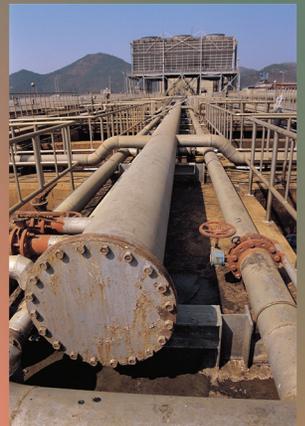


U.S. International Trade Commission

Report on Internal Control for 2012



OIG-AR-13-04

November 9, 2012



Office of Inspector General

The U.S. International Trade Commission is an independent, nonpartisan, quasi-judicial federal agency that provides trade expertise to both the legislative and executive branches of government, determines the impact of imports on U.S. industries, and directs actions against certain unfair trade practices, such as patent, trademark, and copyright infringement. USITC analysts and economists investigate and publish reports on U.S. industries and the global trends that affect them. The agency also maintains and publishes the Harmonized Tariff Schedule of the United States.

Commissioners

Irving A. Williamson, Chairman

Daniel R. Pearson

Shara L. Aranoff

Dean A. Pinkert

David S. Johanson

Meredith M. Broadbent



UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, DC 20436

November 9, 2012

OIG-KK-020

Chairman Williamson:

This memorandum transmits the Independent Auditor's Report on Internal Control (OIG-AR-13-04) associated with the audit of the Commission's financial statements for fiscal year 2012. Your comments on the draft have been included in their entirety as an appendix to the report.

We contracted with the independent certified public accounting firm, Castro & Company LLC, to conduct the financial statement audit. The contract required that the audit be conducted in accordance with U.S. generally accepted government auditing standards and these auditing standards require a report on Internal Control to be produced as part of the audit.

This report contains three new recommendations for corrective action. In the next 30 days, please provide me with your management decisions describing the specific actions that you will take to implement each recommendation.

Throughout the audit and at its conclusion, my office followed procedures and conducted a final review that included monitoring the performance of the audit, reviewing Castro & Company's report and related documentation, and making inquiries of its representatives. Our final review disclosed no instances where Castro & Company did not comply, in all material respects, with the U.S. generally accepted government auditing standards; however, this final review cannot be construed as an audit, and is not intended to enable us to express, and we do not express, any opinion on the Commission's internal control. Castro and Company is solely responsible for this report dated November 8, 2012, and the conclusions expressed in the report.

Thank you for the courtesies extended to the auditors and my staff during this audit.

Sincerely,

Philip M. Heneghan
Inspector General

Independent Auditor's Report on Internal Control

Inspector General
U.S. International Trade Commission

We have audited the financial statements of the U.S. International Trade Commission (ITC) as of and for the year ended September 30, 2012, and have issued our report thereon dated November 8, 2012.

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, 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 Statements*, 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 paragraph 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 is a deficiency in internal control, or a combination of 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.

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

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 consider the first deficiency described below to be a material weakness.

We also noted less significant matters involving internal control and its operations which we have reported to ITC management in a separate letter dated November 8, 2012.

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 8, 2012
Alexandria, VA

MATERIAL WEAKNESS

I. Inadequate Controls over Undelivered Orders (i.e., Open Obligations) Accounts Payable, and Expenditures (Repeat Condition, Modified)

Even though improvements were made over the prior fiscal year (FY), sufficient documentation was not provided to support the validity of certain Undelivered Orders (UDO) balances (i.e. obligating documents, invoices), including accruals not being properly recorded. As a result of material misstatements, we were unable to rely on our interim testing as of June 30, 2012 for the UDO, accounts payable (AP), and expenditures balances because of a significant number of testing exceptions, which required us to perform expanded testing related to all UDO's as of September 30, 2012. However, we were able to determine that the FY 2012 financial statements are fairly presented because ITC performed a significant data clean-up right before year-end, but the controls were not in place for the majority of the fiscal year.

