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FEDERAL TRADE COMMISSION
Audited Financial Statements
For Fiscal Year 2004

OFFICE OF INSPECTOR GENERAL

MANAGEMENT LETTER

Federal Trade Commission
Financial Statement Audit for Fiscal Year 2004
Management Letter

Follow Up of Prior Year Findings

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

FY 2003: Payment errors (over or under payments) are not immediately within the control of the FTC as the General Services Administration (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 Administrative Services Office (ASO) staff review this documentation monthly for possible errors to avoid small mistakes becoming large problems at year-end. During FY 2002, ASO assigned a staff person to monitor the monthly rent bills.

Also, in keeping with a 2001 audit recommendation, ASO developed 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 FY 2002 rent projections. As an added check against over or under payments, ASO provides this report to the Financial Management Office (FMO) for comparison with budgetary and accounting records.

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 the bases for the credits 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 primary responsibility for the monthly 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 was minimal, given no timely detailed analysis was prepared.

FY 2003 Recommendations: The OIG recommended that (a) 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, and (b) ASO request a credit from GSA for the additional amount of $16,756 in overpaid parking rent.

FY 2004 Finding Follow Up: The matrix developed by ASO has been supplemented with a new monthly schedule in FY 2004 called "rent bill analysis" that summarizes rent by property and a description of all rent variances (e.g. differences from projected amounts) that have occurred and are outstanding.

The OIG considers this finding to be closed.

2. Accounts Payable (A/P) Accrual at Fiscal Year End is Understated

FY 2003: 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 (e.g., the OIG identified $1,034,859 of expenses and an $800,000 capital asset item that should have been accrued at September 30, 2002), the OIG noted that the FMO's accrual process did not include asking COTR's 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 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.

FY 2003 Recommendation: The OIG recommended 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 that are paid after year-end, that are not part of the September 30 accounts payable balance to determine if they should be accrued.

FY 2004 Finding Follow Up: On September 15, 2004, FMO sent out notices entitled "Confirmation of Unfilled Orders and Expenditures" to all COTR's with undelivered order balances of $50,000 or greater. FMO requested that all COTR's estimate the total amount of work that was or will be performed as of September 30, 2004 on these contracts. FMO then based its accrual on the COTR responses.

During the FY 2004 testing of 28 undelivered orders totaling $13.2 million out of $22.7 million, the OIG did not find any additional orders that should have been accrued. In addition, the OIG selected 14 disbursements totaling $5.7 million made between 10/1/04 and 10/12/04 to determine if any related to FY 2004 activity that had not been accrued. The OIG did not identify any exceptions in testing.

The OIG considers this finding to be closed.

3. Reconciliation of Premerger Fees Between the Financial Management Office (FMO) Records and the Premerger Notification Office (PNO) Database is Incomplete

FY 2003: The PNO receives applications for mergers and acquisitions. As part of the premerger application, a fee must be submitted. Applications are reviewed for potential antitrust issues by either the FTC or the Antitrust Division of the Department of Justice (DOJ). Regardless of which agency reviews the application, the FTC has responsibility to collect the application fee, which it then splits evenly with DOJ. 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 prepares a monthly reconciliation spreadsheet that compares the premerger fee collections recorded by FMO with the premerger filings recorded by PNO. FMO uses the reconciliation process to capture premerger fee collections, monitor differences between the two systems and record fee revenue in the accounting system. However, the results of the reconciliation process were flawed because 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 the amount of 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 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 filing activity to determine the amount of premerger revenues to be recorded for the year, the total did not include these missing "$0" 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, who told the OIG that FMO would be changing its reconciliation method and its process for recording premerger revenues to address this error.

FY 2003 Recommendation: The OIG recommended 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.

FY 2004 Finding Follow Up: During the FY 2004 audit, the OIG determined that FMO refined its monthly reconciliation spreadsheet that compared the premerger fee collections recorded by FMO with the premerger filings recorded by PNO. FMO reviews each case appearing on the monthly activity report prepared by PNO and also reviews on a quarterly basis PNO's database for the entire year to verify that all cases are properly accounted for. In addition, all quarterly reports are reviewed by the Assistant CFO-Finance to verify that the databases are reconciled properly. The OIG did note one error that was not identified in the reconciliation.

