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FEDERAL TRADE COMMISSION
Audited Financial Statements
For Fiscal Year 2003

OFFICE OF INSPECTOR GENERAL

MANAGEMENT LETTER

Federal Trade Commission
Financial Statement Audit for Fiscal Year 2003

Management Letter

Follow Up of Prior Year Findings

1. Prior Year Finding: Rent Expense in Prior Years Included Both Overpayments and Underpayments.

FY 2002

Payment errors (over or under payments) are not immediately within the control of the FTC as GSA makes direct charges to the FTC's appropriation account at Treasury. The agency receives documentation only after the fact detailing the amount transferred to GSA and the date of the transfer. It is therefore critical that ASO staff review this documentation monthly for possible errors to avoid small mistakes becoming large problems at year-end. Toward this end, ASO assigned a staff person to monitor the monthly rent bills. The OIG noted that this review occurred in early FY 2002 as an overpayment was identified by ASO staff resulting in a timely refund to the agency.

Also, in keeping with a 2001 audit recommendation, ASO further refined this process by developing a matrix detailing expected monthly rent payments, by location, based on occupancy agreements (OA) or, in situations where OA's do not exist, on GSA-provided rent projections. As an added check against over or under payments, ASO stated that it will provide this report to the Financial Management Office (FMO) for comparison with budgetary and accounting records. The variance analysis of actual to budgeted rent costs has, in past years, been performed by the Budget Office (Budget).

This newly developed matrix, while an improvement over the 2001 process, did not provide the necessary data to accurately record a year-end rent accrual. As a result, Budget developed its best estimate for the accrual. In the auditor's analysis of rent activity, the OIG calculated a year-end accrual amount that was $194,000 less than the estimate provided by Budget. As a result, FMO made an adjustment to reduce its year-end rent liability by $194,000

Given the accrual adjustment, the matrix developed by ASO has been modified to assist ASO in i) monitoring rent payments, ii) reconciling cost variances, and iii) providing an accrual estimate to FMO that accurately reflects the year-end rent liability. Another benefit of a fully developed matrix would be to allow ASO to perform the variance analysis that Budget now performed.

FY 2003 Finding Follow Up

ASO prepared a monthly matrix analysis of rent throughout FY 2003. However, during its review and testing of rent activity during FY 2003, the OIG noted the following:

- FTC received a credit of $109,956 on its December 2002 bill and a $35,002 credit on its September 2003 bill. ASO had identified the first credit in its analysis, but not the second. ASO did not follow up on either credit to determine what the bases for the credits were until the OIG requested an explanation for the credits.

- GSA charged FTC for parking spaces vacated at the Department of Labor. While ASO had requested a refund for the overpayment, ASO-provided documentation did not support its calculated refund amount ($39,853). Rather, based on the facts and financial data provided by ASO, the OIG calculated the refund to be $56,609, or an increase of $16,756.

One individual in ASO has primarily responsibility for the monthly matrix rent analysis. Rent deviations (e.g. credits, overpayments) do not appear to be properly documented, tracked and resolved in a timely fashion. Management review of these changes is minimal, given no timely detailed analysis is prepared.

Recommendation 1. The OIG recommends that all rent deviations from the monthly matrix analysis should be reviewed, explained and reported to management shortly after they are identified by staff, but prior to the next monthly rent statement. Actions taken toward resolution or closure should be documented

Recommendation 2. The OIG recommends that ASO request a credit from GSA for the additional amount of $16,756 in overpaid parking rent.

2. Prior Year Finding: Credit Card Transaction Recording Process Would Be More Efficient Using Citibank Direct.

FY 2001

During the testing of the payment process related to Citibank credit card charges, the OIG noted that personnel at the NBC were spending approximately 32 hours per month or an annual cost of $9,500 to record coding changes to credit card transactions. Currently, the Citibank monthly bill electronically records its transactions into FTC's payment system. These transactions are automatically coded to organization, program and budget object class. When changes to any of these data fields are desired, e.g., to more specifically classify an item purchased or to make corrections to default codes, the individual cardholder must make manual changes on the individual statements and forward them to NBC. NBC staff then calls up on-line the transaction that was already posted and re-inputs the transaction to reflect these changes.

The OIG believes that the time spent on the routine change process can be avoided if FTC used the Citibank Direct program. The Citibank Direct program contains budget object codes that are generated automatically based upon the type of purchase (rather than just one default budget object class code). More importantly, it allows the cardholder to make changes to the codes on-line *prior* to final payment, thus eliminating the necessity for NBC staff to make such changes.

FMO staff informed the OIG that it is aware of the program benefits and, as such, will continue to work closely with Citibank to implement a more efficient system that meets FTC's unique matter reporting objectives.

FY 2002

The Assistant CFO for Acquisitions informed the OIG that the development of the online reconciliation process was not implemented in FY 2001 because Citibank was not able to resolve all program issues until early in FY 2002. FMO told the OIG that, since then, it has begun discussions with Citibank to implement the electronic process. According to these officials, Citibank was scheduled to begin work with the FTC in late June 2002 to set up the accounting "strings and templates" necessary for the reallocation program. The FMO's goal was for full FTC implementation by October 2002, but Citibank informed the FTC that it was making significant enhancements to the process that would be completed in February 2003. Rather then implement an inferior version, the FTC chose to wait for the enhancements and implement the process at that time. FMO staff has informed the OIG that the enhancements were completed in February 2003, and implementation at the FTC is expected in March 2003.

