The Honorable Timothy J. Muris
Chairman
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Dear Chairman Muris:

The attached report covers the Office of Inspector General's (OIG) activities for the first half of fiscal year 2002, and is submitted according to Section 5 of the Inspector General Act of 1978, as amended.

During this six-month reporting period ending March 31, 2002, the OIG completed its audit of the FTC's fiscal year 2001 financial statements, issued a companion management letter containing financial related findings, responded to a Congressional request to evaluate how the agency managed its "SmartPay" credit card program, and searched the agency's Unsolicited Commercial Email (UCE) or "spam" database to ascertain if any individual appearing on the FBI's Watch list used "spam" during the past few years to attempt to either solicit contributions or defraud the public.

In addition, the OIG opened four investigations into wrongdoing during the period, two of which were subsequently referred to either a prosecutor or management for ultimate disposition.

As in the past, management has been responsive in attempting to implement all OIG recommendations. I appreciate management's support, and I look forward to working with you in our ongoing efforts to promote economy and efficiency in agency programs.

Sincerely,

Frederick J. Zirkel
Inspector General

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INTRODUCTION

The Federal Trade Commission (FTC) seeks to assure that the nation's markets are competitive, efficient, and free from undue restrictions. The FTC also seeks to improve the operation of the marketplace by ending unfair and deceptive practices, with emphasis on those practices that might unreasonably restrict or inhibit the free exercise of informed choice by consumers. The FTC relies on economic analysis to support its law enforcement efforts and to contribute to the economic policy deliberations of Congress, the Executive Branch and the public.

To aid the FTC in accomplishing its consumer protection and antitrust missions, the Office of Inspector General (OIG) was provided five workyears and a budget of $710,000 for fiscal year 2002.

AUDIT ACTIVITIES

During this semiannual period, the OIG issued an audit of the FTC's FY 2001 financial statements and a companion report to management containing financial-related findings and recommendations resulting from the audit. The OIG also responded to a congressional request to evaluate how the agency managed its "SmartPay" credit card program and searched the agency's multiyear Unsolicited Commercial Email (UCE) or "spam" database to determine if individuals listed on the FBI's Watch List were using the internet to solicit funds or engage in fraud to finance their activities. The OIG also began audit work to review ITM's administration of software development contracts and to conduct a follow-up of the Government Information Security Reform Act evaluation relating to the agency's information security program. Details regarding these audits and reviews are provided below.

Completed Audits/Reviews

Audit Report Number	Subject of Audit
AR 02-052	Audit of the Federal Trade Commission's Financial Statements for the Fiscal Year Ending September 30, 2001
AR 02-052A	Management Letter to the FY 2001 Financial Statements
Letter Report	Letter Report Review of the FTC's "SmartPay" Program
Unnumbered	Key Word Search of UCE Database

In AR 02-052, *Audit of the Federal Trade Commission's Financial Statements for the Fiscal Year Ending September 30, 2001*, the objective was to determine whether the agency's financial statements fairly present the financial position of the agency. The statements audited were the Balance Sheets as of September 30, 2001 and 2000, and the related Statements of Net Cost, Statements of Changes in Net Position, Statements of Budgetary Resources, Statements of Financing, and Statements of Custodial Activity for the years then ended. The agency received an unqualified opinion, the highest opinion given by independent auditors.

The FY 2001 audited statements provide insight into the mission and operations of the Federal Trade Commission. The FTC had total assets of $167.0 million as of September 30, 2001. Approximately $79.5 million represented funds on account or to be collected and distributed as part of the consumer redress program under the agency's consumer protection mission. Another $6.4 million represents undisbursed Hart-Scott-Rodino (HSR) Act premerger filing fees due to the Department of Justice. Remaining assets include fund balances in appropriated accounts, accounts receivable and fixed assets.

Financing sources for FY 2001 included exchange revenue derived from the collection of pre-merger notification filing fees ($86.3 million in fees), reimbursements received from other government agencies, appropriated amounts from the general fund of the Treasury, and imputed revenue to cover unfunded benefits. At the close of the fiscal year, any financing source not needed to fund the gross cost of operations is added to Cumulative Results of Operations.