FMO prepares a monthly schedule showing the total cash received for premerger fees less any refunds, which is then used to identify the FTC's portion of the total fees and fee amounts owed to DOJ. On a monthly basis, DOJ requests an electronic transfer (IPAC) from FTC for the previous month's fees from the suspense account.

During FY 2004, the OIG noted that FMO double counted a refund that totaled $187,500. The amount was deducted from its monthly schedule in September 2003 (FY2003) and again in October 2003 (FY2004). This error had three results. First, the FTC underreported revenue in FY 2004 by $93,750 (50% of the refunded amount). Second, the FTC had $93,750 sitting in the premerger suspense account with Treasury that it could have used in FY 2004 to fund operations. Third, amounts reported to DOJ were understated by $93,750.

FMO does reconcile the monthly report of premerger activity with the Treasury suspense account. According to FMO accountants, the error occurred in October 2003 when the refund was returned by the bank because it lacked some essential routing information. When the refund was reissued after the information was added, the amount was again deducted, this time from the October 2003 monthly activity report.

FMO told the OIG that the adjustment to revenue was made in October 2004, and that the monthly status report was amended to reflect the availability of $93,750 to the FTC and to DOJ in FY 2005. Further, the OIG verified that only one cash refund was provided to the applicant, although it was recorded twice on the books. As the reconciliation process seems to be otherwise working, and that an adjustment to revenue has already been made by FMO, the OIG does not believe that changes are warranted in the reconciliation process.

The OIG considers this finding to be closed.

4. Decisions on Recording Capitalization Activity Should be Reviewed and Approved by the Assistant CFO-Finance

FY 2003: FTC's capitalization policy requires that property, equipment, leasehold improvements and software, all with an acquisition value greater than $100,000 and a useful life over two years, be capitalized using the straight-line method over the estimated useful lives of the assets. Items purchased that do not meet these criteria are expensed.

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 which 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 for Finance. The OIG believes that supervisory review of the capitalization determinations would reduce the possibility of misclassification.

FY 2003 Recommendation: The OIG recommended that the Assistant CFO-Finance review and approve all potential capitalization decisions and estimates.

FY 2004 Finding and Follow Up: During the review of the major object class 31 and 32 (equipment and software), the OIG identified three software items totaling $1.98 million that had been expensed that should have been capitalized. A misinterpretation of applying capitalization rules by the senior accountant and Assistant CFO-Finance caused the misclassification. This audit adjustment was recorded for financial statement purposes.

The OIG believes that no recommendation is needed as the audit adjustment to record the capitalized asset was made.

The OIG considers this finding to be closed.

5. Improvement Needed in Quality Assurance Review of Financial Statements

FY 2003: The Assistant CFO for Finance and her staff are integrally involved in the financial statement compilation. With the shortened time frame to produce financial statements, the resources used to compile the statements limit the availability for a quality assurance (QA) review. Further, the over-familiarity with 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 has not dedicated 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.

FY 2003 Recommendation: The OIG recommended 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.

FY 2004 Finding Follow Up: The Assistant CFO for Finance told the OIG that the financial statement process had been revamped for the year-end financial statements. Responsibility for the preparation of the financial statements is now with the senior accountant. Two staff accountants assist the senior accountant in preparing schedules and proofing the statements for grammar and mathematical errors. The Assistant CFO for Finance then performs a quality assurance review of the financial statements. Although this area was revamped, the OIG still found several errors in the financial statements that included: the statement of finance not conforming to the form and content of government financial statements, footnotes that did not tie to the financial statements, and prior year financial statement numbers that were inaccurate.

In the FY 2003 management letter, the OIG recommended that FMO establish a quality control review of the financial statements and develop a guide or a checklist to assist in the review. As errors have again been identified, management should take the additional step to formalize a process that will ensure that common mistakes, such as formatting errors and inconsistencies do not occur.