FY 2003 Finding Follow Up

The Citibank Direct system was implemented during FY 2003. Management indicated that it discovered a few glitches in the system, but considered them minor to the overall operations and functionality of the system.

The OIG considers this finding closed.

3. Prior Year Finding: Accounts Payable (A/P) Accrual at Fiscal Year End is Understated.

FY 2001

While the recording of year-end A/P accruals improved in FY 2001 as the FMO implemented the OIG's prior recommendations, the OIG again found that the costs for still other services/goods delivered on or before September 30, 2001 were not accrued at year end. In each of these instances, the OIG noted that there were no invoices or receiving reports submitted, yet an agency liability still existed. Consequently, basing the recording of year-end accruals solely on having either an invoice or a receiving report on file was not sufficient for all transactions. The majority of the errors detected were included in adjustments to the financial statements after the OIG brought them to the attention of FMO.

To avoid a recurrence of under accruing, FMO should develop a list of these items each year to review when booking the year-end accruals. As an added check, FMO could make inquiries to COTRs to review the status of large contracts which may not routinely appear at year-end.

FY 2001 Recommendation:

a.) Maintain a list of goods/services that are likely to be accrued at year-end. This list should then be reviewed to ensure that all applicable accruals are made.

b.) For large undelivered orders not accrued via receipt of an invoice or receiving report, the OIG recommends that the FMO make inquiries of selected COTRs to determine if services/goods have been received and accrued accordingly.

FY 2002

During the current year testing, the OIG noted that FMO has made improvements to the process of capturing items that need to be accrued, as described above in (a.). However exceptions were still found that related to large undelivered orders (b.), e.g., nonrecurring items. The OIG noted $1,034,859 of expenses and an additional capital asset item for $800,000 that should have been accrued at September 30, 2002. This latter amount was subsequently recorded as a FY 2002 item as a result of our discussion with FMO.

In the semiannual audit recommendation follow-up, management concurred with recommendation (b.), and told the OIG that a review of contracts and large-dollar goods/services received near year-end had been performed to capture large undelivered orders. Further, COTRs were also contacted by FMO staff to determine whether the goods/services were received. Based on our FY 2002 update, it appears that these procedures were not fully implemented at the end of FY 2002. As the OIG again identified missed accruals, it is imperative that the FMO take steps to fully implement last year's recommendation in this area.

FY 2003 Finding Follow Up:

During the FY 2003 testing of 21 undelivered orders totaling $11,972,024, the OIG determined that one of the items should have been accrued for $174,021. While this is a significant reduction from the prior year, the OIG noted that the FMO's accrual process did not include asking COTRs about the status of large, non-recurring contracts (except for reimbursable work orders). The OIG believes that neglecting this step, although not material in FY 2003, could have a significant impact on accruals in years where a larger volume of services/goods are delivered near the fiscal year end, as occurred in prior years.

Additionally, the OIG reviewed six disbursements totaling $360,500 made between 10/1/03 and 10/21/03 to determine if any related to FY 2003 activity that should have been accrued at 9/30/03. The OIG identified three disbursements totaling $180,450 of payments made related to FY 2003 for which no accounts payable or accrual had been set up.

When payables are understated at year end, the agency understates its liabilities.

Recommendation 3. The OIG recommends that FMO establish a threshold dollar amount for the agency's undelivered orders, above which FMO should review to determine if services/goods have been received and properly accrued. In addition, FMO should, where possible, review invoices above its threshold limits paid after year-end that are not part of the September 30 accounts payable balance to determine if they should be accrued.

4. FY 2002 Finding: Reconciliation of Premerger Fees Between FMO Records and Premerger Notification Office's Database is Incomplete.

FTC's Premerger Notification Office (PNO) receives, reviews and processes applications for potential mergers. As part of the premerger application, a fee must be submitted. The premerger review process does not begin until both the application and the fee have been received. The premerger application filing is recorded in the PNO's database.

FMO monitors and records premerger fees that have been credited to FTC's premerger account at Treasury. Most fees are paid via wire transfer.

FMO had implemented a monthly reconciliation process to compare its records of premerger fees received and confirmed by Treasury to PNO's premerger filings recorded in its database. However, the reconciliation process was incomplete as it only compared the records between FMO and PNO without addressing differences between the two systems. The emphasis of the comparison was to identify all the deposited premerger fees that were credited by Treasury (FMO's records). No further monitoring or research was performed for filings that appeared on the PNO database, but not listed in the FMO records for the month of reconciliation.

Without tracking and researching the differences until resolution, FMO cannot ensure the accuracy and completeness of the two systems and that proper controls are being maintained to capture all transactional activity.