During our testing, we noted multiple issues surrounding the accounting for UDO, AP, and expenditures as summarized below.

- ITC's obligated balance recorded in the general ledger (GL) was not adequately supported: certain documentation was not provided; documentation on file did not agree with amounts recognized in the GL (invoice amounts differed from invoice amounts recognized in the GL, obligation amounts differed from obligations recognized in the GL); and modifications on file were not posted to the GL. For example:
 - ITC recorded a modification in the GL without a valid obligating document. Management discovered this error during the year-end open obligations review, but made the decision not to correct as of September 30, 2012 in order to avoid increasing its surplus at the end of FY 2012. Creating obligations without authorized obligating documentation is a control deficiency that could lead to an Anti-Deficiency Act violation.
- Accruals were not properly recorded throughout the fiscal year. Because ITC does not record accruals at the transaction level, in order to determine the amount to record as AP through Journal Vouchers (JVs), ITC performed a quarterly review of open obligations throughout the fiscal year. The review consisted of sending the open obligations report to each Contracting Officer's Representative (COR) in order for the COR to review and state whether the obligations were valid. If the obligation was valid, the COR should have provided an amount to accrue for AP. However, during our UDO testing, we noted that ITC did not always have a detailed logical methodology to accrue expenses for goods/services that were received but not paid. For example:
 - Accruals were not recorded as of June 30, 2012 for obligations related to the leasehold improvement for the build-out of the second floor at the ITC headquarters building, even though construction was substantially completed as of June 30, 2012.

As a result, the AP and Construction-In-Progress (CIP) balances were materially understated, and the UDO balance was materially overstated on the third quarter financial statements submitted to OMB.

- Certain accruals were not supported by proper documentation such as an estimate of services received based on past services received, and paid. Some CORs did not include the methodology used for the accruals; even though this information was required. In addition, some CORs provided accruals estimates with no clear documented explanation on the methodology used to record the accruals. There was no documentation to clearly support finance's review and approval to ensure explanations used by COR's for accrual methodologies used and other needed information were included as required, or that methodologies used for accruals were clearly explained, reasonable and supported by adequate documentation,
- Certain accruals recorded by finance were incorrect, as methodologies used by the COR contained accruals for services for which invoices were received subsequent to the accrual calculation and recognized in the GL, but for which the accrual was not adjusted causing overstatements of AP and understatements of the UDO. Review of subsequent invoices received and approved by the COR, and booked by finance was inadequate as the over accrual was not caught and corrected.
- For certain obligations, the COR did not submit an amount to be accrued because invoices had not been received; however, services had been received by ITC and therefore an accrual should have been recorded. There was no documentation to clearly support finance's detailed review of the accrual process to ensure accruals were properly recognized when goods and services were received.

In the prior fiscal year, we recommended to ITC management to reconcile all open obligation folders to the general ledger. We reviewed ITC Management's Decision regarding this recommendation, and even though ITC management made significant improvements to the procurement folders, the balances in the procurement folders were not properly reconciled to the general ledger, evidenced by certain GL posting errors reported in the prior year's audit that were not corrected during FY 2012.

Additionally, in the prior fiscal year, we recommended to ITC management to establish and implement quality control procedures for the open obligation reviews. We reviewed ITC Management's Decision regarding this recommendation, and determined that ITC did not adequately document management's quality control procedures for open obligation reviews and there continued to be errors in the accruals proposed by the COR's. Controls were not adequate to ensure the amount recorded as an AP through the accrual JV was reasonable. There was no documentation to clearly support finance's review and approval of the accrual spreadsheet to ensure COR's properly recognized accruals when goods and services were received, methodologies used for accruals were clearly explained, reasonable and supported by adequate documentation, explanations for methodologies used and other needed information were included as required.

