self-assessment provided for in A-127 of financial management controls.

The FEC has commented to the FEC IG on prior occasions that the FEC does not require a comprehensive plan to integrate its one existing financial system with any other financial systems. In terms of integrating the financial system with systems such as the budget reporting systems, as well as the property (fixed assets) and procurement systems, the FEC indicates in both the main FEC and FEC IT Strategic Plans and Performance Plans, the schedule for improving these systems. As noted the FEC is currently engaged in developing and implementing a more fully integrated budgeting system with the accounting system.

Limitations on the Financial Statements

Management has prepared the accompanying financial statements to report the financial position and results of operations of the Federal Election Commission, for fiscal year 2004 pursuant to the requirements of Title 31 of the United States Code, section 3515(b).

While the statements have been prepared from the books and records of the Federal Election Commission in accordance with generally accepted accounting principles (GAAP) for federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the understanding that they represent a component of the U.S. Government, a sovereign entity. One implication of this is that the liabilities presented herein cannot be liquidated without the enactment of appropriations, and ongoing operations are subject to the enactment of future appropriations.

Principal Statements

Federal Election Commission
Balance Sheet
As of September 30, 2004

Assets		
Intragovernmental:		
Fund balance with Treasury (Note 2)	$	11,817,284
Total Intragovernmental Assets		11,817,284
Accounts Receivable, net (Note 3)		95,358
General property and equipment, net (Note 4)		8,753,961
Advances to others		4,014
Total Assets	**$**	**20,670,617**
Liabilities		
Intragovernmental:		
Accounts Payable (Note 5)	$	237,080
Custodial Liability		461,025
Total Intragovernmental		698,105
Accounts payable		742,256
Accrued payroll and benefits		1,190,514
Unfunded leave		1,785,307
Actuarial Federal Employees Compensation Act (FECA) liability (Note 6)		43,425
Other		5,187
Total Liabilities		**4,464,794**
Commitments and Contingencies		-
Net Position		
Unexpended appropriations		9,280,593
Cumulative results of operations		6,925,230
Total Net Position		**16,205,823**
Total Liabilities and Net Position	**$**	**20,670,617**

The accompanying notes are an integral part of these statements

Federal Election Commission
Statement of Net Cost
For the year ended September 30, 2004

	Obtain Compliance	Promote Disclosure	Public Financing	Election Administration	Totals
Intragovernmental gross costs	$ 4,843,146	$ 2,485,933	$ 716,013	$ -	**$ 8,045,092**
Less: Intragovernmental earned revenue				-	**-**
Intragovernmental net costs	**4,843,146**	**2,485,933**	**716,013**	**-**	**8,045,092**
Gross costs with the public	26,215,665	13,456,214	3,875,738	309,386	**43,857,004**
Less: earned revenues from the public		(149,818)			**(149,818)**
Net costs with the public	**26,215,665**	**13,306,396**	**3,875,738**	**309,386**	**43,707,186**
Net Cost of Operations	**$ 31,058,811**	**$ 15,792,329**	**$ 4,591,751**	**$ 309,386**	**$ 51,752,277**

The accompanying notes are an integral part of these statements

Federal Election Commission
Statement of Changes in Net Position
For the year ended September 30, 2004

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	$ 6,014,404	$ 10,411,548
Budgetary Financing Sources:		
Appropriations received		51,240,000
Appropriations transferred in/out (+/-)		(481,092)
Other adjustments (rescissions, etc) (+/-)	-	(1,463,081)
Appropriations used	50,426,782	(50,426,782)
	50,426,782	**(1,130,955)**
Other Financing Sources:		
Imputed financing from costs absorbed by others	2,236,321	
	2,236,321	-
Total Financing Sources	**52,663,103**	**(1,130,955)**
Net Cost of Operations (+/-)	(51,752,277)	
Ending Balances	**$ 6,925,230**	**$ 9,280,593**

The accompanying notes are an integral part of these statements

Federal Election Commission
Statement of Budgetary Resources
For the year ended September 30, 2004

	Combined Total
Budgetary Resources	
Budget authority:	
Appropriations received	$ 51,240,000
Net transfers	(481,092)
	50,758,908
Unobligated balance:	
Beginning of period	1,323,078
	1,323,078
Subtotal	**52,081,986**
Recoveries of prior year obligations	887,780
Enacted rescissions	(302,316)
Permanently not available:	
Cancellations of expired/no-year accounts	(1,160,764)
Total Budgetary Resources	**$ 51,506,686**
Status of Budgetary Resources	
Obligations Incurred	
Direct	
Category A	42,587,222
Category B	7,518,185
	50,105,407
Unobligated balance	
Balance currently available	
Category A	86,214
	86,214
Unobligated balance not available	1,315,065
Total Status of Budgetary Resources	**$ 51,506,686**
Relationship of Obligations to Outlays:	
Obligated balance, net, beginning of period	**$ 10,564,690**
Obligated balance transferred, net, end of period	
Undelivered orders	7,875,301
Accounts payable	2,169,850
Other liabilities	5,187
	$ 10,050,338
Outlays	
Disbursements	49,737,166
Net Outlays	**$ 49,737,166**

The accompanying notes are an integral part of these statements

Federal Election Commission
Statement of Financing
For the year ended September 30, 2004

Resources Used to Finance Activities	
Budgetary Resources Obligated	
Obligations Incurred	$ 50,105,407
Less: Recoveries of prior year obligations	(887,780)
Net obligations	**49,217,627**
Other Resources	
Imputed financing from costs absorbed by others	2,236,321
Net other resources used to finance activities	**2,236,321**
Total resources used to finance activities	**51,453,948**
Resources Used to Finance Items not Part of the Net cost of Operations	
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	(1,209,155)
Resources that finance the acquisition of assets	3,421,957
Total resources used to finance items not part of the net cost of operations	**2,212,802**
Total resources used to finance the net cost of operations	**49,241,146**
Components of the Net Cost of Operations that will not require or Generate Resources in the Current Period	
Components Requiring or Generating Resources in Future Periods:	
Increase in annual leave liability	86,430
Increase in FECA liability	17,158
Total components of Net Cost of Operations that will require or generate resources in future periods	**103,588**
Components not Requiring or Generating Resources:	
Depreciation and amortization	2,407,543
Total components of Net Cost of Operations that will not require or generate resources	**2,407,543**
Total components of net cost of operations that will not require or generate resources in the current periods	**2,511,131**
Net Cost of Operations	**$ 51,752,277**

The accompanying notes are an integral part of these statements

Federal Election Commission
Statement of Custodial Activity
As of September 30, 2004

Collections on Behalf of the Federal Government		
Cash Collections		
Miscellaneous Receipts	$	476,507
Civil Penalties		3,737,570
Administrative Fees		830,330
Allowance for Uncollectible Receivables		(381,431)
Total Custodial Revenue	**$**	**4,662,976**
Disposition of Collections		
Transferred to Treasury		4,567,618
Amount to be transferred		95,358
Total Disposition of Collections	**$**	**4,662,976**

The accompanying notes are an integral part of these statements

Notes to the Financial Statements for the Year Ended September 30, 2004

Note 1 - Summary of Significant Accounting Policies

Reporting Entity

The accompanying financial statements present the financial position, net cost of operations, changes in net position, custodial activity, budgetary resources, and financing of the Federal Election Commission (FEC). Created in 1975 by an act of Congress, the FEC is an independent agency charged with administering and enforcing the Federal Election Campaign Act (FECA). The financial activity presented relates primarily to the execution of the FEC congressionally approved budget. Until March 31, 2004 FEC retained responsibility for Election Administration. Under P.L. 107-252, effective April 1, 2004, that responsibility and remaining funds were transferred to the newly formed Election Assistance Commission.