The $86.3 million in HSR filing fees was $20.6 million less than the fees collected the previous year. In February 2001, the filing fee structure was changed from a flat fee of $45,000 per filing to a three-tier fee structure with fee amounts varying from a low of $45,000 to a high of $280,000 depending on merger size. As the transaction ceiling was also increased from $15 million in total assets to $50 million in FY 2001, the number of filings processed were less than half the total from the previous year. The FTC collects a filing fee from each acquiring business entity required to file a Notification and Report form. The fee, which is set by law, is divided equally between the FTC and the Antitrust Division of the Department of Justice (DOJ). All premerger filing fees are collected by the FTC pursuant to Sec. 605 of the Act, as amended. The disposition of amounts collected for DOJ are reported as non-exchange revenues on the Statements of Custodial Activity.

The budgetary authority appropriated from the general fund, was reduced by the amount of offsetting collections (HSR fees) received, which resulted in a net financing source from the general fund of $58.9 million, or 39.1 percent of total funding sources for FY 2001.

The gross cost of operations during FY 2001 was approximately $141.1 million, an 8.5 percent increase over FY 2000. Of the $141.1 million in operating costs, $136.6 million was funded through budget authority. The remaining $4.5 million represents costs which will be funded in a future period, such as the government's share of employee retirement benefits. During FY 2001, salaries and benefits totaled $96.3 million, or 68.2 percent of the agency's total expenses. Lease space rental amounted to $12.7 million for another 9.0 percent. The remaining $32.1 million, or 22.8 percent, included travel, facility maintenance and utilities, IT equipment rental, imputed benefit costs, depreciation, along with miscellaneous other items. This funding level supported 1010 staff-years which were employed in fulfilling the two FTC missions.

The OIG also issued a *Management Letter to the FY 2001 Financial Statements* (*AR 02-052A)*. The report brings to management's attention financial and/or internal control weaknesses that were discovered during the audit of the agency's financial statements, and makes recommendations for corrective action. The management letter also provides details on the status of prior year financial statement audit findings. A management letter finding of particular interest concerned management's payment of interest penalties to vendors.

The OIG found that the agency continues to pay interest penalties resulting from the late payment of invoices and that the amount paid has grown over the past three years. The Prompt Pay Act requires that agencies pay their bills timely (e.g., within thirty days) and take discounts whenever applicable. When the agency fails to meet its obligation to pay timely, the Act requires that an interest penalty be paid to the vendor. In FY 2001, the OIG found that the agency made 534 interest payments, amounting to $20,252.

The FTC requires proof that an invoice is valid before it will pay the vendor. Agency Contracting Officer's Technical Representatives (COTR) provide such proof by completing a receiving report certifying that goods/services were delivered as specified on the invoice. COTRs are responsible for certifying and forwarding a receiving report to the accounting center, noting the date the goods/services were accepted. This requirement is independent of whether the vendor has submitted an invoice. The accounting center proceeds with payment to the vendor when it has received both the invoice and the certified receiving report. When a receiving report is not on file at the center, payment will not be made.

The OIG found that there is a lack of accountability for the payment of interest penalties. Most COTRs we spoke with were unaware that penalties were paid. Further, there appears to be few controls in place to alert bureau managers to this unnecessary drain on their office budgets. Only one agency financial report contains information on these penalties by division, but the user must have knowledge of payment codes to identify them. The two most frequently occurring causes for penalties include late receiving report submissions to the finance office by COTRs and permitting vendors to operate without valid task orders, resulting in payment delays while task orders are processed or amended.

To curb interest penalties, the OIG recommended that management prepare monthly reports to senior bureau managers identifying contracts that resulted in interest penalties, and the penalty amount. The OIG also recommended that invoices requiring contract modifications be paid to the extent permitted in the original contract, and that the portion reflecting a change from the contract be processed separately after the modification is prepared. The prompt pay "clock" could then begin with the receipt of the modification by the central finance office. The OIG also recommended that the agency authorize the payment of invoices by labor category, negating the need for a contract modification before paying invoices containing the names of individuals not in the contract.

