

***Office of Inspector General***



***Independent Auditor's Report on Internal  
Control for 2009 Financial Statements***

**November 6, 2009**

OIG-AR-02-10

**United States International Trade Commission**

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## **Independent Auditor's Report on Internal Control**

Acting Inspector General  
U.S. International Trade Commission

We were engaged to audit the financial statements of the U.S. International Trade Commission (ITC) as of and for the year ended September 30, 2009, and have issued our report thereon dated November 6, 2009. The report states that because of the matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the balance sheet as of September 30, 2009, and the related statements of net cost, changes in net position, budgetary resources, and the statement of custodial activity for the fiscal year then ended.

In planning and performing our work, we considered ITC's internal control over financial reporting by obtaining an understanding of the design effectiveness of ITC's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of ITC's controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, which we were ultimately not able to do, but not to express an opinion on the effectiveness of ITC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of ITC's internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in the Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statement*, as amended. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

Our consideration of internal control over financial reporting was for the limited purposes described in the preceding paragraphs and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency in internal control, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles (GAAP) such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described above and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we also consider the deficiencies described below to be material weaknesses.

## **MATERIAL WEAKNESSES**

### **Improvement is Needed in ITC's Internal Controls over Financial Reporting, Analyses and Oversight**

Although ITC prepared the September 30, 2009 financial statements, these statements could not be supported due to accounting issues identified during our work. A major contributing factor to the weaknesses noted is due to ITC not having formal documented financial management policies and procedures. Policies and procedures are controls that help program and financial managers achieve results and safeguard the integrity of their programs. We noted a number of the issues, discussed below, surrounding internal control that are material and significant to ITC's financial statements.

The Accountability of Tax Dollars Act of 2002 (ATDA) extends to ITC the requirement to submit to the Congress and the Director of the OMB audited financial statements. OMB Circular A-136, *Financial Reporting Requirements*, defines the form and content of financial statements to be prepared by the agency. To accomplish the objective of complying with the ATDA, the agency is required to develop a system to prepare a complete set of financial statements on a timely basis in accordance with U.S. generally accepted accounting principles. The statements are to result from an accounting system that is an integral part of an integrated financial management system containing sufficient structure, effective internal control and reliable data. Financial reporting also consists of policies and procedures related to the processing and summarizing of accounting entries, and the preparation of financial statements.

During testing of ITC's financial statements preparation, we noted that improvement is needed to ensure that ITC can accurately produce its period end financial statements and perform related analyses. The errors we noted related to incorrect accumulation of account balances, incorrect identification of general ledger accounts, and incorrect postings to the financial reporting system. As a result, management provided several versions of the September 30, 2009 trial balance, with the latest version provided on November 2, 2009. These errors occurred because of ineffective management reviews and approvals to ensure the transactions and adjustments were accurate and properly supported.

Additional challenges were encountered due to ITC's converting its core financial system at the beginning of FY 2009. As a result of the conversion, ITC management and staff were unable to:

- Generate financial data in a timely and consistent manner for review and analysis;
- Allocate sufficient time to perform a review of its financial data to ensure the data was complete and accurate throughout the fiscal year; and
- Obtain additional training in using the new system. Accordingly, additional time was needed by the current staff to process financial transactions and management reports. Furthermore, due to being unfamiliar with the system and its limitations, management was unable to generate financial data in a consistent manner from the prior year.

Given the complexities surrounding the system conversion, and ITC's limited resources allocated to financial management, ITC's FY 2009 financial operations were adversely impacted. Some data issues, account reconciliations, periodic analysis, and financial statement closing processes provided challenges in the timely development of auditable financial statements. A major objective of internal control is to ensure the integrity of the underlying accounting data supporting the financial statements. A key control is performing reconciliations of significant account balances. An adequate reconciliation provides assurances that transactions are properly processed and recorded in the accounting records in a timely manner. Management indicated that reconciliations of material financial statement line items were not performed on a routine basis.

During our review of ITC's financial statement preparation process, we identified certain issues, as summarized below, impacting ITC's ability to effectively accumulate, assemble, and analyze information to timely develop and support its financial statements on a routine and recurring basis.

