AR 08-001A

FEDERAL TRADE COMMISSION
Audited Financial Statements
For Fiscal Year 2007

OFFICE OF INSPECTOR GENERAL

Management Letter

United States of America
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of Inspector General

January 29, 2008

MEMORANDUM

TO: Deborah Platt Majoras
Chairman

FROM: John M. Seeba
Inspector General

SUBJECT: Transmittal of the OIG FY 2007 Management Letter

When performing an audit of an agency's major financial systems and accounting processes, auditors often detect deficiencies in internal controls that do not rise to a level of seriousness to be reported in the auditor's opinion. These findings are communicated to the auditee in a management letter. Attached is a copy of the FY 2007 Financial Statement Management Letter that reports on such findings.

Results in Brief

Our audit testing for fiscal year 2007 noted significant management efforts throughout the FTC that have addressed previously reported weaknesses. As of November 2007, FTC had taken actions to close 6 of the 8 open recommendations from our audit of the agency's 2006 financial statement.

The Redress Administration Office, the Financial Management Office, and the Bureau of Competition all established policies and procedures that addressed and cleared prior year concerns. In our current year testing, no exceptions were found in these areas, and the OIG considers the following comments closed:

- RAO's year-end budget review of redress cases was incomplete
- Accuracy of accounts payable
- Overstatement of undelivered orders
- Performance measures not inclusive
- Reporting requirements of strategic sourcing not met
- RAO's year-end budget review of all redress cases understated the ordered amount

Two areas of concern remain:

- Quality assurance review of financial statements:

  The quality control policies and procedures have improved every year since FY 2003 when the condition was noted by the OIG. The remaining area of concern is final proofreading of year-end financial statements.

- Parking benefits not accurately reported on W-2s:

  During our current year audit, the OIG noted that the procedures put into place were properly designed to calculate taxable parking benefits. OIG will consider this comment closed when we confirm that the W-2s issued in January 2008 were correctly calculated.

One new recommendation was made:

- Closing Procedures Need Improvement:

  This recommendation addresses the recording of FY 2006 year-end journal entries. We recommend that FMO establish policies and procedures to ensure that year-end journal entries are promptly recorded so that the subsequent year's beginning balances are fairly stated.

Agency Comments

In commenting on a draft of this report, the Financial Management Office generally concurred with our recommendations and discussed proposed implementation actions to address our concerns, and also actions already taken. The complete comments from the Financial Management Office and the Human Resources Management Office are reprinted at the end of this report.

We acknowledge and appreciate the cooperation and assistance provided by FTC management and staff during our audit of FTC's fiscal year 2007 financial statements. If you have any questions about this report, I am available to discuss the report with you at your convenience.

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Follow-up on Prior Year Findings

Quality Assurance Review of Financial Statements

During its review of the FY 2003 financial statement package (Management's Discussion and Analysis, statements and notes), the OIG identified several errors that are common in such large and complex products. These errors included misspelled words, misplaced information in the notes, and formatting errors. Between FY 2003 and FY 2007 several procedural steps were undertaken by the Chief Financial Officer to address this issue, resulting in an improved final product. However, our review continued to find errors in the final product.

In 2007, FMO established a quality review document that was used to review the financial statements. The OIG believes that this document has helped improve the financial statements preparation process. However during our review of the agency's financial statements we continued to find a number of errors including footnotes and exhibits that did not tie to the face of the financial statements, prior year numbers that were incorrect, and formatting, footing, and typographical errors.

The OIG will continue to monitor this process.

Parking Benefits Not Accurately Reported on W-2's

Parking provided to an employee at or near the employer's place of business is considered a qualified transportation fringe benefit. Internal Revenue Service (IRS) regulations permit employees provided with this benefit to exclude it from their income, up to a certain monthly limit.[1] If the parking benefit value exceeds this limit, the excess must be included in the employee's income and reported on his/her IRS form W-2. The FTC values non-reserved spaces at the IRS benefit limit, resulting in no tax consequences for those employees parking in non-reserved spaces. However, reserved spots do carry tax consequences.

For calendar years 2003 and 2004, the OIG identified errors in the computation and reporting of the parking benefit.