In response to a request from the Ranking Member of the Senate Finance Committee for information on how the FTC has managed its "SmartPay" Program, the OIG in a letter report entitled "*Review of the FTC's 'SmartPay' Program,*" provided the Committee's staff with information on agency implementation of the program. The program seeks to streamline the procurement process by eliminating unnecessary paperwork, staff time and processing delays. At the FTC, qualifying employees use agency-provided purchase (credit) cards for small acquisitions (generally each under $2,500) to be ordered by phone or in person and paid from a single monthly statement. Agency use of the card has tripled at the FTC since its implementation approximately 13 years ago.

The OIG found that based on discussions with program staff and the review of program documentation, adequate internal controls are in place to guard against employee abuse of the "SmartPay" program. As a result, the OIG made no recommendations for improving the operations of this credit card program.

Finally, after the tragedy of "9/11," the FBI shared with Federal Inspectors General its "Watch List" of suspected terrorists asking that the IG community search its various investigative databases to determine if additional information about any watch list subject might be found. If any new information was discovered on any suspect, it was to be forwarded to the Bureau for its review/analysis. In addition to the Watch List, information was provided the IG community that indicated that suspected terrorists might be financing their activities by either soliciting contributions or engaging in various internet fraud schemes.

Based on this information, the OIG decided to search the agency's UCE database. In early 1998, the FTC asked that consumers and businesses forward to the agency any questionable UCEs they might receive. This request was made after numerous consumers and businesses complained about both the amount of UCE or "spam" messages they were receiving and the fact that much of it contained questionable solicitations and/or business offers that appeared to be deceptive in nature.

As the volume of "spam" forwarded the agency far exceeded expectations, the agency was required to upgrade the search engine it used to access the millions of messages it had stored over the past three/four years. Once the agency had competed its system upgrade and loaded its UCE database, the OIG, using the names, addresses, phone numbers, and e-mail accounts contained on the watch list, searched the multiyear UCE database for possible matches. This effort ended after all watch list data elements were checked against the spam database. No matches were found.

Planned Audits

Audit Report Number	Subject of Audit
Review of "Spam" Database for the Unauthorized Use of Federal Agency Names	As a followup to the analysis of the UCE database, the OIG will search the data-base for scams that attempt to legitimize their product or service by relating them to departments or agencies of the Federal government, either claiming to be such agency, affiliated with such agency or claiming agency approval for their activities. The OIG will alert other Offices of Inspectors General for potential followup when questionable e-mails are identified.
Audit of Contract Administration	The objective of this audit is to review controls over the administration of information technology-related contracts. These contracts were selected because they represent some of the largest contracts let by the agency. In addition, prior OIG financial statement audits have identified potential vulnerabilities in this area.
Phase II Review of the FTC's Information Security Program	As part of the Government Information Security Reform Act, the OIG will (i) conduct a scan of the FTC network to identify vulnerabilities of the agency network to include such devices as servers, routers, and network gear; (ii) perform an in-depth technical vulnerability analysis of key IT systems such as the telecommunications switch; and (iii) evaluate and confirm that IT

	operations comply with FTC security policies and directives. This task also will include detailed testing of security systems to include access to sensitive agency databases, and review of select security issues related to IT contractors.

INVESTIGATIVE ACTIVITIES

The Inspector General is authorized by the IG Act to receive and investigate allegations of fraud, waste, and abuse occurring within FTC programs and operations. Matters of possible wrongdoing are referred to the OIG in the form of allegations or complaints from a variety of sources, including FTC employees, other government agencies, and the general public.

Reported incidents of possible fraud, waste, and abuse can give rise to administrative, civil or criminal investigations. OIG investigations might also be initiated based on the possibility of wrongdoing by firms or individuals when there is an indication that they are, or were, involved in activities intended to improperly affect the outcome of a particular agency enforcement action. Because this kind of wrongdoing strikes at the integrity of the FTC's consumer protection and antitrust law enforcement missions, the OIG places a high priority on investigating it.

