Prepared Statement of the Inspector General of
the Federal Trade Commission
Before the House Subcommittee on
Government Efficiency, Financial Management and Intergovernmental Relations
of the
Committee on Government Reform

Washington, D.C.

May 14, 2002

Audited Financial Statements for Non-CFO Agencies - Why They re a Good Idea

Introduction

Good morning Mr. Chairman. I am Frederick J. Zirkel, Inspector General of the Federal Trade Commission (FTC). I am pleased to testify[1] before the Subcommittee today in support of financial statement auditing.

The FTC is a non-CFO agency that has its financial statements[2] audited annually. The mission of the FTC is 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 an emphasis on those practices that might unreasonably restrict or inhibit the free exercise of informed choice by consumers. The work of the FTC is critical in protecting and strengthening free and open markets in the United States.
To accomplish its competition and consumer protection missions the agency was authorized $155,982,000 and 1074 FTE s for fiscal year 2002. Funds are provided the agency from two major sources: premerger filing fee collections and an annual appropriation. For financial

[1]This written statement, my oral presentation and any responses to questions I might provide reflect my views and do not necessarily reflect the views of the Commission or any individual Commissioner, nor are they endorsed by either the PCIE or the ECIE.

[2]The financial statements prepared by the FTC follow OMB form and content guidance for executive branch agencies.

statement reporting purposes the Financial Accounting Standards Advisory Board (FASAB) defines the agency s premerger filing fees as exchange revenue. That is, funds that the agency has earned and can use with its annual appropriation to pay for salaries and other operating expenses to achieve its mission objectives.

The FTC also receives non-exchange revenues.[3] For example, the agency collects civil penalties. Civil penalties cannot be used to pay for agency operating expenses but instead must be remitted to the U.S. Treasury. According to FASAB Statement of Federal Financial Accounting Standard No. 7, an agency with substantial non-exchange revenue is required to prepare, as part of its financial statement package, a Statement of Custodial Activity (SCA).

I mention these accounting concepts/authorities because the FTC as part of its financial statement package, prepares a custodial activity statement. During the years under audit, the FTC s non-exchange revenue has always exceeded its exchange revenue. Yet, without a financial statement audit this major area of financial activities would receive little if any scrutiny. Futhermore, for the FTC, the preparation and audit of the SCA has helped management integrate its financial and program management systems. In addition, the statement provides information that interested third parties could use to judge how well the agency is meeting its basic mission responsibilities.

Audit Approach

At the FTC, the annual financial statement audit is performed by an audit team comprised of OIG staff and an independent public accounting firm (IPA) under contract to the OIG. As IG, I sign the audit opinion. In each of the five years the audit has been conducted the agency has received a clean opinion. The OIG and the IPA have always been in agreement as to the final

[3]Non-exchange revenues are inflows of resources that the Government demands or receives by donation. Such revenues include taxes, fines and penalties.

opinion. As audit efficiency and effectiveness increases with experience, the OIG utilizes a multi-year contract to obtain IPA services.

Audit Benefits

I believe annual audits are worth the expenditure of agency funds for the reasons detailed on page 19 of GAO survey report 02-281R (survey)[4]. The benefits specific to the FTC include improvements in internal control, strengthening of financial management systems and enhanced accountability.

Of course, obtaining a clean audit opinion is not an end in itself but merely the first step to improving agency financial management. It is also a necessary step if an agency is to fully implement GPRA, i.e., tie performance measures and/or objectives to audited costs contained in the Statements of Net Cost.

The OIG has made a practice of identifying at least one vulnerability/finding stemming from our financial statement work each year for detailed audit follow-up. In addition, the OIG prepares a separate summary of selected Custodial Activity Statement information originating from the financial statements that is provided to program managers.

It is important to note that the information appearing in the aforementioned analysis is not what either management or the OIG defines as necessary to manage the agency s consumer protection program. Rather, this financial information is what FASAB defines as being minimally necessary for FTC management to meet its accountability mandate.

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[4]Benefits include: enhanced accountability, improved financial systems, improved reliability of management information, improved internal controls and more timely identification of inefficiencies and/or weaknesses.

In short, the OIG attempts to use the financial audit as a building tool for other purposes.