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[1] The IRS limit was $195 in 2004 and $200 in 2005

In FY 2004 the OIG recommended that HRMO establish a quality control process whereby:

- the names of benefit recipients are verified with ASO quarterly, and
- calculations establishing tax liabilities are checked by an individual other than the person performing the calculation to ensure that computation errors are identified and corrected before W-2's are prepared.

On June 21, 2005, management informed the OIG that the FY 2004 recommendation had been implemented. HRMO management provided the OIG with a set of procedures for the identification of beneficiaries, calculation of benefit totals and quality assurance checks. Notwithstanding these efforts, the OIG continued to find errors in the computation of taxable parking benefits in FY 2005 and 2006.

In his August 13, 2007, response to the OIG, the Executive Director has completed the following actions:

- A comprehensive review has been completed of all employees subject to the taxable parking benefit for the last three years. Where a discrepancy was uncovered, employees were notified.
- A review of pay period 1 through 17 for tax year 2007 has been initiated with the agency's payroll provider.
- The standard operating and reporting procedures have been updated to include a quarterly review by FMO.
- A template memo has been developed to notify new employees subject to the taxable parking benefit and to notify existing employees of a change to their taxable parking benefit.

During our current year audit the OIG reviewed parking benefits for the first 16 pay periods of 2007. The OIG noted that the procedures put into place during the year were properly designed to calculate the taxable parking benefit for the year.

The OIG will consider this comment closed after we confirm that the W-2s issued in January 2008 are correctly calculated.

RAO's Year-End Budget Review of Redress Cases Was Incomplete

The Redress Administration Office (RAO) is located in the Bureau of Consumer Protection's (BCP) Division of Planning and Information. The RAO is responsible for the oversight and tracking of all judgments, collections and claims disbursements in BCP, including consumer redress and civil penalties.

When FMO compared its FY 2005 cash receipt records for FTC cases with RAO's list of FY 2005 judgment activity, FMO noted a discrepancy. Specifically, FMO records indicated that the agency received a payment against a FY 2005 judgment that was not identified on RAO's report. As this report is the primary source document for BCP activity detailed on the audited financial statements, FMO immediately questioned the accuracy of the various totals. The OIG agreed with this concern and brought this to the attention of RAO officials. RAO reviewed its files and agreed that this case had been inadvertently omitted. In addition, RAO identified three additional redress cases they had also omitted. These four redress cases represented approximately $19.5 million in additional redress orders.

These omissions led the OIG to review controls in place to identify the universe of reported cases. This is especially important as these same systems are relied upon to report performance information to Congress, the Office and Management and Budget, and the agency's stakeholders.

To address this weakness, RAO developed an automated database to track all redress cases. This new system amalgamated computer data from all offices within the FTC and existing reports submitted by redress contractors. According to RAO officials, the new system includes triggers signifying that RAO needs specific information (i.e. annual fraudulent sales for GPRA reports). Staff expects that the new database will reduce reliance on manual input and will achieve more accurate and timely results.

In FY 2006 the OIG reviewed redress cases during the year and did not find any redress cases were missed. In addition, in FY 2007 the new redress database was fully implemented. No exceptions were noted during the OIG's review of FY 2007 redress cases.

The OIG considers this comment closed.

Accuracy of Accounts Payable

During the year, accounts payable is recorded based on receipt of an invoice, a completed receiving report, or confirmation from a COTR. Annually, FMO sends out a request for confirmation of unfilled orders and expenditures for all undelivered orders greater then $50,000 to determine if any additional accrual or expenditures need to be recorded.

In FY 2006, the OIG reviewed undelivered orders and the detailed subsidiary of accounts payable. During the OIG's review of undelivered orders, the OIG discovered an additional accrual of approximately $426,000. This accrual was not recorded because the COTR failed to respond to FMO's request for confirmation of unfilled customer orders and expenditures. In addition, during the OIG review of the accounts payable subsidiary ledger, the OIG noted two accruals that were overstated by approximately $1.1 million. This overstatement was due to an error by a staff accountant recording the accruals in the accounting software. After the OIG discussed the overstatements with FMO, adjustments were made to the financial statements.