In conducting criminal investigations during the past several years, the OIG has sought assistance from, and worked jointly with, other law enforcement agencies, including other OIGs, the Federal Bureau of Investigation (FBI), the U.S. Postal Inspection Service, the U.S. Secret Service, the U.S. Marshal's Service, the Internal Revenue Service, Capitol Hill Police, as well as state agencies and local police departments. In past years, the OIG has also provided assistance to, and worked with, foreign government law enforcement agencies, including the Royal Canadian Mounted Police and the Canada Customs and Revenue Agency.

Investigative Summary

During this reporting period, the OIG received 47 complaints or allegations of possible wrongdoing. Of these 47 complaints/allegations, 29 involved issues which the OIG determined were the responsibility of either FTC program components or other government or law enforcement agencies. Consequently, the OIG referred these 29 matters to appropriate FTC components for disposition, while three other complaints were referred to other law enforcement agencies for review/disposition.

The OIG decided to close nine (9) of the fifteen (15) complaints/allegations remaining after a careful review of the issues involved and/or after conducting preliminary investigative reviews. Of the six (6) remaining complaints/allegations, one matter was incorporated into an audit that had already been planned by the OIG, and a second was addressed when the OIG consulted with the Designated Agency Ethics Official (DAEO).

Therefore, based on the complaints/allegations of possible wrongdoing received during this reporting period, the OIG opened four (4) investigations, two (2) of which were referred to DOJ for consideration of prosecution. Also, during this reporting period, the OIG closed one (1) case that was opened in a prior period while referring two others to appropriate government officials for final resolution.

Following is a summary of the OIG's investigative activities for the six-month period ending March 31, 2002. The OIG opened (3) new criminal investigations during this reporting period, and closed three (3) cases.

Cases pending as of September 30, 2001	**2**
Plus: New cases	**+4**
Less: Cases closed	**-3**
Cases pending as of September 30, 2001	**3**

Investigations Referred for Action or Closed During the Period

Unauthorized Disclosures (1)
During this reporting period, management referred a matter to the OIG that indicated that nonpublic information had been shared with a third party. After opening an investigation, the OIG developed evidence suggesting a possible ethical violation by an agency

employee. Following discussions with a federal prosecutor, the matter was referred to appropriate management officials for their review and ultimate disposition. Consequently, this OIG matter awaits closure pending a final management decision.

Employee Misconduct & Ethical Violations (1)
The OIG opened an investigation during the current reporting period after receiving a referral from the DAEO which indicated a staff attorney had possibly violated a federal criminal financial conflict of interest statute (***18 U.S.C. § 208***). The evidence suggested that the person personally and substantially participated in both a "merger review" and a "failure to file" case in which the person's spouse owned stock in excess of $5000 in one of the parties under investigation.

While no financial enrichment occurred, the evidence developed suggested a possible technical violation of § 208. Consequently, the OIG referred the matter to a federal prosecutor.

Crimes Against the Government (1)
During this reporting period, the OIG closed a criminal case that had been opened in a prior reporting period. The OIG had been working with other federal investigators and auditors, including the FBI on the matter. The case involved the embezzlement of several million dollars over a number of years from ten receivership estates by a court-appointed receiver. Eight (8) of the receiverships involved FTC consumer fraud cases. The other two cases (which were not part of the OIG inquiry) involved non-FTC cases. The case was under the supervision of a federal prosecutor in California and was closed after the principle subject was killed in an auto accident.

Matters Referred for Prosecution

During the current reporting period the OIG referred two (2) cases to federal prosecutors.

OTHER ACTIVITIES

Significant Management Decisions

Section 5(a)(12) of the Inspector General Act requires that if the IG disagrees with any significant management decision, such disagreement must be reported in the semiannual report.

Further, Section 5(a)(11) of the Act requires that any decision by management to change a significant resolved audit finding must also be disclosed in the semiannual report. For this reporting period there were no significant final management decisions made on which the IG disagreed, and management did not revise any earlier decision on an OIG audit recommendation.