The Presidential Election Campaign Fund ("the fund") is not a reporting entity of the FEC's. Federal Accounting Standards Advisory Boards' (FASAB) Statement of Federal Financial Accounting Concept No. 2, "Entity and Display," states that two criteria determine whether a program qualifies as an agency's reporting entity: conclusive criteria and indicative criteria. Conclusive criteria include which agency budgets the funds. Indicative criteria include which agency exercises "continuing administrative control including the ability to select or remove the governing authority and the authority to review and/or modify budget requests." Since the funds are budgeted, apportioned, recorded, reported and paid by Treasury, the accounts of the Presidential Election Campaign Fund are not included in the FEC's financial statements.

The FEC maintains eligibility requirements for the fund. Under the Internal Revenue Code, qualified Presidential candidates receive money from this fund. The FEC helps Treasury determine which candidates are eligible to receive the funds and the amount of funds to be received. The Secretary of the Treasury makes the payments to eligible candidates and major party and qualified minor party nominees as well as National Party Conventions also receive money from this fund. The Fund is financed exclusively by a voluntary tax check off. Individual taxpayers may direct $3 of their tax to the Fund (up to $6 for joint filers) by checking a box on their tax return.

Basis of Accounting and Presentation

These financial statements reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting is designed to recognize the obligation of funds according to legal requirements. Budgetary accounting is essential for compliance with legal constraints and controls over the use of federal funds.

These financial statements have been prepared from the books and reports of FEC in accordance with U.S. generally accepted accounting principles (GAAP) for the federal government, the Office of Management and Budget (OMB) Bulletin No. 01-09, Form and Content of Agency Financial Statements. FEC did not prepare audited financial statements for FY 2003 and therefore, there is no presentation of comparative information for the FY 2004 statements.

Assets

Intra-governmental assets are those assets that arise from transactions with other federal entities. Entity assets are available for use by the entity in its operations while nonentity assets are assets held by the entity but not available for use by the entity in its operations.

Fund Balance with Treasury

FEC does not maintain cash in commercial bank accounts. The U.S. Treasury processes cash receipts and disbursements. Funds with the U.S. Treasury consist of appropriated and deposited funds that are available to pay current liabilities and finance authorized purchase commitments.

Accounts Receivable

FEC's accounts receivable represent amounts due from the public or U.S. Treasury for fines and penalties assessed by FEC and referred to Treasury for collection. An allowance for uncollectible accounts has been established and included in Accounts Receivable, net on the balance sheet. The allowance is a percentage of the overall receivable balance and the collection rate of past balances.

General Property and Equipment

General P&E is reported at acquisition cost. The capitalization threshold is established at $25,000 and a useful life of 2 or more years. General P&E consists of items that are used by FEC to support its mission. Depreciation on these assets is calculated using the straight-line method with no salvage value. Depreciation begins the month after the asset is placed in service. Maintenance, repairs and minor renovations are expensed as incurred. Expenditures that materially increase values, change capacities or extend useful lives are capitalized.

Internal use software development and acquisition costs of $25,000 are capitalized as software development in progress until the development stage is completed and the software successfully tested. At acceptance, 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 5 years. Purchased commercial software that does not meet the capitalization criteria is expensed. Enhancements which do not add significant new capability or functionality are expensed. Construction costs of $25,000 or more are accumulated as Construction in Progress until occupancy and then are capitalized as a Leasehold Improvement over 5-7 years or the life of the lease whichever is shorter.

The land and building in which the FEC operates is leased from a commercial entity. The General Services Administration (GSA) provides the facility occupied by the FEC. GSA charges the FEC a Standard Level Users Charge that approximates the commercial rental rates for similar properties.

Liabilities

Liabilities represent amounts that are likely to be paid by the FEC as the result of transactions or events that have already occurred; however, no liabilities are paid by the FEC without an appropriation. Intragovernmental liabilities arise from transactions with other federal entities.

Accounts Payable

Accounts payable consist of amounts owed for goods, services, and other expenses received but not yet paid.

Accrued Payroll and Benefits

Accrued Payroll and Benefits represents salaries, wages and benefits earned by employees, but not disbursed as of September 30, 2004. Accrued payroll and benefits are payable to employees and are therefore not classified as intragovernmental.

Annual, Sick and Other Leave

Annual leave is recorded as a liability when it is earned; the liability is reduced as leave is taken. Each year, the balance in the accrued, restored, and compensatory leave account is adjusted to reflect current leave balances and pay rates. Accrued annual leave is paid from future funding sources and accordingly is reflected as a liability not covered by budgetary resources. Sick leave and other types of non-vested leave are expensed as taken.

Employee Retirement Plans

Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS)

FEC employees participate in one of two retirement programs, either the CSRS or the FERS, which became effective on January 1, 1987. Most FEC employees hired after December 31, 1983, are automatically covered by FERS and Social Security.

For CSRS covered employees, the FEC withheld 7.0% of gross earnings. The FEC matches the withholding, and the sum of the withholding and the matching funds is transferred to the Civil Service Retirement System.

For each fiscal year the Office of Personnel Management (OPM) calculates the U.S. Government service cost for covered employees, which is an estimate of the amount of funds that, if accumulated annually and invested over an employee's career, would be enough to pay that employee's future benefits. Since the U.S. Government's estimated FY 2004 service cost exceeds contributions made by employer agencies and covered employees, this plan is not fully funded by the FEC and its employees. For FY 2004 FEC recognized $2.236 million as an imputed cost and as an imputed financing source for the difference between the estimated service cost and the contributions made by FEC and its employees.

FERS contributions made by employer agencies and covered employees exceed the U.S. Government's estimated FY 2004 service cost. For FERS covered employees the FEC made contributions of 10.7% of basic pay. Employees contributed .80% of gross earnings. Employees participating in FERS are covered under the Federal Insurance Contribution Act (FICA) for which the FEC contributes a matching amount to the Social Security Administration.

Thrift Savings Plan (TSP)

Employees covered by CSRS and FERS are eligible to contribute to the U.S. Government's TSP, administered by the Federal Retirement Thrift Investment Board. The FEC makes a mandatory contribution of 1% of basic pay for FERS-covered employees. FERS employees are eligible to contribute up to 12% of basic pay to their TSP account. In addition, FEC makes matching contributions, of up to 5% of basic pay, for employees who contribute to the Thrift Saving Plan. Contributions are matched dollar for dollar for the first 3 percent of pay contributed each pay period and 50 cents on the dollar for the next 2 percent of pay. CSRS participants may contribute up to 9% of their gross pay, but there is no governmental matching contribution. The maximum amounts that either FERS or CSRS employees may contribute to the plan in calendar year 2004 is $13,000 for those under age fifty and $16,000 for those fifty and older.

The FEC financial statements do not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, which may be applicable to FEC employees and funded by FEC. Such reporting is the responsibility of OPM.

Contingencies

A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. A contingency liability is recognized when a past event or exchange transaction has occurred, and future outflow or other sacrifice of resources is measurable and probable. A contingency is not disclosed when any of the conditions for liability recognition are met but the chance of the future event or events' occurring is remote. A contingency is disclosed when any of the conditions for liability recognition are not met and the chance of the future confirming event or events occurring is more than remote but less than probable.