OIG recommended that:

- FMO establish follow-up procedures to ensure that COTR confirmations are received in a timely manner,
- Training should be provided to COTR's to ensure that they understand what is required by the confirmation of unfilled customer orders and expenditures,
- FMO should establish a review process of accruals posted to the general ledger.

During our current year testing of accounts payable, FMO obtained documentation on all COTR confirmations. In addition, FMO noted that the agency maintains an on-line training course for all COTR's. No exceptions were noted during testing.

The OIG considers this comment closed.

Overstatement of Undelivered Orders

Obligations represent the amount of orders placed, contracts awarded, services received, and similar transactions during a given period that will require payment during the same or future period. Undelivered orders are obligations that are awaiting the receipt of the goods or services ordered before funds are paid. During the normal course of business, officials may cancel an obligation (i.e. undelivered order) that is no longer needed. An example of a service frequently canceled after an obligation has been established is travel. Once canceled, the funds may be used for other purposes, subject to appropriation and reprogramming limitations.

Periodically, and at the end of each fiscal year, federal agencies are required to reconcile their obligation controlling accounts to the total amount posted to supporting records. In addition, program and support offices are to review obligations to determine whether the amounts obligated on the books are, in fact, valid commitments of funds.

In the absence of adequate system controls to perform deobligation of invalid or unneeded orders, obligations will both accumulate and remain open for long periods. Because funds for these obligations originated from a "no-year" appropriation, these funds are needlessly encumbered when they could be deobligated for re-programming and re-apportionment.

The FY 2006 financial statement audit identified undelivered order balances totaling $487,130 for orders between FY 2001 and FY 2005 that should have been deobligated by September 30, 2006. Upon discovery, the Financial Management Office made the appropriate adjustments to the financial statements. In addition, the OIG found that no detail review was performed on outstanding undelivered orders balances identified within FY 2001 ($231,570) and FY 2002 ($338,783). Due to the length of time that these remaining undelivered orders have been open, it is doubtful that they still represent legitimate obligations awaiting delivery of goods or services.

The OIG recommended that the FMO provide a list of open obligations for FY 2001 through FY 2006 to the COTRs to review for deobligations. Periodic reviews of open obligations should continue to be performed using the same approach.

In FY 2007, the chief acquisition officer established procedures to review all open obligations for FY 2001 through FY 2006. The chief acquisition officer contacted all COTR's to determine the status of the obligations. For all obligations where the contract was completed, a letter was sent to the contractor stipulating that funds under the contract will be deobligated in 30 days and any invoice unpaid must be sent to the agency by this time period. At September 30, 2007, the agency's balance in undelivered orders for FY 2001 and FY2002 has been reduced to zero. In addition the balance for FY 2003's undelivered orders decreased from approximately $500,000 at September 30, 2006 to $80,000 as of September 30, 2007. The OIG believes that procedures put into place are properly designed to review the status of undelivered orders and determine when undelivered orders should be deobligated.

The OIG considers this comment closed.

Performance Measures not Inclusive

Pursuant to the Government Performance and Results Act of 1993, the OIG conducts a review of the agency's performance activity. The objective of the review is to determine whether there are systems in place to accumulate performance related information and that the data included in the agency's Performance and Accountability Report is accurate.

During the OIG's review of the performance measures, we noted that one of the performance measures prepared by the Bureau of Competition, "2.3.3 Prevent consumer injury through education by tracking the number of hits on the FTC antitrust web page," was inaccurate. The fiscal year 2006 target for this measure was 10 million hits. The agency accumulated this data for the period of October 2005 through February 2006 and it amounted to approximately 10.6 million hits. This five-month period was then recorded as the yearly sum of hits on the FTC antitrust website for measurement of whether the agency met their goal of 10 million hits. However, this calculation does not take into account hits on the FTC's antitrust website for the months of March 2006 through September 2006. FMO stated that during the five month period there was an unusual amount of activity on the agency's antitrust website due to the agency's activities in the real estate and petroleum area and therefore believed that 10.6 million hits on the antitrust website was a more accurate figure. However, the performance measure in the PAR did not provide an explanation on why the agency elected to use a five-month period.