Audit Cost

The OIG at the FTC is provided with an annual budget of 5 FTE s and contracting dollars of approximately $100,000 per year. The OIG budget, when adjusted for inflation, has stayed relatively constant over the past 5 years or for the time span we have been conducting financial statement audits. From this budget, my office commits approximately $60,000 per year to an IPA contract ($56,500 in 1997 and $60,500 in 2001) to perform the financial statement audit. In addition, my office also applies approximately one half to three quarters of an FTE to the audit. Consequently, conducting a financial statement audit is a major commitment of OIG resources.

Yet, I believe the resource commitment is a wise expenditure of taxpayer funds. For example, in reviewing the comparative FTC financial statements for fiscal years 2000 and 2001, a total of over $616,000,000 was subjected to audit. The OIG audit cost for these two years (IPA contract cost plus OIG staff) totaled approximately $240,000. To use an analogy, this is similar to an individual earning $100,000 ($616 million) annually who decides to spend $39 ($240,000) on a physical exam.

A few comments on management cost.

1- When public servants are provided control over taxpayer funds they have an obligation to ensure that such funds are properly managed and accounted for. Undertaking a financial statement audit is a recognized way to discharge this important obligation.

2 - A financial statement audit should be viewed as a quality control activity that is an integral part of the overall management process. It provides needed feedback to management. The absence of such audits in past years may in part explain why government financial management is held in low regard.

3 - When considering management costs, it is important to distinguish between the incremental cost of an audit verses the cost management will need to incur to correct a procedural weakness or respond to a system breakdown. For example, taking the time to meet with auditors to discuss adjustments on a cash reconciliation that ties a Treasury cash account to the agency s general ledger account would be an incremental cost. When auditors request management to prepare or correct a routine reconciliation required of all financial organizations, the resources needed to complete this task should be assigned to the cost of administering an effective financial operation and not the audit.

These points lead me to a general statement about auditing cost. All other things being equal, the better managed the unit or organization being audited the lower the cost of the audit will be for management. The more knowledge the audit team has of the organization being audited the lower the cost will be for the audit organization.

Finally, from either side of the cost ledger one should also consider audit recommendations that result in money being returned to the agency. For example, in FY 2000 the OIG audit team identified rent overpayments by the agency of $189,000. In 2001, the majority of these overpayments were repaid to the agency. While audit savings can help offset audit cost and are therefore important, they should not be the driving force for justifying why a financial statement audit should be performed. This is particularly true for small agencies where such savings will be intermittent or even in larger organizations whose financial management program functions effectively.

Lessons Learned

1 - The process is evolutionary. Management needs to believe that they have a chance to succeed and that sufficient resources and accounting help is available. This is particularly important in the first few years when no blueprint or financial statements exist.

2 - If a custodial activity statement is required the OIG should involve itself directly in the audit as the IPA learning curve will result in a high contract price.

3 - Stay the course. Ad hoc efforts to provide information to the auditors in the early years are ultimately replaced with systems that routinely collect needed data which is used to prepare the financial statements. Obtaining quality information becomes easier over time.

4 - After a number of years of performing the audits it becomes possible to identify trends. Unusual trend deviations provide worthwhile areas to investigate further.

5 - The OIG should make an effort to use the results of its financial statement audit to select targets for more in-depth follow-up reviews.

Managers in non-CFO agencies were provided flexibility by Congress when their agencies were not named as needing to comply with the CFO Act. This exclusion provided federal managers with the freedom to move into financial statement auditing at a pace of their choosing. After all, the CFO Act does not preclude agencies from undertaking financial statement audits. It appears based on the GAO survey, that many managers viewed their agency exclusion from the CFO Act as a reason for not needing to undergo a financial statement audit. I view this as a lost opportunity.

In the GAO survey which provides background for today s hearing, a chart appears on page 15 that details the Key Legislation Requiring FS Audits. These various pieces of legislation make it clear how broad based financial statement audit coverage is and how universally recognized its value is as a method to improve internal controls, identify weaknesses and thereby help to ensure accountability.

I believe the onus should be placed on those officials who do not perform financial statement audits to explain why such an expenditure is so low on their list of spending priorities. They should be asked to explain how they are currently satisfying themselves that all funds under their control are being accounted for, particularly in light of the long legislative history of requiring such reviews of other public and private organizations of differing size.

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Mr. Chairman, this concludes my remarks. I would be happy to answer any questions you or any member of the Subcommittee may have about my office s experience in conducting financial statement audits at the FTC.