In the opinion of FEC management and legal counsel, FEC is not a party to any legal actions which are likely to result in a material liability. Accordingly, no provision for loss is included in the financial statements.

Revenues and Other Financing Sources

Annual Salaries and Expenses Appropriation

Annual one year appropriations are provided by Congress and are available for obligation in the fiscal year for which it was provided to fund the overall operation of the FEC.

Imputed Financing Sources

In accordance with OMB Bulletin No. 01-09, all expenses should be reported by agencies whether or not these expenses would be paid by the agency that incurs the expense. The amounts for certain expenses of the FEC, which will be paid by other federal agencies, are recorded in the "Statement of Net Cost." A corresponding amount is recognized in the "Statement of Changes in Net Position" as an "Imputed Financing Source." These imputed financing sources primarily represent unfunded pension costs of FEC employees.

Statement of Net cost

Sub-Organization Program Costs

The FEC Statement of Net Cost is presented by Responsibility Segment. The Responsibility Segments are based on the FEC's mission and funding sources. The major programs that comprise the Responsibility Segments are: Obtain Compliance, Promote Disclosure and Public Financing. Costs for a fourth segment, Election Administration, is reported for the six months ended March 31, 2004, when the function transferred to the Election Assistance Commission.

Earned Revenue

Earned revenues collected by FEC included fees for seminars and conferences held during the year in various parts of the country. Earned revenues collected by FEC also included amounts collected from the public for information provided under the Freedom of Information Act (FOIA), primarily photocopying.

Net Position

Net position is the residual difference between asset and liabilities and comprises Unexpended Appropriations and Cumulative Results of Operations.

Unexpended appropriations include appropriations not yet obligated or expended, represented by the unobligated balances and undelivered orders of FEC's appropriated funds. Unobligated balances associated with appropriations that expire at the end of the fiscal year remain available for obligation adjustments, but not for new obligations, until that account is closed, five years after the appropriations expire. Cumulative Results of Operation is the Net Result of FEC's operation since inception.

Statement of Custodial Activity

The Statement of Custodial Activity summarizes collections transferred or transferable to the U.S. Treasury or other parties for miscellaneous receipts, fines and penalties. These amounts are not reported as revenue to FEC.

Use of Estimates

The preparation of financial statements in accordance with the accounting principles described above require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying footnotes. Actual results could differ from those estimates.

Note 2 - Fund Balance with Treasury

Fund balance with Treasury at September 30, 2004, consisted of the following:

	2004
Appropriated Funds	$11,451,617
Other Funds	365,667
Total Fund Balance with Treasury	$11,817,284

Status of Fund Balance with Treasury

	2004
Unobligated Balance	
- Available	$ 86,214
- Unavailable	1,315,065
Obligated Balance, Not Yet Disbursed	10,050,338
Other Funds	365,667
Total Status of Fund Balance with Treasury	$11,817,284

Fund Balance with Treasury is an asset maintained with Treasury. The appropriated funds are available to pay current liabilities. FEC has the authority to disburse funds to agencies and institutions participating in its programs through the Treasury, which processes cash receipts and disbursements on its behalf. Other Funds consist of custodial collections and are not available to finance FEC activities and are therefore classified as non-entity assets.

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts that are not apportioned for obligation during the current fiscal year and expired appropriations no longer available to incur new obligations. Obligated balances not yet disbursed include reimbursements and other income earned, undelivered orders and expended authority-unpaid.

Non-entity Assets

Non – entity assets at September 30, 2004 consist of the following:

	FY 2004
Fund balance with Treasury (Custodial)	$ 365,667
Accounts Receivable	95,358
Total non-entity Assets	$ 461,025
Total entity Assets	20,209,592
Total Assets	$ 20,670,617

Non-entity assets are not available to finance FEC activities.

Note 3 - Accounts Receivable, Net

Accounts Receivable at September 30, 2004, consist of the following:

	Gross Accounts Receivable	Allowance	Net Accounts Receivable
NON-ENTITY			
Intragovernmental	$ -	$ -	$ -
With the Public	476,789	381,431	95,358
Total Non-Entity	476,789	381,431	95,358
TOTAL	$ 476,789	$ 381,431	$ 95,358

Note 4 - Property and Equipment, Net

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

Asset Class	Service Life (years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Software	5	$ 8,150,070	$ 3,651,895	$ 4,498,175
Desktop and laptop computers and peripherals	3	2,431,700	1,460,814	970,885
Leasehold Improvements	5-7	1,912,848	1,153,973	758,875
Furniture	7	694,730	173,555	521,175
Telecommunication Equipment	5	234,763	234,763	-
Software-in-Development	n.a.	1,078,650	-	1,078,650
Construction-in-Progress	n.a.	926,200	-	926,200
Totals		$ 15,428,961	$ 6,675,000	$ 8,753,961

Depreciation expense was $2,407,543 for the fiscal year ended September 30, 2004.

Note 5 - Liabilities Covered and Not Covered By Budgetary Resources

Liabilities Covered by Budgetary Resources are those for which budgetary resources are available in the current fiscal year. Liabilities Not Covered by Budgetary Resources result from the receipt of goods and services, or the occurrence of events, for which appropriations, revenues, or other financing sources necessary to pay the liabilities have not yet been made available through Congressional appropriation. These include FECA and annual leave liability. FEC's liabilities covered and not covered by budgetary resources are as follows:

Liabilities Covered by Budgetary Resources	
Accounts Payable	$ 979,336
Accrued Payroll and Benefits	1,190,514
Other	5,187
Liabilities Not Covered by Budgetary Resources	
Accrued Unfunded Annual Leave	1,785,307
Custodial Liability	461,025
Accrued Unfunded FECA Liability	43,425
Total Liabilities Covered and Not Covered by Budgetary Resources	**$4,464,794**

Note 6 - FECA Liability

The Federal Employee's Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for FEC employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by the FEC.

The FEC accrues FECA liability at September 30, 2004. FECA liability includes two components: (1) the accrued liability which represents money owed for claims paid by the DOL through the current fiscal year, for which billing to and payment by the FEC will occur in a subsequent fiscal year and; (2) the liability for future costs which represents the expected liability for approved compensation cases beyond the current fiscal year. Estimated future costs have been actuarially determined, using the model provided by DOL and are regarded as a liability to the public because neither the costs nor reimbursement have been recognized by DOL. FECA liability is included in Liabilities Not Covered by Budgetary Resources, as described in Note 5.

Note 7 - Leases

The FEC has a commitment under an operating lease for its headquarters office space. The lease is for a period of ten years and expires September 30, 2007. Under their lease agreement with GSA, the FEC is charged rent that is intended to approximate commercial rental rates. FEC has no capital leases. Future payments due under the lease:

Future Operating Lease Payments

Fiscal Year		Lease Payments
2005	$	3,722,474
2006		3,738,582
2007		3,755,389
Total Future Lease Payments	$	11,216,445

Note 8 - Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) compares budgetary resources with the status of those resources. As of September 30, 2004, budgetary resources were $51,506,686 and net outlays were $49,737,166.

Apportionment Categories of Obligations Incurred

FEC receives apportionments of its resources from OMB. Category A apportionments are those for resources that can be obligated without restriction on the purpose of the obligation, other than to be in compliance with legislation underlying programs for which the resources were made available. Category B apportionments are to be used for Information Technology enhancements only.