The OIG recommended that when performance measures are shown they should be representative of a 12 full month period. When 12 months of data is not maintained, a rational method should be used to extrapolate the data to a 12-month period and that when activity for a performance measure increases dramatically that an explanation of what occurred should be included.

During our review of performance measures for the FY 2007 audit we noted that all performance measures were for a 12-month period and included explanations for variances from the prior year.

The OIG considers this comment closed.

Reporting Requirements of Strategic Sourcing Not Met

OMB issued a memorandum on May 20, 2005, defining how agencies should implement strategic sourcing. Strategic sourcing is the collaborative and structured process of critically analyzing an organization's spending and using this information to make business decisions about acquiring commodities and services more effectively and efficiently. This process helps agencies optimize performance, minimize price, increase achievement of socio-economic acquisition goals, evaluate total life cycle management costs, improve vendor access to business opportunities, and otherwise increase the value of each dollar spent. Each agency's Chief Acquisition Officer (CAO), CFO, and Chief Information Officer (CIO) are responsible for development and implementation of the agency's strategic sourcing effort.

As part of the strategic sourcing initiative, the CAO has established a program for strategic sourcing. This program includes use of the Economy Act to purchase office supplies and Government Wide Acquisition Contract to purchase hardware and software products and IT services.

Beginning in January 2006, OMB required the CAO to report annually to the Office of Federal Procurement Policy (OFPP), regarding at a minimum, reductions in the prices of goods and services, reductions in the cost of doing business, improvements in performance, and changes in achievement of socio-economic acquisition goals at the prime contract and, if possible the subcontract level. When the OIG asked for a copy of this annual report, the CAO stated that no report was filed with OFPP.

In FY 2006, the OIG recommended that beginning with FY 2006, that CAO file annual reports with the OFPP to comply with OMB's strategic sourcing initiative. In FY 2007, the CAO noted that the agency is part of the Small Agency Council. The Small Agency Council reports annually to OFPP on strategic sourcing for all agencies that are members of the Council. Since the agency is a member of this Council it meets the reporting requirements of OMB.

The OIG considers this comment closed.

RAO's Year-End Budget Review of all Redress Cases Understated the Ordered Amount

Through the OIG review of RAO's FY 2006 Accomplishment report, we determined that several cases were listed with a judgment amount as "to be determined." Most of these cases were considered "to be determined" because the defendant had to liquidate assets and pay the agency the proceeds from the sale. In many instances, the agency receives millions of dollars upon liquidation of these assets.

However, RAO's accomplishment report does not reflect the value of assets, such as homes, automobiles, boats, airplanes, etc, prior to being sold. These cases are reported as "to be determined." These assets have an appraised value for tax purposes that RAO can use to provide an estimate of the potential amount that can be recovered when sold. By not reporting the appraised value, RAO reports do not show millions of dollars of accomplishment achieved by the agency.

In FY 2006, the OIG recommended that RAO modify its accomplishment reports to include the appraised value instead of "to be determined" to properly reflect the accomplishments of the agency.

In FY 2007, RAO's accomplishment report was updated to include estimates of the appraised value of assets on all judgments. FMO used this to properly reflect the judgment receivable for the fiscal year.

The OIG considers this comment closed.

Current Year Findings

Closing Procedures Need Improvement

At fiscal year-end, FMO performs procedures to close the agency's general ledger for the year and prepare financial statements. FMO closes their general ledger by the first week of October. Historically after the general ledger is closed, it has been discovered that journal adjustments to the general ledger are needed to properly reflect the financial statements of the agency. These entries are tracked outside of the general ledger; however they are used to adjust the general ledger to the audited financial statements. These adjustments have to be entered into the general ledger in the subsequent fiscal year in order for beginning balances to be fairly stated.

During our current year audit we discovered that adjustments from fiscal year 2006's preparation of the financial statements were not recorded in the general ledger during fiscal year 2007. Due to this fact, the OIG recommended an adjustment of approximately $400,000 to reconcile cumulative results of operations as part of the fiscal year 2007 financial statement preparation process.