FY 2004 Recommendation #1: The OIG recommends that the Assistant CFO-Finance develop a checklist of items containing common financial statement errors as a guide for the quality assurance review of the financial statements.

Current Year Findings

6. Receiving Reports Are Not Prepared Timely

Receiving reports provide written evidence of acceptance of property or services by a Government official. Receiving reports contain the following information: (i) contract or other authorizing number, (ii) product or service description, (iii) quantities received - if applicable, (iv) date that the property or services were delivered or received, (v) date the property or services were accepted, and (vi) signature of the Contracting Officer's Technical Representative (COTR).

The Prompt Pay Act of 1982 (PL. 97-177) requires the payment of interest to vendors on payments made after the payment due date which is specified in the contract or invoice, or if a payment date is not specified, 30 days after the latter of the acceptance date of the services, or the date the invoice is received at NBC. The Act's guidelines are very specific as to the need for complete and accurate invoices from vendors, and for the requirement of timely acceptance of goods and services. Receiving reports are to be submitted through the FMO to the NBC once goods are accepted by the COTR.

The FTC's vendor payment processor, the National Business Center (NBC), requires proof that an invoice is valid before it will pay the vendor. Agency COTR's provide such proof by completing a receiving report certifying that goods/services were delivered as specified on the invoice.

Upon the receipt of an invoice, NBC logs it into its payments system (e.g., the log date). If a COTR has not submitted a receiving report, NBC will send a blank receiving report and a copy of the invoice to FMO for forwarding to the delinquent COTR's. This provides the COTR with an invoice that serves as a reminder that a receiving report has not been submitted and that payment will not occur until it is received. NBC sends these invoices and forms to FMO two to three times per week. Again, the 30-day window the agency has to pay its bills begins on the latter of the acceptance date or the NBC log date.

Interest penalties paid to vendors for late payments by the agency pursuant to the Prompt Payment Act are usually the result of receiving reports not filed timely by COTR's.

The OIG made a recommendation in the FY 2002 management letter for FMO to send letters to bureau/office heads alerting them to interest penalty expenditures by vendor. This procedure resulted in a dramatic drop in interest penalties paid by the agency, from $18,884 in FY 2002 to $6,475 in FY 2003. Unfortunately, that downward trend was short-lived, as the OIG noted in reviewing FY 2004 interest penalties an increase of 98%, from FY 2003 to FY 2004 ($6,475 vs. $12,814). The OIG noted that 69% or $8,800 of the interest penalties in FY 2004 was associated with the Information & Technology Management Office.

FY 2004 Recommendation #2: The OIG recommends that the Finance Office notify bureau and office heads of the interest penalties charged to their respective organizations while continuing to identify specific COTR's responsible for the penalties.

7. Parking Benefits Are 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 ($195 in 2004 and $190 in 2003). 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's Administrative Services Office (ASO) manages both the reserved and non-reserved spaces at its headquarters garage. For reserved spaces, ASO determines the value of the parking benefit by averaging monthly fees at similar, nearby parking facilities. In calendar years 2004 and 2003, the average in the area around the FTC headquarters building for reserved spots was $388 and $353 per month, respectively. The names of employees receiving parking benefits in excess of the exclusion are forwarded to the Human Resources Management Office (HRMO), along with the per-pay period amount to be included as income. HRMO, in turn, submits the names of the identified employees along with their social security numbers, organization codes and per-pay period amounts to be reported as income to the National Business Center.

For calendar year 2003, the OIG examined taxable parking benefit for agency employees receiving a taxable-parking benefit. Four employees' parking benefits were incorrectly reported on their W-2 forms. Of these four, three had their parking benefits over-reported and one had no benefit income reported. The parking benefits that were over-reported belonged to commissioners who are paid on a bimonthly basis.

For calendar year 2004, the OIG reviewed parking benefits for the first 16 pay periods for the four employees that received incorrect benefit information on their W-2's. The OIG found that one employee's parking benefit was still incorrectly reported. This employee had received no benefit income reported.