The apportionment categories of obligations incurred as of September 30, 2004 are summarized below:

	2004
Direct:	
Category A	$ 42,587,222
Category B	7,518,185
Total Apportionment Categories of Obligations Incurred	$ 50,105,407

Comparison to the Budget of the United States Government

Statement of Federal Financial Accounting Standards No. 7 (SFFAS No. 7), *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires an explanation of material differences between budgetary resources available, the status of those resources and outlays as presented in the Statement of Budgetary Resources to the related actual balances published in the *Budget of the United States Government (Budget)*. However, the *Budget* has not yet been published. The *Budget* is scheduled for publication in February 2005 and will be available through OMB. Accordingly, information required for such disclosure is not available at the time of publication of these financial statements. In FY 2004 FEC adjusted the beginning balance of Expended Authority Unpaid downward by $105,866 in its SF-133 submission to Treasury to correct an administrative error in the FY 2003 report. Undelivered Orders Unpaid went up by a corresponding amount. The general ledger reported the figures correctly.

Note 9 - Custodial Revenues and Accounts Receivable

FEC uses the accrual basis of accounting for the collections of fines, penalties and miscellaneous receipts. Collectibility by FEC of the fines and penalties is based on the responsible parties' willingness and ability to pay:

	2004
Fines, Penalties and Other Misc. Revenue	$4,662,976
Accounts Receivable for Fines, Penalties and Other Miscellaneous Receipts	
Accounts Receivable	476,789
Less: Allowance for Doubtful Accounts	381,431
Total	$ 95,358

Note 10 – Explanation of the Relationship Between Liabilities Not Covered by Budgetary Resources on the Balance Sheet and the Change in Components Requiring or Generating Resources in Future Periods

The increase in FECA Liability of $17,158 is included as part of the Resources that fund expenses recognized in prior periods line item of the Statement of Financing. The change in the unfunded annual leave balance between FY 2003 and FY 2004 of $86,430 is reflected as Components Requiring or Generating Resources in future Periods on the Statement of Financing. See Note 5 for the liability balance.

Required Supplementary Information

Federal Election Commission
Required Supplementary Information
As of September 30, 2004

Intragovernmental Assets:

Trading Partner Agency:	**Fund Balance with Treasury**
Treasury	$ 11,817,284
Total	**$ 11,817,284**

Intragovernmental Liabilities:

Trading Partner Agency:	**Accounts Payable**
Covered by Budgetary Resources:	
Department of Health & Human Services	$ 11,574
Department of Labor	2,947
Department of Treasury	5,198
Government Printing Office	347
General Services Administration	198,444
OPM	588
U. S. Department of Agriculture	10,002
U. S. Postal Service	7,980
Total Covered by Budgetary Resources	**$ 237,080**

Federal Election Commission
Required Supplementary Information
Statement of Budgetary Resources
For the year ended September 30, 2004

	Obtain Compliance	Promote Disclosure	Public Financing	Election Administration	Totals
Budgetary Resources					
Budget authority:					
Appropriations received	$ 30,710,026	$ 15,658,690	$ 4,563,660	$ 307,624	$ 51,240,000
Net transfers	(288,337)	(147,019)	(42,848)	(2,888)	(481,092)
	30,421,689	**15,511,671**	**4,520,812**	**304,736**	**50,758,908**
Unobligated balance:					
Beginning of period	792,970	404,326	117,839	7,943	1,323,078
	792,970	**404,326**	**117,839**	**7,943**	**1,323,078**
Subtotal	**31,214,659**	**15,915,997**	**4,638,651**	**312,679**	**52,081,986**
Recoveries of prior year obligations	532,079	271,301	79,070	5,330	887,780
Enacted rescissions	(181,189)	(92,386)	(26,926)	(1,815)	(302,316)
Permanently not available:					
Cancellations of expired/no-year accounts	(695,689)	(354,723)	(103,383)	(6,969)	(1,160,764)
Total Budgetary Resources	**$ 30,869,860**	**$ 15,740,189**	**$ 4,587,412**	**$ 309,225**	**$ 51,506,686**
Status of Budgetary Resources					
Obligations Incurred					
Direct					
Category A	25,524,096	13,014,444	3,793,006	255,676	42,587,222
Category B	4,505,926	2,297,520	669,603	45,136	7,518,185
	30,030,022	**15,311,964**	**4,462,609**	**300,812**	**50,105,407**
Unobligated balance					
Balance currently available					
Category A	51,670	26,347	7,679	518	86,214
	51,670	**26,347**	**7,679**	**518**	**86,214**
Unobligated balance not available	788,168	401,877	117,125	7,895	1,315,065
Total Status of Budgetary Resources	**$ 30,869,860**	**$ 15,740,188**	**$ 4,587,413**	**$ 309,225**	**$ 51,506,686**
Relationship of Obligations to Outlays:					
Obligated balance, net, beginning of period	**$ 6,331,809**	**$ 3,228,517**	**$ 940,938**	**$ 63,426**	**$ 10,564,690**
Obligated balance transferred, net, end of period					
Undelivered orders	4,719,959	2,406,653	701,409	47,280	7,875,301
Accounts payable	1,300,472	663,095	193,256	13,027	2,169,850
Other liabilities	3,109	1,585	462	31	5,187
Total Obligated balance, net, end of period	**$ 6,023,540**	**$ 3,071,333**	**$ 895,127**	**$ 60,338**	**$ 10,050,338**
Outlays					
Disbursements	29,809,321	15,199,432	4,429,811	298,602	49,737,166
Net Outlays	**$ 29,809,321**	**$ 15,199,432**	**$ 4,429,811**	**$ 298,602**	**$ 49,737,166**

Inspector General Assessment of Major Performance and Management Challenges

FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

Office of Inspector General

MEMORANDUM

TO: The Commission

FROM: Inspector General

SUBJECT: Inspector General Statement on the Federal Election Commission's Management and Performance Challenges

DATE: October 25, 2004

On November 22, 2000 the President signed the Reports Consolidation Act of 2000 (Public Law 106-531), an amendment to the Chief Financial Officers (CFO) Act of 1990. The Reports Consolidation Act of 2000 requires Inspectors General to provide a summary and assessment of the most serious management and performance challenges facing Federal agencies and the agencies' progress in addressing these challenges. Previously, the Federal Election Commission (FEC) Inspector General was not subject to this requirement, since the FEC was not a covered agency of the CFO Act of 1990. As a result of the enactment of the Accountability of Tax Dollars Act of 2002, the FEC is now subject to these provisions. The attached document responds to the requirements, and provides the annual statement on Commission challenges to be included in the *Federal Election Commission Performance and Accountability Report (PAR) Fiscal Year (FY) 2004*.

The first annual Inspector General Statement on the Federal Election Commission's Management and Performance Challenges summarizes three areas for inclusion in the FEC's FY 2004 Performance and Accountability Report. The following three areas have been identified by the Inspector General as significant management and performance challenges facing the FEC:

Information Technology Security
Financial Reporting
Human Capital Management

The assessment of these three FEC management and performance challenges is attached. The Inspector General's (IG) assessments are based on information derived from a combination of several sources; including Office of Inspector General audit and inspection work, Commission reports, and a general knowledge of the Commission's programs. The IG considers Information Technology Security to be a significant challenge for the FEC, and therefore it has been highlighted in the following assessment of management and performance challenges.