The OIG recommended that:

a.) FMO establish a monthly reconciliation process that 1) compared FMO's premerger fee records with PNO's premerger database records, 2) identified records that are in FMO's records, but not in PNO's database (and vice versa), and 3) track the differences to subsequent postings or other resolution measures. The monthly reconciliation preparer's supervisor should review and approve the reconciliation.

b.) Based upon the data from the monthly reconciliation, FMO should prepare a journal entry to record its premerger fees on an accrual basis. Ideally, this would be monthly; at a minimum, the journal entry should be recorded as part of any financial statement compilation.

FY 2003 Finding Follow Up:

During the FY 2003 audit, the OIG determined that FMO prepared a monthly reconciliation spreadsheet that compared the premerger fee collections recorded by FMO with the premerger filings recorded by PNO. FMO utilizes the reconciliation process to capture premerger fee collections, monitor differences between the two systems and record fee revenue in the accounting system. Unfortunately, the results of the reconciliation process were flawed as FMO reported fee revenues for financial statement purposes based on the filings from the PNO monthly activity reports, which were understated, rather than fee revenues based on cash received at Treasury.

Fees from the PNO monthly activity reports are understated due to the method in which PNO records its monthly activity. If PNO has not received all the documentation for a particular filing, it will establish a filing record in its database. However, PNO will enter a "$0" placeholder in the fee data field until it receives all the required documentation, even when the fee payment has been received. PNO then reports all filings recorded during the month to FMO, including filings with $0 recorded.

When PNO receives the required filing documentation in the subsequent month, the fee amount is then recorded in its (PNO) database, but for the prior month when the initial filing material was received. However, PNO does not update the recorded fee amount to FMO. As a result, it stays at "$0" in FMO's database.

When FMO summed the twelve months of the PNO monthly filings activity to determine the amount of premerger revenues to be recorded for the year, the total did not include these "missing" fee amounts. In FY 2003, these filings totaled $1.4 million, half or which would be revenue to FTC and half would be funds to be distributed to the Department of Justice. The OIG did confirm that while the entire amount of premerger *revenues* were not recorded by FTC, all funds collected in FY 2003 were recorded in its Funds with U.S Treasury.

The OIG brought this discrepancy to the attention of the Assistant CFO – Finance. While the recommendations from FY 2002 are still pertinent to FY 2003, the Assistant CFO for Finance indicated that FMO would be changing its reconciliation method and its process for recording premerger revenues to address this error.

> ***Recommendation 4. The OIG recommends that fee revenue reported be based on cash received at Treasury. The reconciliation process should ensure that the differences between FMO records and PNO records are tracked and identified as to the cause.***

Current Year Findings

1. FY 2003 Finding: Decisions on Recording Capitalization Activity Should be Reviewed and Approved by the Assistant CFO - Finance

FTC's capitalization policy states that all property, plant, equipment acquired and internal use software developed with a unit value of $100,000 or greater and a useful life longer than two years are to be capitalized. Items purchased that do not meet these criteria are expensed. Depreciation of capitalized assets is calculated on a straight-line basis over the estimated useful lives of the assets.

The OIG reviewed all expenditure amounts over $100,000 (14 transactions) totaling $3.58 million, recorded to major object class 31 (equipment and software). The OIG identified two hardware items totaling $940,063 that had been expensed that should have been capitalized. A misinterpretation of applying capitalization rules by the senior accountant caused the misclassification. This audit adjustment was recorded for financial statement purposes.

Currently, the senior accountant within the Finance office reviews expenditures in the major object class 31 for capitalization of fixed assets and works closely with staff from Information and Technology Management to determine the amount to be capitalized for internally-developed software. However, these determinations are not always reviewed with the Assistant CFO - Finance. The OIG believes that supervisory review of the capitalization determinations would reduce the possibility of misclassification.

> ***Recommendation 5. The OIG recommends that the Assistant CFO – Finance review and approve all potential capitalization decisions and estimates.***

2. FY 2003 Finding: Improvement Needed in Quality Assurance Review of Financial Statements

The Assistant CFO – Finance and her staff are integrally involved in the financial statements compilation process. With the timeframe to produce financial statements continually being reduced, the resources used to compile the financial statements limit the availability for the quality assurance (QA) review process. Further, the over-familiarity of the details by the persons compiling the financial statements and notes can be counterproductive when the QA review process commences.

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 among such large and complex products. These errors range from misspelled words to formatting errors to misplaced information in the notes. Currently, FMO does not utilize any personnel to perform the QA review of the financial statements and notes other than those involved with compiling the financial statements.

During the exit conference, the CFO told the OIG that he agreed with the finding and had designated a staff person to assist in this process as part of the FY 2003 financial statement quality control. However that individual left FTC and no other person was assigned. The CFO plans to assign this function to a new hire for the FY 2004 statements.

The OIG will follow up on the CFO's plans in the FY 2004 audit.

> ***Recommendation 6. The OIG recommends that the quality control review include reviews for mathematical accuracy and consistency within the statements and among the statements, notes and supporting tables. To assist in this process, the Assistant CFO – Finance should develop a guide outlining procedural steps that the QA reviewers could follow.***