FY 2004 Recommendation #3: HRMO establish a quality control process whereby (a) the names of benefit recipients are verified with ASO quarterly, and (b) 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.

8. The FTC Is Not Maximizing Interest Earnings on Funds Held for Redress

The FTC obtains consumer redress in connection with the settlement or litigation of both its administrative and its federal court cases. As the FTC rarely distributes funds to consumers directly, it has established a contractual relationship with two claims administration and distribution agents (contractors) to perform this important function. The FTC maintains complete control of the funds deposited with them.

The Redress Administration Office (RAO) is responsible for the overall management of the redress program, including oversight of contractor performance.

When defendants make payment(s) toward a monetary judgment directly to the FTC, funds are deposited in the agency's deposit account with the U.S. Treasury.[1] The funds are held in the account pending transfer to the contractor, or to the Treasury general fund (disgorgement). In other cases, funds may be wired directly to one of the agency's two redress contractors by the defendant, per instructions contained in the court order. Factors determining where funds are initially deposited include, but are not limited to, the likelihood of redress and whether the case is on appeal.

The advantage of contractor accounts over the FTC's Treasury Deposit Fund (TDF) is that contractor accounts pay interest on deposits, while funds in the TDF earn no interest. As collections against redress judgments totaled $337.8 million in FY 2004, the interest earnings can be significant. It is very important that funds are managed to maximize interest as the interest earnings are used to offset the fees contractors charge to open and manage redress accounts and to perform tasks associated with claims administration and distribution. Any fees not covered by interest earnings must be paid from the fund corpus, reducing the consumer's pro rata share of redress, or the final amount of funds disgorged to the Treasury.

A. RAO Cash Management Practices Result in Lost Interest Earnings on Numerous Redress Cases

The OIG found that the FTC lost thousands of dollars in interest income by holding funds in non-interest bearing deposit accounts in the TDF instead of depositing funds in interest bearing accounts managed by the agency's redress distribution contractors. These earnings could have been used to offset contractor fees, resulting in either more funds being distributed to consumers or disgorged to the U.S. Treasury. As of September 30, 2004, there were approximately $13 million in the TDF.

To illustrate the impact of holding large sums of cash in the TDF, the OIG selected the four largest case balances as of 9/30/04 for review. These four accounts totaled $9.4 million of the $13 million in the account at year end. An estimate of the lost interest for these four cases is provided below.

[1] A U.S. Treasury deposit account is an account established to hold monies that do not belong to the Federal government. These amounts include deposits received from outside sources for which the government acts solely as a banker, fiscal agent or custodian.

Estimated Lost Interest Earnings on Selected TDF Case Balances as of 9/30/04 (in thousands of dollars)

Cases	Deposit #1	Deposit #2	Deposit #3	Total Deposit	Lost Interest [2]
1	8/03 $601	2/04 $461	8/04 $2,373	9/04 $3,435	$ 6
2	5/04 $2,307	7/04 $475	9/04 $65	9/04 $2,847	$ 5
3	3/04 $1,500	9/04 $50	n/a	9/04 $1,550	$ 4
4	12/02 $1,600	n/a	n/a	9/04 $1,600	$ 14
//////////	///////////////////	//////////////	**Totals**	**$9,432**	**$ 29**

As the table illustrates, funds are held for varying lengths of time awaiting final disposition. The column depicting "lost interest" shows the interest that could have been earned on these four cases had the funds been deposited directly with the contractors instead of in the TDF. The OIG notes that the four cases identified above were still in the TDA as of 12/31/04, adding another $11,800 in lost interest to the $29,000 estimate above.

The OIG did not go back to calculate lost interest on all prior cases deposited in the TDF other than the four cases identified above. However, moving forward, the OIG noted that the balance in the TDA has grown to $19 million as of 12/31/04. Of this total, 17 cases totaling $14.7 million were at least three months old.