The Reports Consolidation Act of 2000 permits agency comment on the Inspector General's statements. Agency comments, if applicable, are to be included in the final version of the PAR that is due on November 15, 2004.

Lynne A. McFarland
Lynne A. McFarland
Inspector General

Attachment

Cc: James A. Pehrkon, Staff Director

2

FEC Management and Performance Challenges

(Prepared by FEC's Office of the Inspector General)

INFORMATION TECHNOLOGY SECURITY

The Federal Election Commission's (FEC) mission is to assure that the campaign finance process is fully disclosed, and that the rules are effectively and fairly enforced, fostering the electorate's faith in the integrity of the nation's political process. The FEC's responsibilities are divided into three primary programs: disclosure of campaign finance information; enforcement of the provisions of the law, such as the limits and prohibitions on campaign contributions; and oversight of the public funding of Presidential elections.

The FEC's goal is to provide the electorate with the capability to make educated, informed decisions about the source of financial support for candidates of Federal office, as well as provide confidence that those who disregard the laws regarding campaign financing and/or its requirements for public disclosure will be held accountable for non-compliance. Accomplishment of the FEC's mission and goals depend heavily on computerized systems. The Commission's computerized disclosure database plays a significant role in this process. The database contains millions of transactions, and is available through the FEC's website, which allows the public to access campaign contribution information.

While information technology (IT) can result in a number of benefits, such as information being processed quickly and communicated almost instantaneously, it also increases the risk of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services. The Government Accountability Office (GAO), formerly named the General Accounting Office, has reported IT security as a high-risk area throughout the government since February 1997. The GAO designated IT security as a government-wide high-risk area because of growing evidence indicating that controls over computerized operations were not effective, and risks were increasing.

GAO commented in November 2002, that although progress had been made on Federal computer security, serious and widespread information security weaknesses continue to place Federal assets at risk of inadvertent or deliberate misuse; financial information at risk of unauthorized modification or destruction; sensitive information at risk of inappropriate disclosure; and critical operations at risk of disruption. A primary reason for these weaknesses is that Federal agencies have not yet fully implemented comprehensive security management programs, which are critical to identifying information security weaknesses and risks on an ongoing basis. The Congress has shown continuing interest in addressing these risks, as evidenced by Congressional hearings on information security and enactment of the Federal Information Security Management Act (FISMA) of 2002.

The FEC is not immune to the government-wide information security weaknesses reported by GAO. The FEC lacks a comprehensive disaster recovery plan for the Commission's data centers, networks, and telecommunications. The disaster recovery plan is necessary to assist the Commission to respond to minor business interruptions, such as temporary power failures, as well as major disasters, such as fire, other natural, or terrorist disasters. In addition, the Commission has documented weaknesses related to computer access controls that are necessary to limit and monitor access to the Commission's computer resources.

To compound the challenges, the FEC is also seriously lacking a critical statutory and/or regulatory IT security framework necessary for a Federal agency. The Inspector General believes the framework is essential to establish and ensure the minimum appropriate requirements to adequately protect the FEC's critical IT resources from fraud, waste, loss, unauthorized modification or appropriation.

The FEC's General Counsel (GC) opined in September 2004 on the FEC's exemption from several important Federal laws, regulations, and standards related to management controls and procedures for IT security. The basis for the exemptions is primarily due to the FEC's exemption from the Paperwork Reduction Act (PRA), an Act generally unrelated to IT security. The majority of the Federal IT security laws and regulations, such as the Computer Security Act of 1987, as amended, and the FISMA derive their authority from the PRA or other laws from which the FEC is exempt.

Specifically, the GC concluded that the FEC is exempt from the Computer Security Act of 1987, a law that established minimum acceptable security practices for Federal computer systems. In addition, the FEC is not required to follow Federal Information Processing Standards (FIPS) issued by the National Institute of Standards and Technology (NIST). The FIPS are standards and guidelines pertaining to Federal computer requirements. Lastly, the FEC is exempt from the FISMA, a law followed by a majority of both small and large Federal departments and agencies to provide information security for the operations and assets of Federal agencies.

The Government Accountability Office (GAO) is one of a handful of Federal agencies that is also exempt from FISMA. However; although GAO is not obligated by law to comply with FISMA, unlike the FEC, GAO has formally adopted the requirements of

FISMA to help ensure the establishment of an effective information security program, and to fulfill GAO's goal of being a model Federal agency.

The FISMA was signed into law on November 27, 2002. FISMA replaces the Government Information Security Reform Act (GISRA), which expired in November 2002. FISMA requires agency Chief Information Officers (CIOs) to work with agency program officials in conducting annual security reviews of agency programs and systems. It also directs Inspectors General (IGs) to perform annual independent evaluations of an agency's security program.

In addition, FISMA requires Federal agencies to develop, document, and implement an agency-wide information security program to provide information security for the operations and assets of the agency. This includes:

- Periodic risk assessments;
- Policies and procedures that are based on risk assessments;
- Subordinate plans for providing adequate information security for networks, facilities, information systems, or groups of information systems, as appropriate;
- Security awareness training to inform employees (including contractors) of the security risks associated with their activities, and their responsibilities to comply with those agency policies and procedures designed to reduce those risks;
- Periodic testing and evaluation of the effectiveness of information security policies;
- A process for planning, implementing, evaluating, and documenting remedial action to address any deficiencies in the information security policies, procedures, and practices of the agency;
- Procedures for detecting, reporting, and responding to security incidents; and
- Plans and procedures to ensure continuity of operations of the agency's information systems.

The FEC deserves credit for the improvements made to its IT security program recently, including implementation of a mandatory security awareness training program for employees and contractors, approval in September 2004 of an Information System Security Policy, and appointment of an agency-wide IT security officer. The IT Division is staffed by a dedicated and motivated staff. The commitment of the staff is critical to the accomplishment of the numerous tasks necessary to protect the FEC's IT infrastructure, as well as to accomplish the many aggressive IT initiatives contained in the FEC's IT strategic plan. However; as information security threats become more aggressive and potentially more destructive, the challenge will be to provide increasing vigilance, continuous system improvement, and support at all organizational levels to ensure the integrity, confidentiality, and availability of mission critical information and information systems. The Inspector General believes a proper balance of resources is essential to the accomplishment of the agency mission and to protect the IT infrastructure.

FINANCIAL REPORTING

The Federal government has a stewardship obligation to prevent fraud, waste, and abuse; to use tax dollars appropriately; and to ensure financial accountability to the President, the Congress, and the American people. Timely, accurate, and useful financial information is essential for making operating decisions day-to-day; managing the government's operations more efficiently, effectively, and economically; meeting the goals of Federal financial management reform legislation (such as the Chief Financial Officers Act); supporting results-oriented management approaches; and ensuring accountability on an ongoing basis.

One of the goals of the President's Management Agenda (PMA) is improved financial management. In identifying improved financial performance as one of its five government-wide initiatives, the PMA stated that a clean financial audit is a basic prescription for any well-managed organization, and recognized that "most federal agencies that obtain clean audits only do so after making extraordinary, labor-intensive assaults on financial records." Further, the PMA stated that without sound internal controls, and accurate and timely financial information, it is not possible to accomplish the President's agenda to secure the best performance and highest measure of accountability for the American people.