Finally, in the prior fiscal year, we recommended to ITC management to post financial transactions, including adjustments at the detailed general ledger transaction level, including accruals, deobligations and refunds. We reviewed ITC Management's Decision regarding this

recommendation, and determined that the manual posting of accruals continued to cause significant testing errors. By not recording accruals at the GL transaction level, some of the manual accruals booked by ITC using the open obligation review contained accruals for services for which invoices were received subsequent to the accrual calculation and recognized in the GL, but for which the accrual was not adjusted causing overstatements of AP and understatements of the obligations.

Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government* states:

Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained.

The Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities* states:

Accounts payable are amounts owed by a Federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities...When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated.

By not performing an accurate review of UDOs, ITC's obligations, AP and net position were materially misstated as of June 30, 2012. In addition, as noted above, ITC did not properly record accruals throughout the majority of the fiscal year when goods and services were received, or accruals were incorrectly calculated.

Recommendations:

We made eight recommendations in the prior fiscal year related to this issue. Six of those recommendations were not implemented as of September 30, 2012; therefore, additional recommendations will not be issued related to this Material Weakness.

SIGNIFICANT DEFICIENCY

II. Inadequate Internal Controls over Financial Reporting (Repeat Condition, Modified)

During FY 2012, ITC filled certain key positions, including hiring a Chief Financial Officer (CFO) and a systems accountant, and created a CFO Office. During testing of ITC's financial reporting, we noted that improvements were made over the prior year in producing its quarterly financial statements and related reconciliations. However, during our review of ITC's financial statement and reconciliation preparation process, we identified certain issues, as summarized below, impacting ITC's ability to effectively accumulate, assemble, and analyze information presented in its financial statements in accordance with applicable guidance. Specifically, we noted the following:

- ITC did not prepare the Statement of Budgetary Resources (SBR) in compliance with the updated required format in the revised OMB Circular No. A-136, *Financial Reporting Requirements*, in the original year-end draft financial statements. ITC made the necessary correction to the final issued financial statements.
- A significant number of transactions were processed through the use of manual JVs throughout the fiscal year, instead of posting the adjustments at the detailed transaction level in the general ledger. ITC posted a total of 76 JVs during FY 2012. Although manual journal vouchers in and of themselves are not considered an issue, they do increase the risk for errors. For example, ITC prepared a JV with documentation to accrue for training and travel incurred as of September 30, 2012. However, the amount related to training was erroneously omitted from the JV total posted.
- ITC did not report an updated amount for the unfunded and actuarial Federal Employees Compensation Act (FECA) liability for FY 2012 on the original year-end draft financial statements. ITC erroneously reported the same amount from the prior fiscal year. ITC made the necessary correction to the final issued financial statements.
- Reconciliations between the subsidiary listings and the general ledger on key financial accounts were not well documented, and did not always contain the signatures evidencing the review and approval for the reconciliation throughout the majority of the fiscal year.

These errors occurred because of ineffective management reviews and approvals. The fact that the significant deficiency related to the financial reporting was not adequately corrected, but ITC management considered its Management Decision complete relating to the prior year's internal control report recommendation, continues to highlight that ITC still needs to strengthen its controls and ensure management personnel with the appropriate skill sets and expertise are responsible for the financial management accounting and reporting functions.

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 contains evidence of management's review and

approval which provides assurance that transactions have been properly processed and recorded in the accounting records. Another key control is performing detailed management review and approval of transactions recorded in the financial system, and of financial reports.

GAO's *Standards for Internal Control in the Federal Government* states:

Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties. Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination.

Control activities are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results...They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of the activities as well as appropriate documentation.

Management sets the objectives, puts the control mechanisms and activities in place, and monitors and evaluates the control. However, all personnel in the organization play important roles in making it happen. All personnel need to possess and maintain a level of competence that allows them to accomplish their assigned duties, as well as understand the importance of developing and implementing good internal control. Management needs to identify appropriate knowledge and skills needed for various jobs and provide needed training, as well as candid and constructive counseling, and performance appraisals.

In the prior fiscal year, we recommended to ITC to document quality control procedures performed related to the review and approval of financial statements and related account reconciliations. We reviewed ITC Management's Decision regarding this recommendation, and even though ITC management created policies, the policies were not consistent and not always followed.

Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the ITC's ability to meet its objectives, would be prevented or detected in a timely manner. However, based on the issues noted above, ITC management needs to strengthen its internal control surrounding financial management to ensure compliance with applicable laws and regulations throughout the year.

By not adequately performing management functions specific to monitoring, analysis, oversight, and reconciliations, discrepancies may exist but go undetected and uncorrected; thereby causing the financial information to be misstated. Effective management oversight greatly increases ITC's ability to proactively identify and resolve issues that could result in misstatements in financial accounting and reporting records.

Recommendations

We recommend that ITC management:

1. Perform a detailed review of all manual JVs to determine which JVs should be eliminated by posting at the detailed general ledger transaction level.
2. Revise its procedures to require management's review and approval of quarterly financial statements are clearly documented.
3. Revise its procedures to require management's review and approval of all account reconciliations are clearly documented.



UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, DC 20436

November 8, 2012

Thomas Castro, Partner
Castro & Company, LLC
2121 Eisenhower Avenue, Suite 606
Alexandria, VA 22314

The Audit Report on Internal Control identified one material weakness and a significant deficiency. I concur with your assessment that in the financial management area the Commission has inadequate controls over undelivered orders, accounts payable, and expenditures. I also concur that we have to enhance our controls over financial reporting.

The Commission has made significant progress in addressing financial management deficiencies and challenges over the past two years. We have eliminated the material weaknesses reported in fiscal year 2011 that related to the procurement process and insufficient resources and personnel with appropriate skill sets. For example, the newly formed Office of the Chief Financial Officer is now staffed with highly skilled personnel in Procurement, Finance, and Budget. In addition, our comprehensive strategy, being implemented under our new Chief Financial Officer, has resulted in significant progress in addressing control weaknesses in undelivered orders and financial reporting.

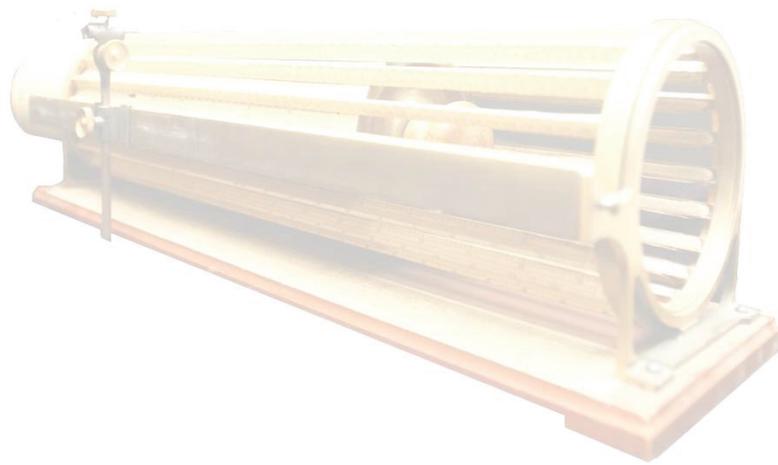
We recognize that we have much more to do to change the financial management culture within the Commission and will continue to aggressively address each of your recommendations.

Sincerely,

A handwritten signature in cursive script that reads "Irving A. Williamson".

Irving A. Williamson

cc: Philip M. Heneghan
Inspector General



“Thacher’s Calculating Instrument” developed by Edwin Thacher in the late 1870s. It is a cylindrical, rotating slide rule able to quickly perform complex mathematical calculations involving roots and powers quickly. The instrument was used by architects, engineers, and actuaries as a measuring device.

To Promote and Preserve the Efficiency, Effectiveness, and Integrity of the U.S. International Trade Commission



U.S. International Trade Commission
Office of Inspector General
500 E Street, SW
Washington, DC 20436

Office: 202-205-6542
Fax: 202-205-1859
Hotline: 202-205-6542
OIGHotline@USITC.gov