RAO officials told the OIG that there are reasons for depositing cash in the TDF as opposed to interest-bearing accounts with the contractors. One explanation given is that some of these cases are on appeal (e.g., case nos. 1 and 2 above), and there exists the possibility that all funds taken from these various defendants would have to be returned to them if they should win their appeal. Contractors are required to provide liability and dishonesty bonds and incur other fees when each account is opened. If the defendant's principle is reduced by contractor fees and the agency is required to return the money, the interest earnings may not, according to agency officials, cover the fees. This would potentially result in two undesirable outcomes. First, either the defendant would receive less money back than s/he provided to the FTC, or the agency would have to make up the difference from its appropriation.

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[2] In its calculation, the OIG assumed an annual rate of return on investment of 0.5%. Contractor staff told the OIG that it was earning between 0.5% and 0.7% on deposits during the period under review. Given that current (2/05) interest rates for short-term CD's, T-Bills and money market accounts are above 2%, the OIG believes that lost interest in the future will be even greater.

While the possibility of losing on appeal exists, the risk of such an outcome occurring quickly is remote. In fact, the OIG could not find any similar cases where the FTC lost on appeal and had to return funds to defendants. Given the large sums of money in these accounts, it is highly probable that moving funds to contractor accounts immediately would, in most cases, result in interest earnings that would quickly outpace any contractor fees. The OIG believes, for most cases, interest earned after several weeks would be sufficient to cover all start-up fees.

Cases may also be held in the TDF when additional collections are expected (Case #3). In these cases, staff may be unable to determine whether redress can be accomplished until it becomes clear how much will be collected. There is no risk of funds being returned to defendants, hence fees are not the issue. It is important to note that in all cases, accounts transferred to contractors will result in fees. The only variable is timing, e.g., when the fees (and interest) would be charged (and credited) to the individual accounts. For redress cases, the agency does not avoid paying fees by holding funds at Treasury, nor does it necessarily reduce the fees. On the other hand, the amount of interest income lost represents the opportunity cost of depositing funds in the non-interest bearing TDF. Even if the redress distribution is not made, the funds, plus interest, could be returned to the FTC for disgorgement. In both scenarios, the consumer and/or the U.S. Treasury come out ahead.

Although it is unlikely that funds would be returned to defendants prior to their earning sufficient interest to cover account initiation fees, one FTC contractor told the OIG that it would be willing to take on the risk involved in any such deposits, and charge no more than the interest earned on the account.[3] This means that even if the agency incurred fees in excess of interest earnings, it would not have to make up the difference from its appropriation or short the defendant. In return, the FTC would agree to have that contractor perform the redress distribution when redress is deemed practical. The OIG believes that this solution benefits consumers and the government alike.

FY 2004 Recommendation #4: In keeping with sound financial management principles, the OIG recommends that BCP deposit all funds with contractors as soon after the receipt of these funds from defendants as practicable, but no longer than 30 days. Contractor accounts where no distribution occurs should be disgorged to the Treasury, to include net interest earnings. The OIG also recommends that BCP modify its redress contracts to identify how contractor fees are to be calculated on cases on appeal in the event interest earnings are not sufficient to cover expenses.

Management, in its January 13, 2005 response to the OIG generally concurred with the recommendation. However, management noted that some orders prohibit the transfer of monies to contractors. Further, management believes that the existing contract for redress management and distribution may need to be modified to include money management in potentially non-redress situations. Management also believes that the potential interest earnings could present a liability to the FTC if the court decides that all interest belongs to the defendant. Finally, management suggested that it needs time to consider these and other potential obstacles.

[3]The contractor suggested that such an arrangement be limited to a six month trial period before a long-term commitment is made.

The OIG agrees with RAO that not all cases can or should be deposited with contractors. We also agree that some modifications to the redress contract may be required to implement this recommendation. But, for its part, RAO must question existing procedures, to include the practice of holding funds in the TDF pending the outcome of appeals. We rhetorically ask, what judge would not want interest to be earned on (in some cases) millions of dollars over periods covering several months? In any event, those cases where the agency cannot move funds immediately, we believe, are the exception and not the rule. Therefore a policy addressing the majority of cases should be developed.