On November 7, 2002, the President signed the Accountability of Tax Dollars Act of 2002 (Public Law 107-289). The Act requires the FEC and other Federal agencies not previously covered by the Chief Financial Officers Act, to prepare and submit to the Congress and the Director of the Office of Management and Budget (OMB) audited financial statements, beginning with the fiscal year (FY) 2002 cycle. In recognizing the challenges of the new requirement, the Act permitted the OMB Director to waive the reporting requirement during an initial transition period for FYs 2002 and 2003 for those agencies that had not prepared audited financial statements in the past. Beginning in FY 2004, the FEC is required to prepare and submit annual audited financial statements.

In addition to audited financial statements, the FEC is required to submit un-audited quarterly financial statements forty-five days after each quarter end. Also, beginning in FY 2004, the FEC will prepare and submit for the first time an annual Performance and Accountability Report (PAR). The PAR provides financial and performance information that enables Congress, the President, and the public the ability to assess the performance of the FEC relative to its mission, and for management to be accountable for its actions and resources.

The effort required to accomplish these financial and performance reporting requirements and meet the deadlines imposed is a significant challenge for the FEC. Many entities must cooperate to make this happen; including financial management and staff, program managers with performance reporting responsibilities, consultants, and independent auditors. The FEC's first year preparing audited financial statements and the PAR coincide with the OMB's accelerated reporting initiatives. OMB guidance shortens the time to prepare and submit the PAR, as well as to audit the year-end financial statements, from 120 days for FY 2003, to 45 days for FY 2004.

The Commission's ability to meet these accelerated time frames will depend upon having effective and timely interim and year-end procedures to accumulate and record financial transactions, close the books, and prepare the financial statements. A challenge for the FEC's financial management system is the ability to produce timely, accurate, and reliable information throughout the course of the year. By doing so, the effort will be lessened at fiscal year end to compile, analyze, and correct its financial data in order to prepare accurate financial statements within a reasonable timeframe after the close of the fiscal year. The FEC has made progress towards these goals, but significant challenges remain ahead.

HUMAN CAPITAL MANAGEMENT

In January 2001, the Government Accountability Office (GAO) designated strategic human capital management as a government-wide high-risk area. GAO's high risk reports, started in 1990, are a means to focus attention on problems that are impeding effective government and illustrate a greater vulnerability to fraud, waste, abuse, and mismanagement. According to GAO, "the basic problem, which continues today, has been the long-standing lack of a consistent strategic approach to marshaling, managing, and maintaining the human capital needed to maximize government performance and assure its accountability." GAO stated that "importantly, although strategic human capital management remains high-risk government-wide, federal employees are not the problem." Rather, GAO believes the problem is a set of policies and practices that are not strategic, and are viewed by many as outdated and over-regulated. In the final analysis; modern, effective, and credible human capital strategies will be essential in order to maximize the performance, and assure the accountability of the government for the benefit of the American people. A challenge for the Federal government; including the FEC, is acquiring, developing, and retaining talented staff. Several important factors are necessary to ensure a competent and satisfied staff; to include renewed efforts in recruiting, hiring, professional development, and retention strategies to ensure that agencies have the needed talent.

5

Studies conducted by government oversight agencies, such as the Government Accountability Office (GAO), and the Office of Personnel Management (OPM), have predicted a potential gloomy retirement scenario for the Federal government. The potential problem could significantly impact the Federal government's ability to manage its tasks and programs due to the possibility of large numbers of employees that may retire over a relatively short period of time. The aging work force and government attrition are the primary factors that contribute to the potential crisis.

The Office of Inspector General (OIG) completed a study in December 2001 and concluded, "the FEC's potential loss of a large number of office heads over the next several years is noteworthy." The study found that 21% of the 24 office heads were eligible for retirement in 2001. By the end of calendar year 2006, 46% will have become eligible for regular retirement; 67% by the end of calendar year 2008. The OIG commented the numbers were noteworthy due to the FEC's organizational structure, which consists of several small offices with potentially only a handful of staff to draw upon who possess the institutional knowledge of the divisions.

The FEC acknowledged to the Office of Management and Budget in June of 2001 "the most significant result of possible retirements over the next five years will be the loss of senior management." The FEC also reported to the OMB that budget limitations have precluded the FEC from establishing an executive development program, which would be a way to address the retirement scenario. An executive development program can include such things as formal training and mentoring programs geared toward grooming first-level supervisors for upward mobility within an organization.

To acquire and retain an adequate work force and replace the sizeable number of Federal employees eligible for retirement over the coming years demands that agencies improve their recruiting, hiring, and retention practices. The ability to retain employees is dependent, to a great extent, on employee job satisfaction. In the last couple of years, the FEC instituted a semi-annual performance appraisal meeting that allows for management and staff to discuss goals and objectives for both the manager and employee instead of having to wait until the formal annual appraisal process.

In addition, the FEC's 2004 legislative recommendations to the President included a recommendation that Congress should amend federal law to permit the FEC to establish Senior Executive Service (SES) positions at the FEC. Currently, the FEC is prohibited by law from creating SES positions within the agency. The Commission believes that conversion of current and future senior level positions to SES positions will "assist the FEC in retaining highly qualified individuals and will attract superior candidates when vacancies arise, thus permitting the Commission to remain competitive in the marketplace for federal executives."

Challenges remain at the FEC to develop agency programs to acquire, develop, and retain talent necessary to ensure the FEC is equipped to accomplish its mission, and achieve its goals. The FEC is lacking a formal telecommuting program that would enable staff to work from home, or designated telecommuting centers. Section 359 of the 2001 Department of Transportation appropriations bill (Public Law 106-346) requires all Executive agencies to establish telecommuting policies. The Office of Personnel Management believes Federal telecommuting programs can improve employees' work lives by allowing a better balance of work and family responsibilities, and by reducing work-related stress.

Hiring, training, and retaining adequate personnel to handle the myriad duties of the Commission are ongoing challenges. The increasing technical and sophisticated nature of the Commission's work, coupled with the competition for qualified employees – often against private sector companies or other government agencies – only increases the Commission's challenge in this area. Without a continued focus on recruitment, retention, and training, the Commission runs the risk of losing ground in its efforts to address several other top management challenges, such as information technology security and financial reporting.

Management's Response to the Inspector General's Statement on the Management and Performance Challenges Facing the Federal Election Commission

Information Technology Security

The Commission agrees with the Inspector General that the benefits of information technology (IT) also bring the risks of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services. While the Federal Election Commission's (FEC) exemption from the Paperwork Reduction Act provides it derivative exemption from federal statutes governing IT management controls and procedures for IT security, such as the Federal Information Security Management Act (FISMA) of 2002, FEC management is committed to the spirit and intent of such legislation.

As the Inspector General points out, computerized systems enable the FEC to carry out its mandate to ensure that the campaign process is fully disclosed. The Commission's ability to foster Americans' faith in the integrity of the Nation's political process rests primarily on the validity of the information it provides through its IT systems. To address the ever-present threats of data misuse, destruction, or inappropriate disclosure, as well as to ensure continuity of operations in the event of a disaster, the Commission has taken aggressive actions to secure its IT infrastructure. In FY 2004, the Commission implemented a mandatory security awareness training program for its employees and contractors. It approved an Information System Security Policy and appointed an IT security officer with responsibility for overseeing the security of all of FEC's IT resources.

The FEC will continue its vigilance in this area and welcomes further work from the Inspector General on IT security issues.