We recommend that FMO establish policies and procedures to ensure that all journal entries made as part of the prior year financial statement preparation process are properly reflected in the current fiscal year records.

Status of Recommendations

The following tables show the status of the Federal Trade Commission's (FTC) recommendations related to opportunities for improvements in FTC's internal control over accounting and financial reporting. Tables 1 and 2 reflect the status of OIG recommendations as of the end of the 2006 audit.[2] Table 3 shows the OIG recommendation from the current year's audit.

As of November 2007, FTC had taken actions to close 6 of the 8 open recommendations from our audits of the agency's 2005 and 2006 financial statements.

Table 1: Recommendations from 2005 Audit	Status of recommendations	
	Closed	Open
1. Quality Assurance Review of Financial Statements		X
2. Parking Benefits Not Accurately Reported on W-2s		X
3. RAO's Year-End Budget Review of Redress Cases Was Incomplete	X	

Table 2: Recommendations from 2006 Audit	Status of recommendations	
	Closed	Open
4. Accuracy of Accounts Payable	X	
5. Overstatement of Undelivered Orders	X	
6. Performance Measures not Inclusive	X	
7. Reporting Requirements of Strategic Sourcing Not Met	X	
8. RAO's Year-End Budget Review of all Redress Cases Understated the Ordered Amount	X	

Table 3: Recommendation from 2007 Audit	Status of recommendation	
	Closed	Open
9. Closing Procedures Need Improvement		X

[2] AR-07-001A *Financial Statement Audit for Fiscal Year 2006, Follow Up of Prior Year Findings, Management Letter*

Comments from the Financial Management Office

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

Financial Management Office

To: **John Seeba, Inspector General**

From: **Steven A. Fisher, Chief Financial Officer**

Subject: **FMO response to Draft of FY 2007 Management Letter**

We reviewed the draft report of IG fiscal year (FY) 2007 Management Letter which accompanies the Financial Statement Audit report for Fiscal Year 2007 (AR-08-001). I am pleased that the IG was able to close six of eight open recommendations that were identified in previous audits. Regarding the two prior year items that remain open:

> We agree that additional improvements can be implemented relative to the Financial Management Office's (FMO) quality assurance review process of the financial statements. We appreciate the acknowledgement of our efforts to improve the process which address this finding that was originally reported in FY 2003. As noted in the management letter, in FY 2007 the FMO developed step-by-step written procedures for completing the compilation and internal review of the financial statements. During FY 2008 and thereafter, the FMO will closely monitor compliance with its established procedures to better ensure errors are detected as part of the final quality assurance review.
>
> Relative to the finding on the proper reporting of parking benefits, we believe that the corrective actions implemented in FY 2007 as described in the management letter adequately address the concern over accuracy of reporting parking benefits. The Human Resource Management Office and FMO will continue to closely monitor the accuracy of reporting parking benefits on employees' IRS form W-2.

In regards to the finding and new recommendation that pertain to year-end closing procedures, we generally concur. While we have already established detailed procedures for financial statement preparation and the year-end closing processes, we concur that such procedures should explicitly require the verification that any prior year-end adjustments (that were made subsequent to closing the general ledger but prior to issuing the financial statements) were subsequently posted to the core financial system and are properly accounted for in the current year compilation.

Thank you for the opportunity to review and comment on the draft report.

Comments from the Human Resources Management Office

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

Human Resources Management Office

January 22, 2008

MEMORANDUM

TO: John Seeba
Inspector General

FROM: Karen Leydon, Director
Human Resources Management Office

SUBJECT: Response to Draft FY 2007 Management Letter

Thank you for the opportunity to review and comment on the section of the draft FY 2007 Management Letter regarding parking benefits. We are delighted that you noticed the procedures put into place were designed to correctly calculate taxable parking benefits. Additionally, we are pleased that you will consider the comment closed once you confirm the taxable parking benefits are correctly calculated on the 2007 W-2s.

Again, we appreciate the opportunity to comment on this letter. If you have any questions relating to our response, please contact me at extension 3633.