Access to Information

The IG is to be provided with ready access to all agency records, information, or assistance when conducting an investigation or audit. Section 6(b)(2) of the IG Act requires the IG to report to the agency head, without delay, if the IG believes that access to required information, records, or assistance has been unreasonably refused, or otherwise has not been provided. A summary of each report submitted to the agency head in compliance with Section 6(b)(2) must be provided in the semiannual report in accordance with Section 5(a)(5) of the Act.

During this reporting period, the OIG did not encounter any problems in obtaining assistance or access to agency records. Consequently, no report was issued by the IG to the agency head in accordance with Section 6(b)(2) of the IG Act.

Internet Access

The OIG can be accessed via the world wide web at ***www.ftc.gov/oig.*** A visitor to the OIG home page can download recent (1996 - 2001) OIG semiannual reports to Congress, the FY 1998, FY 1999, FY 2000, and FY 2001 CFO Act audits, and other program and performance audits issued beginning in FY 1999. A list of audit reports issued prior to FY 1999 can also be ordered via an e-mail link to the OIG. In addition to this information resource about the OIG, visitors are also provided a link to other federal organizations and offices of inspectors general.

Audit Resolution

As of the end of this reporting period, all OIG audit recommendations for reports issued in prior periods have been resolved. That is, management and the OIG have reached agreement on what actions need to be taken.

Review of Legislation

Section 4 (a) (2) of the IG Act authorizes the IG to review and comment on proposed legislation or regulations relating to the agency or affecting the operations of the OIG. During this reporting period, the OIG prepared no comments on any FTC related pending legislation.

Contacting the Office of Inspector General

Employees and the public are encouraged to contact the OIG regarding any incidents of possible fraud, waste, or abuse occurring within FTC programs and operations. The OIG telephone number is **(202) 326-2800**. To report suspected wrongdoing, employees and the public should call the OIG's chief investigator directly on **(202) 326-2581**. A confidential or anonymous message can be left 24 hours a day.

The OIG is located in Suite 1110, 601 New Jersey Avenue, Washington, D.C. Office hours are from 8:30 a.m. to 6:00 p.m., Monday through Friday, except federal holidays. Mail should be addressed to:

Federal Trade Commission
Office of Inspector General
600 Pennsylvania Avenue, NW
Washington, DC 20580

TABLE I

SUMMARY OF INSPECTOR GENERAL REPORTING REQUIREMENTS

IG Act Reference	Reporting Requirement	Page(s)
Section 4(a)(2)	Review of legislation and regulations	9
Section 5(a)(l)	Significant problems, abuses and deficiencies	2, 3, 4
Section 5(a)(2)	Recommendations with respect to significant problems, abuses and deficiencies	2, 3, 4
Section 5(a)(3)	Prior significant recommendations on which corrective actions have not been made	9
Section 5(a)(4)	Matters referred to prosecutive authorities	8
Section 5(a)(5)	Summary of instances where information was refused	8
Section 5(a)(6)	List of audit reports by subject matter, showing dollar value of questioned costs and funds put to better use	1
Section 5(a)(7)	Summary of each particularly significant report	1
Section 5(a)(8)	Statistical tables showing number of reports and dollar value of questioned costs	11
Section 5(a)(9)	Statistical tables showing number of reports and dollar value of recommendations that funds be put to better use	12
Section 5(a)(10)	Summary of each audit issued before this reporting period for which no management decision was made by the end of the reporting period	12
Section 5(a)(11)	Significant revised management decisions	8
Section 5(a)(12)	Significant management decisions with which the Inspector General disagrees	8

TABLE II

INSPECTOR GENERAL ISSUED REPORTS
WITH QUESTIONED COSTS

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

TABLE III

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

	Number	Dollar Value
A. For which no management decision has been made by the commencement of the reporting period	1	0
B. Which were issued during this reporting period	0	0
C. For which a management decision was made during the reporting period	1	$ 20,252
(i) dollar value of recommendations that were agreed to by management	1	$ 20,252
- based on proposed management action	1	$ 20,252
- based on proposed legislative action	0	0
(ii) dollar value of recommendations that were not agreed to by management	0	0
D. For which no management decision has been made by the end of the reporting period	0	0
Reports for which no management decision was made within six months of issuance	0	0
*See AR 01-050A (pages 2, 20).		