- ITC did not close its fiscal year 2009 general ledger until October 30, 2009. Consequently, ITC could not generate its annual financial statements and the Performance and Accountability Report (PAR) in a timely manner. A first draft of the financial statements, which were incomplete, was provided by ITC management on November 2, 2009. In addition, as a result of not closing the general ledger in a timely manner, transactions that occurred in FY 2010 were applied to the system that impacted the FY 2009 balances. Specifically, the balances for accounts payable and expenditures were increased for each invoice processed after year end.
- OMB Circular A-136 requires agencies to submit unaudited interim financial statements within 21 days after the end of each of the first three quarters of the fiscal year to OMB. In addition, agencies are required to submit an analysis of significant variances along with the quarterly financial statements. We noted that ITC did not perform a quarterly fluctuation analysis of its financial information throughout the entire fiscal year. ITC management indicated that they were aware of the requirement that the analysis was to be submitted to OMB at the end of each quarter, but due to the conversion to the new accounting system did not have the resources to perform the analysis.

Furthermore, our review of ITC's quarterly financial statements identified inconsistencies, which required further explanation. For example, the supporting trial balance provided as of June 30, 2009 and as of September 30, 2009 did not include opening balances for several budgetary accounts. Management was unaware that the trial balance did not include beginning balances for key budgetary accounts until identified as a result of our work. Management indicated the exclusion of the accounts seems to be a system conversion issue. Accordingly, we were unable to perform a crosswalk of the June 30, 2009 quarterly financial statements. Finally, management did not correct the FY 2009 trial balance until late October 2009.

We also noted expenditures appeared higher than expected. Further review and analysis determined that ITC management improperly included the development costs of a system in expenses rather than capitalizing the costs, as required by Statement of Federal Financial Accounting Standard (SFFAS) No. 6, *Accounting for Property, Plant and Equipment*. In addition to the fiscal year 2009 financial statements being incorrect, ITC's FY 2008 balances were also incorrect, causing ITC to restate its prior year financial statements by approximately \$1.7 million.

Another issue noted, specific to the June 30, 2009 unaudited financial statements, was that accounts payable reflected an abnormal debit balance. Management was not aware of the negative balance in accounts payable, as they had not performed an analysis of its financial statements. After management researched the balance, it was determined that the amount reflected in the June 30, 2009 unaudited financial statements was incorrect.

- ITC did not perform a risk assessment in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. As a result, ITC did not identify any material weaknesses or significant deficiencies in the results of its internal control review. However, the results of our efforts identified three material weaknesses. OMB Bulletin 07-04, as amended, requires a comparison of the material weaknesses disclosed during the audit with those material weaknesses reported under the agency's FMFIA report that relate to the financial statements of the entity under audit and document material weaknesses disclosed by the audit that were not reported in ITC's FMFIA report.

OMB Circular A-123 states "Management has a fundamental responsibility to develop and maintain effective internal control. Federal employees must ensure that Federal programs operate and Federal resources are used efficiently and effectively to achieve desired objectives. Programs must operate and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement."

- As of the date of this report, ITC had not prepared a comprehensive version of its PAR. Therefore, we were unable to perform a complete review of the document to assess compliance with OMB Circular A-136. However, for the draft sections of the PAR that were provided, we noted that ITC did not adhere to the reporting requirements of OMB Circular A-136. For example, the PAR does not include a summary of financial statement audit and management assurances. In addition, management did not perform a thorough

review of the PAR. We noted there was no discussion on its most relevant performance measures in the Management's Discussion & Analysis (MD&A). Section 2.6 of OMB Circular A-136 states "Within the MD&A, the agency is required to include, at a minimum, a high-level discussion of performance information. The MD&A should include highlights of the reporting entity's key performance goals and results (shortfalls and successes) for the applicable year." Finally, we noted several typographical errors and incorrect references throughout the PAR.

- ITC does not have adequate resources to perform its day-to-day financial management accounting and financial reporting in a consistent and timely manner. For example, the Chief Financial Officer position is currently being performed by the Chief Information Officer, requiring the individual to split his focus. Furthermore, the Director, Office of Finance, performs the majority of the accounting and reporting responsibilities, which prevents an adequate review and approval process of the financial reporting process. The lack of resources was aggravated by the conversion of the financial system. Finally, ITC did not have the resources with the expertise on how the new system operated. Accordingly, an understanding of the system's key processes did not exist, which impeded ITC's ability to process accounting transactions accurately and generate financial data and reports in a consistent or timely manner. These deficiencies are key factors in many of the weaknesses in financial management as described further in this report.

In an effort to assist in compiling the FY 2009 financial statements, management brought in a consultant toward the end of October. That effort provided ITC the ability to generate the financial statements; however, due to the lateness of contracting with the consultant, ITC was unable to provide a complete PAR in time to perform sufficient audit testing.

Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner. Based on the issues noted above, ITC management needs to strengthen its internal control surrounding financial management.