The OIG further notes that the FTC does have some flexibility in the drafting of orders that would enable it to include provisions requiring that funds be deposited in interest-bearing accounts while decisions on redress and/or appeals are made. For example, language in the order for Case #1 reads that the plaintiff (FTC) *shall deposit funds received from defendants pursuant to this Order in an **interest-bearing account** administered by plaintiff or **its agent** (emphasis added).* The precedent exists, it simply needs to by formalized and universally applied.

Clearly, the obstacles need to be identified, and addressed. As thousands of dollars in interest are lost each month, the OIG believes RAO's research into the development of policies and procedures should be a top priority.

B. Financial Management Practices by One Redress Contractor Results in Lost Interest Earnings on Numerous Redress Cases

Over the past five years, interest earnings from funds on deposit with FTC contractors totaled $4,538,000, which covered some, but not all, of the costs to perform the redress distributions during the same period. Net expenses were paid from the fund principle, thus reducing the fund corpus available for redress.

Once the FTC has determined that redress will be distributed (sufficient funds are available, consumers are located, pro rata shares are determined, checks are printed, etc.) funds are moved from interest bearing accounts to non-interest bearing checking accounts. These accounts are then reduced as the checks are cashed. Any remaining funds either become part of a subsequent distribution, or are disgorged to the U.S. Treasury.

As the distributions are sometimes made in stages, it is prudent to move only those funds sufficient to cover the issued checks, leaving the balance to earn interest. These cases often involve millions of dollars and the accrued interest is significant. One of the agency's contractors (Contractor A) told the OIG that it moves funds from savings to checking sufficient to cover only half of the checks mailed to consumers, but it monitors the account activity daily. When funds in checking are reduced to a certain point, additional, but not all remaining, funds are moved to checking. Contractor A has an agreement with the bank to cover overdrafts on the checking account, as both savings and checking accounts are with the same bank.

The OIG noted that the other contractor (Contractor B) moved all funds prior to beginning the distribution. According to Contractor B, this policy is based on direction from the RAO. As a result of this practice, Contractor B did not earn thousands of dollars in interest that it could have earned if it had managed the accounts as did Contractor A. As the table illustrates, estimates of interest lost on just five judgmentally selected cases totals $87,000.

OIG Estimate of Lost Interest on Five FTC Accounts with the Contractor[4]
as of 9/30/04
(in thousands of dollars)

Cases	Deposits	Interest	Redress	Expenses	Months w/o Interest	Lost Interest
1	$8,648	$68	$5,224	$296	24	$35
2	10,000	634	7,539	1675	19	30
3	30,000	590	25,115	1802	4	18
4	1,017	15	650	288	21	3
5	590	1	292	5	6	1
/////////	////////////	///////////	///////////	//////////////	**Total**	$87

The OIG calculated lost interest based on the monthly balance of funds in the non-interest bearing checking accounts. The column "Months w/o Interest" is a measure of time between when funds stopped earning interest (moved to checking) and the date the account was either closed (case nos. 2 & 4) or 9/30/04. Again, the OIG notes that the lost interest estimate of $87,000 is conservative, as it only includes five cases, and not the dozens of other cases managed by this contractor.

FY 2004 Recommendation #5: The OIG recommends that RAO instruct the contractor to notify it when funds will be moved from interest-bearing savings to non-interest bearing checking accounts, the amount of the transfer, and to provide a work up of the amount needed to be transferred. RAO should review the planned transfer with the objective of minimizing the time that idle funds sit in non-interest bearing accounts.

RAO informed the OIG that it concurs with the recommendation. As soon as the finding was brought to the attention of RAO management, it instructed this contractor to move only those funds necessary to cover outstanding checks, and to move any funds not disbursed within 30 days back to interest-bearing accounts.

[4]Interest is calculated based on monthly account balances and is assumed to be 0.5% per annum. (See Note 2.)