Financial Reporting

The FEC agrees with the Inspector General that the financial reporting requirements imposed by the Accountability of Tax Dollars Act of 2002 create special challenges for the FEC. Clearly the agency responsible for fostering the public's faith in the integrity of campaign financing must be able to demonstrate that its own financial recordkeeping is beyond reproach. The Commission's financial management and documentation has been sound over the years, but its reporting mechanisms have been geared toward informing the public of campaign financing matters. During the Fall of 2004, the Commission prepared its first financial statements and subjected them to audit, and issued its first Performance and Accountability Report (PAR). FEC has not been required to produce auditable financial statements, nor has it been required to issue a PAR based upon the financial and performance results within 45 days of the close of the fiscal year. At the same time, it performed its core mission of disclosing campaign finance information, enforcing campaign finance laws, and overseeing public funding of the 2004 Presidential and Congressional elections, in which a record amount of funds exceeding $1 billion was raised and spent by the candidates.

FEC is not the only agency challenged by the new requirements of the Accountability of Tax Dollars Act. While this process enhances accountability and instills a discipline in the Commission's financial management, it requires the Commission to retool its financial management system to provide accurate, timely, and reliable information throughout the year. The Commission sought the assistance of outside experts to prepare its financial statements and PAR. The Inspector General hired an independent audit firm to conduct the audit. When the FEC realized that it would be unable to meet the November 15 deadline unless the auditors stopped their work and issued a disclaimer of opinion, it sought permission from the Office of Management and Budget to extend the audit period and submit the PAR no later than December 20, 2004. While the Commission is disappointed it was unable to meet the deadline, it still issued its PAR 2 weeks earlier than the deadline imposed for all agencies in FY 2003.

Human Capital Management

The Commission agrees with the Inspector General that human capital is a challenge for the FEC as well as the federal government as a whole. In her 2001 report, the Inspector General noted the retirement eligibility of a significant number of experienced senior employees. The loss of institutional memory is of concern to all organizations, and especially to one with small, specialized staffs such as FEC. While it cannot change the demographics of its current workforce and prevent employees from taking advantage of the opportunity to retire, the Commission has taken steps toward effective succession planning and making the FEC an employer of choice. In FY 2004, the Commission sought to amend its legislation to convert senior level positions to Senior Executive Service (SES) positions. SES benefits would help attract and retain talented individuals and make FEC competitive in the marketplace. FEC employees receive a semiannual performance update as well as an annual appraisal.

The FEC does participate in the transit subsidy program up to $100 per month (the maximum benefit in 2004). We also send managers to the Federal Management Development Centers. The FEC is also exploring flexiplace work plans and allows flex time and compressed work week schedules, although not for management personnel.

Appendix A:
Management's Decision and Final Actions on OIG Audit Recommendations

As of September 30, 2004, no OIG audit report with corrective actions remained outstanding.

Appendix B: Glossary of Terms

ADR	Alternative Dispute Resolution
BCRA	Bipartisan Campaign Reform Act of 2002
DAP	Data Access Program
EAC	Election Assistance Commission
EQS	Enforcement Query System
EPS	Enforcement Priority System
FEC	Federal Election Commission
FECA	Federal Election Campaign Act
FMFIA	Federal Managers' Financial Integrity Act
FTE	Full Time Equivalent
FY	Fiscal Year
GPRA	Government Performance and Results Act
IG	Inspector General
IT	Information Technology
MIS	Management Information System
MUR	Matters Under Review
OAR	Office of Administrative Review
OEA	Office of Election Administration
OGC	Office of General Counsel
OIG	Office of the Inspector General
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
PAC	Political Action Committee
RAD	Reports Analysis Division
RTB	Reason to Believe
RFAI	Request for Additional Information

Appendix C:
Historical Data

TABLE 1, HISTORICAL DATA BY ELECTION CYCLE

		PROCESSED DATA ENTRY			REPORTS REVIEWED		
Election Cycle	Number Filed	Entered	Backlog	Percent	Reviewed	Backlog	Percent
2004 as of 9/30/2004	58,757	58,379	378	99%	50,190	8,567	85%
2002 as of 9/30/2002	49,245	47,195	2,050	96%	34,574	14,671	70%
2000 as of 9/30/2000	49,700	48,609	1,091	98%	32,173	17,527	65%
	Documents						
Election Cycle	Median Days	Days To 95% Done	Docs Over 30 Days Old		Median Days	Days To 95% Done	Docs Over 30 Days Old
2004 as of 9/30/2004	2	12	42	as of 9/30/04	2	12	42
2002 as of 9/30/2002	6	50	522	as of 9/30/04	6	71	8
2000 as of 9/30/2000	11	42	157	as of 9/30/02	10	45	-
	Transactions				Documents		
Election Cycle	Total Processed	Date Reached 1.5 Million	Final Total*		50,000 Filed	Processed 99%	Reviewed 95%
2004 as of 9/30/2004	2,146,177	31-May-04		2004	30-Jul-04	29-Feb-04	
2002 as of 9/30/2002	1,475,684	31-Oct-02	2,445,253	2002	31-Oct-02	31-May-03	30-Jun-03
2000 as of 9/30/2000	1,649,941	31-Aug-00	2,454,413	2000	31-Oct-00	31-Mar-01	30-Sep-01
* as of 9/30/2004							

TABLE 2, PROCESSING OF ITEMIZED TRANSACTIONS

Table 2 supports Figure 1.14 (page 29) and shows the volume of transactions.

Itemized Transactions Coded Per FTE	FY 2001	FY 2002	FY 2003	FY 2004
Direct FTE Itemized Coding				
Transactions Processed	1,181,000	1,125,000	1,457,000	1,660,000
Transactions Coded Per FTE	134,000	128,000	158,000	169,000

TABLE 3, REVIEW OF REPORTS, RFAI'S AND REFERRALS

Table 3 provides additional information about the workload of RAD.

RAD–Reports Analysis Workloads And Outputs				
Reports Reviewed	FY 2001	FY 2002	FY 2003	FY 2004
Form 3 Reports Reviewed	52,500	40,100	61,400	44,600
FTE	24.6	23.1	23.1	27.6
Hours Per Review	0.82	1.01	0.66	1.09
RFAI'S Prepared				
Requests For Addl Information	11,500	8,800	11,300	9,700
FTE	5.4	4.8	5.6	3.2
Hours Per RFAI	0.83	0.96	0.87	0.57
Referrals				
Referred For Audit	52	1	73	1
Referred To OGC	11	15	17	43

TABLE 4, CALLS/REQUESTS FOR INFORMATION HANDLED

Table 4 provides additional detail about FEC's disclosure and outreach efforts.