### **Recommendations**

We recommend that ITC management perform the following:

1. Ensure that the general ledger is closed in a timely manner. Furthermore, management should not allow transactions that occur in the subsequent fiscal year to be processed until the general ledger from the preceding fiscal year is closed. This is to maintain the integrity of the balances as of September 30th.
2. Review and analyze the quarterly financial statements to identify and document any significant variances in a timely manner, as required by OMB Circular A-136.
3. A review of its internal control consistent with the requirements of OMB Circular A-123 to ensure the objectives of the FMFIA are achieved and documented.

4. Establish formal policies and procedures to ensure ITC is able to comply with applicable accounting, financial management and reporting standards and regulations. These policies and procedures should incorporate adequate segregation of duties, as well as a sufficient level of review and approval process.
5. Review its current organizational structure to ensure adequate resources are allocated to the ITC financial management. In addition, provide training to the financial staff on federal accounting and reporting requirements, as well as the accounting servicer's financial system.

### **Management Response**

Management concurs with the finding and recommendations. ITC management is committed to improving its internal control and accordingly, will develop a corrective action plan to address the issues identified.

### **Improvement is Needed in ITC's Identification, Recording and Reporting of Property, Plant and Equipment**

SFFAS No. 6 defines general Property, Plant & Equipment (PP&E) as "items that could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but are used by the Federal entity to produce goods or services, or to support the mission of the entity." Also, SFFAS No. 6 requires general PP&E to be reported in the basic financial statements: the balance sheet and the statement of net cost. The acquisition cost of general PP&E shall be recognized as an asset and subsequently charged to expense through depreciation.

During our testing, management was unable to provide the subsidiary property listing in a timely manner. In addition, we noted several issues surrounding the accounting for PP&E. For example:

- A new information system, which had been in the development phase for several years, was placed into service mid-FY 2009. Approximately \$2.8 million of the costs associated with the system had been expensed rather than capitalized. Accordingly, the balance sheet was understated and the statement of net cost was overstated for the applicable fiscal years. In addition, approximately \$2.0 million associated with the obsolete system that was replaced was not removed from the accounting records. Therefore, the balance sheet was overstated and the statement of net cost was understated.
- Reconciliations were not being performed, reviewed or approved on a consistent basis or by someone independent of performing the detail work.
- ITC does not have formal policy or procedures in place surrounding the accounting for PP&E. In addition, ITC has not established a threshold to capitalize bulk purchases or leasehold improvements. In addition, ITC was unable to provide supporting

documentation for the rationale on its current capitalization policy. Finally, we noted that PP&E was not being depreciated on a consistent basis.

The Office of Facilities Management (OFM) is responsible for monitoring and tracking all PP&E. Additionally, when PP&E is placed into service, disposed of, or no longer in service, OFM is responsible for notifying the Office of Finance of the transaction to ensure that ITC's accounting records are updated accordingly. Based on the weaknesses noted above, it appears that the communication was not effectively being performed.

OMB Circular A-123, *Management's Responsibility for Internal Control*, states that management has a fundamental responsibility to develop and maintain effective internal control. Programs must operate and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement. Internal control should be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use or disposition of assets.

### **Recommendations**

We recommend that ITC's management perform the following:

6. Implement a formal procedure requiring the OFM to report to the Office of Finance, at least quarterly, to ensure that PP&E is properly stated in the accounting records, and the quarterly financial statements due to OMB, as outlined in OMB Circular A-136.
7. Prepare a reconciliation between the fixed asset report and the accounting records, on a quarterly basis. Both the Director of the Office of Finance and the Director of OFM should review and approve the reconciliation. Management should also ensure differences noted during the reconciliation process are promptly resolved.
8. Establish and document formal policies and procedures to ensure PP&E is being capitalized, depreciated, monitored, and reported in accordance with applicable accounting standards and OMB regulations.

### **Management Response**

Management concurs with the finding and recommendations. ITC management is committed to improving its internal control and accordingly, will develop a corrective action plan to address the issues identified.

### **Improvement is Needed in ITC's Recording and Reporting of Accounts Payable, Expenditures, and Obligations**

During our work, management was unable to provide subsidiary ledgers in a timely manner. In addition, we noted several issues surrounding the accounting for accounts payable, expenditures, and obligations as summarized below:

- ITC does not have any formal policy or procedures specific to its accrual methodology for accounts payable. Management provided a spreadsheet to support its accrual calculation. Based on our review and understanding of the calculation, we noted that the calculation included an error of approximately \$1.9 million. Accordingly, the FY 2009 accrual was understated by approximately \$500K. Furthermore, management was unable to provide supporting documentation behind its accrual methodology as the methodology used to calculate the accounts payable accrual was not supported or documented. Therefore, we were unable to obtain adequate documentation that expenditures were being captured and recorded in the proper period.
- ITC does not perform a sufficient review and analysis of its expenditures to determine if payments are properly supported, classified, or reported in the proper period. During our work, we noted many expenditures recorded in FY 2009 were related to the prior years. For example, one invoice that we reviewed related to expenditures that covered a period of performance from December 2005 through September 2008. An invoice in the amount of approximately \$315K was not received until October 2008; therefore, ITC did not record the expense in its accounting records until the invoice was received in FY 2009. However, ITC also included this expense of approximately \$315K in its FY 2009 accrual calculation. As a result, the fiscal year 2009 accounts payable and expenditures were overstated, while FY 2008 accounts payable and expenditures were understated.

Additionally, we noted an invoice for two subscriptions totaling approximately \$185K. During our review, we noted that the amount pertained to services from July 2009 through May 2010. ITC expensed the full amount of the invoice in FY 2009 rather than capture the amount as an “advance or prepayment.” Furthermore, the invoice did not agree to the terms of the purchase order. However, the COTR approved the invoice and Finance processed and paid the invoice without noting any exceptions.

- A routine review of obligations was not performed on a regular basis to ensure that obligations incurred were valid as of September 30, 2009. Specifically, management was unable to provide a report identifying open obligations as of September 30, 2009. Management indicated they were unable to generate the report for the last couple of months of the fiscal year due to a system issue. Management had notified its accounting service provider of the issue; however, it was not resolved until early November 2009. Specifically, on November 3, 2009, management was notified by its accounting service provider that the open obligations report provided to ITC incorrectly included 51 cancelled purchase orders with a total abnormal balance of approximately \$108K.

By not performing a review on a routine basis, obligations incurred may be over or understated. For example, in addition to the errors noted by the ITC’s accounting service provider, we noted during testing of rent expenditures that ITC recorded an obligation for rent of approximately \$8.8 million. However, total rent expenditures equaled only \$8.4 million. Therefore, obligations incurred should have been reduced by approximately \$400K; thereby ensuring that obligations incurred were properly stated as of September 30, 2009.

- We noted that ITC's contract files did not always contain adequate documentation. We also noted instances where the invoiced amount exceeded the contract value or billing rates charged to ITC were inconsistent or greater than the contractor's GSA Schedule rates. Based on the documentation provided, ITC appeared to modify several existing contracts without sufficiently documenting the need for the increases.
- ITC prepared a significant number of manual journal vouchers in fiscal year 2009. Although manual journal vouchers in of themselves are not considered an issue, they do increase the risk for errors. During our work, we noted that many of the manual journal vouchers did not have any evidence supporting a review and approval was performed. As a consequence of not performing an adequate review or approval, we noted that ITC incorrectly posted the increase of approximate \$270K in accrued annual leave as a debit to the liability and a credit to the expense, when in fact the journal entry should have been recorded as a credit to the liability and a debit to the expense. Management corrected the error once it was brought to their attention as a result of our testing.

### **Recommendations**

We recommend that ITC management perform the following:

9. Formalize and periodically update policies and procedures to provide guidance to management and staff in performing their responsibilities specific to financial management. These procedures should incorporate, at a minimum, day-to-day accounting procedures and financial reporting requirements to ensure the timeliness and accuracy of financial operations.
10. Conduct a more detailed and routine review of its expenditures to ensure transactions are properly supported, classified, or reported in the proper period.
11. Enhance controls over the monitoring of obligation balances to ensure the amounts remaining are needed and legally valid. Specifically, a report of open obligations should be generated on a regular basis, at least quarterly, for management to review and certify obligations are complete and accurate.
12. Provide additional training to ITC staff specific to ITC's procurement policies and procedures, as well as the Federal Acquisition Regulation to enhance compliance with the applicable requirements.
13. Implement procedures surrounding manual journal vouchers to ensure transactions are properly reviewed and approved. Formalizing accounting policies and procedures should help to reduce the number of manual journal vouchers.

## **Management Response**

Management concurs with the finding and recommendations. ITC management is committed to improving its internal control and accordingly, will develop a corrective action plan to address the issues identified.

In addition to the material weaknesses described above, we noted certain other matters involving internal control and its operations that we will report to ITC management in a separate letter.

This report is intended solely for the information and use of the management and the Office of Inspector General of ITC, OMB, Government Accountability Office and Congress and is not intended to be and should not be used by anyone other than these specified parties.

*Castro & Company, LLC*

November 6, 2009  
Alexandria, VA