Informational Requests and Inquiries	FY 2001	FY 2002	FY 2003	FY 2004
Total Calls	84,900	74,800	82,100	92,700
Percent Change	N/A	-12%	10%	13%
Press Calls	11,300	7,900	8,300	5,500
Percent Change	N/A	-30%	5%	-34%
RAD Calls For Assistance	12,500	14,900	20,200	18,500
Percent Change	N/A	19%	36%	-8%

TABLE 5-A, ADMINISTRATIVE FINES PENALTIES ASSESSED

Tables 5-A, 5-B and 5-C (below) list the fines and penalties assessed by FEC in FYs 2001–2004

	FY 2001	FY 2002	FY 2003	FY 2004
Total Fines	$ 563,810	$ 289,891	$ 668,392	$ 369,055
Number Of Fines	361	117	394	137
Ave. Fine Amount	$ 1,562	$ 2,478	$ 1,696	$ 2,694

TABLE 5-B, ADR PENALTIES ASSESSED (Final Civil Penalty Assessed)

	FY 2001	FY 2002	FY 2003	FY 2004
Total Fines	$ 32,143	$ 23,000	$ 30,200	$ 66,650
Number Of Fines	19	7	14	15
Ave. Fine Amount	$ 1,692	$ 3,286	$ 2,157	$ 4,443

TABLE 5-C, OGC ENFORCEMENT PENALTIES ASSESSED (Final Civil Penalty Assessed)

	FY 2001	FY 2002	FY 2003	FY 2004
Total Fines	626,855	$ 1,153,563	$ 2,215,375	$ 3,024,595
Number Of Fines	41	54	69	46
Ave. Fine Amount	15,289	$ 21,362	$ 32,107	$ 65,752

TABLE 5-D, OGC ENFORCEMENT PENALTIES ASSESSED (Final Civil Penalty Assessed)

Table 5-D shows the fines collected for FYs 1995–2000

FY	AMOUNT	NUMBER	AVERAGE
1995	$ 1,922,050	77	$ 24,962
1996	$ 656,654	60	$ 10,944
1997	$ 1,364,750	63	$ 21,663
1998	$ 1,055,599	45	$ 23,458
1999	$ 567,055	33	$ 17,183
2000	$ 1,087,100	60	$ 18,118
TOTALS	$ 6,653,208	338	$ 19,684

TABLE 6, ALLOCATED FTE AND COSTS–OBLIGATED FUNDS

FEC Staff Resources–FTE with Management and Support Allocated

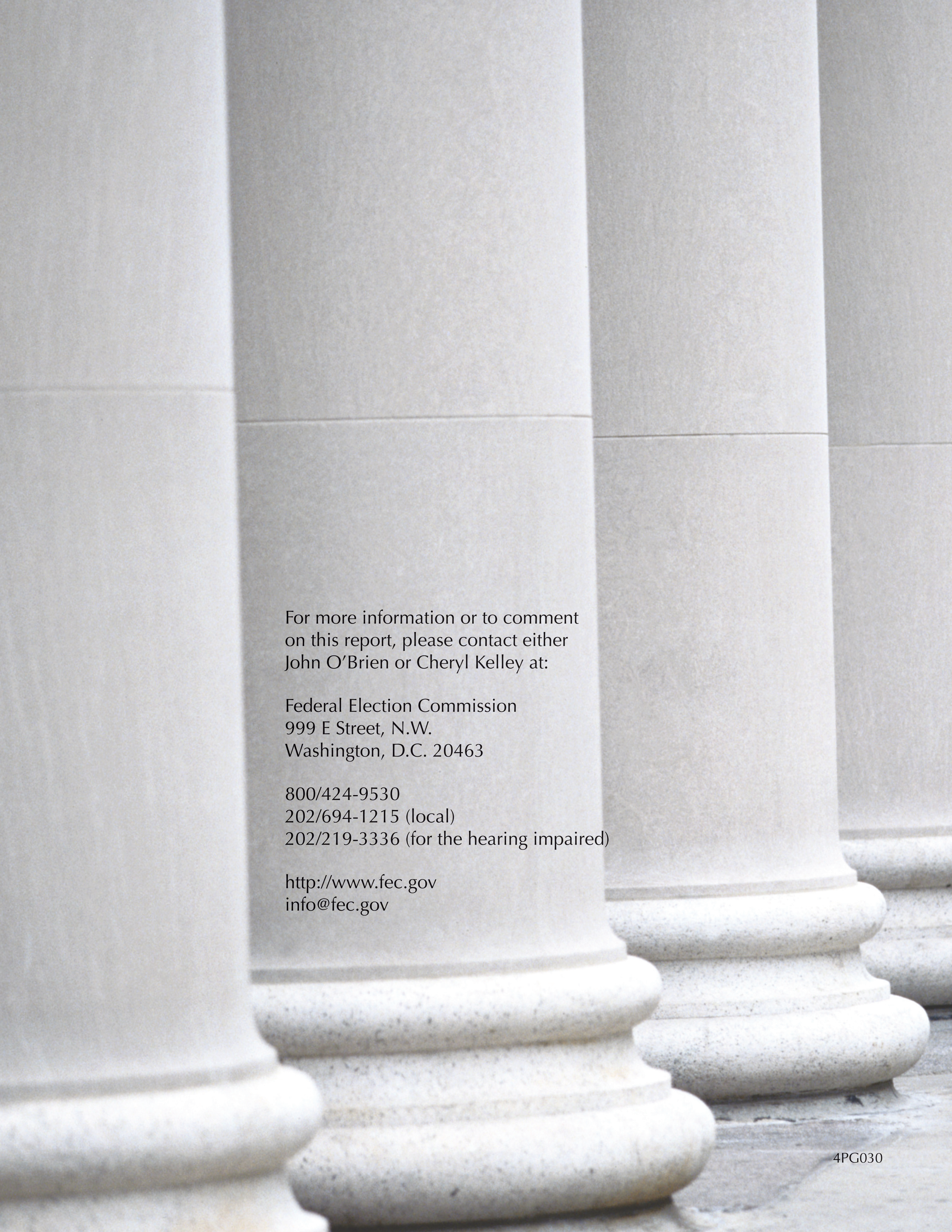
FEC Program	FY 2001		FY 2002		FY 2003		FY 2004	
	FTE	FTE %	FTE	FTE %	FTE	FTE %	FTE	FTE %
Disclosure	126.5	36.6%	125.6	35.6%	125.6	34.8%	142.8	38.3%
Compliance	164.4	47.6%	182.3	51.7%	202.9	56.1%	197.4	52.9%
Public Financing	48.3	14.0%	36.7	10.4%	25.9	7.2%	30.7	8.2%
Elections Admin.	6.2	1.8%	8.2	2.3%	6.9	1.9%	2.0	0.5%
Total FEC	345.4	100.0%	352.8	100.0%	361.4	100.0%	372.9	100.0%

FEC Program Costs with Management and Support Costs Allocated

FEC Program	FY 2001		FY 2002		FY 2003		FY 2004	
	OBLIGATIONS	PERCENT	OBLIGATIONS	PERCENT	OBLIGATIONS	PERCENT	OBLIGATIONS	PERCENT
Disclosure	$11,440,707	28.3%	$12,302,038	27.8%	$13,579,924	27.4%	$15,497,480	30.9%
Compliance	$21,086,119	52.2%	$25,434,873	57.5%	$30,666,366	61.9%	$30,107,438	60.1%
Public Financing	$5,970,714	14.8%	$4,656,894	10.5%	$3,907,876	7.9%	$4,474,112	8.9%
Elections Admin.	$1,867,918	4.6%	$1,825,518	4.1%	$1,387,705	2.8%	$309,386	Direct Costs
Total FEC	$40,365,458	100.0%	$44,219,323	100.0%	$49,541,871	100.0%	$50,388,416	100.0%

TABLE 7, FEC ANNUAL BUDGET AND FTE, FYs 2001–2004

Fiscal Year	Annual Budget	FTE
FY 2001	$40,365,458	345.4
FY 2002	$44,219,323	352.8
FY 2003	$49,541,871	361.4
FY 2004	$50,388,416	372.9



For more information or to comment on this report, please contact either John O'Brien or Cheryl Kelley at:

Federal Election Commission
999 E Street, N.W.
Washington, D.C. 20463

800/424-9530
202/694-1215 (local)
202/219-3336 (for the hearing impaired)

http://www.fec.gov
info@fec.gov

4PG030