U.S. International Trade Commission

Management Letter Fiscal Year 2015 Financial Statement

OIG-ML-16-08

December 17, 2015

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.

OFFICE OF INSPECTOR GENERAL

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, DC 20436

December 17, 2015 IG-NN-037

Chairman Broadbent:

This memorandum transmits the Management Letter Report (OIG-ML-16-08) from the audit of the Commission's financial statements for fiscal year 2015. We contracted with the independent certified public accounting firm, Davis and Associates, to conduct the audit. The management letter discusses matters involving internal control that the auditors identified during the audit but were not required to be included in the audit reports. In finalizing this report, we analyzed management's comments to the draft report and have included those comments in their entirety as Appendix A.

The Management Letter Report contains three recommendations for corrective action. In the next 30 days please provide me with your management decisions describing the specific actions you will take to implement the recommendations.

Thank you for the courtesies extended to Davis and Associates during this audit.

Sincerely,

Philip M. Heneghan
Inspector General

Management Letter

To the Inspector General
US International Trade Commission

We have audited the Consolidated Balance Sheet of the US International Trade Commission (USITC) as of September 30, 2015, and have issued our report thereon dated November 5, 2015. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*. Professional standards require that we provide you with the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for selection and use of appropriate accounting policies. The significant accounting policies used by USITC are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended September 30, 2015. We noted no transactions entered into by USITC during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the depreciation allowance.

We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We did not note any adjustments that, in our judgment, have a significant effect on USITC's financial reporting process.

Management Representations

We have requested certain representations from management that are included in their management representation letter to us.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of any accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Finding Number: **1**

Audit Area: **Property, Plant and Equipment – Internal Use Software**

<u>Criteria</u>

The Federal Accounting Standards Advisory Board's **Statement of Federal Financial Accounting Standards Number 10** states:

> "*Capitalizable Cost*
>
> *16. For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage.*
>
> *17. Such costs include those for new software (e.g., salaries of programmers, systems analysts, project managers, and administrative personnel; associated employee benefits; outside consultants' fees; rent; and supplies) and documentation manuals."*

<u>Condition</u>

When recording the capital costs associated with the internal-use software, USITC did not include Administrative personnel costs occurring in 2014 totaling $5,829.72.

<u>Cause</u>

The costs were accounted for incorrectly due to inconsistent practices by the Office of the Chief Financial Officer for recording capital costs.

<u>Impact</u>

Failing to include all Administrative labor costs associated with the development of internal-use software results in an understatement in Property, Plant and Equipment, as well as an overstatement of expenses. In this case, Property, Plant and Equipment is understated by $5,829.72, which is an immaterial amount.

Recommendation 1:

We recommend that USITC make an adjustment to include the $5,829.72 in personnel costs in the cost of the asset.

Recommendation 2: We recommend that the Office of the Chief Financial Officer develop a standardized process for recording capital costs.

Risk Level

Moderate

Finding Number: **2**

Audit Area: **Accounting for Internal-Use Software – Deficiency in Internal Controls**

Criteria

USITC Financial Management Manual –Section 1020-05 – Accrual Accounting states:

> *a. Method. Generally accepted accounting methods will be used in developing accruals. Accruals will be recorded against the appropriate contract as of the end of each quarter. Simplified methods for quarterly accruals such as estimates based on previous experience may be used when demonstrated to be reasonably reliable, otherwise a calculated method must be used.*
>
> *b. Documentation. Documents reflecting computations and support for accruals and analyses of the accuracy of the accruals shall be retained by the Office of Finance and the COR for reference and audit.*
>
> *c. Timing. All accruals will be calculated at the end of each quarter and again at year end.*

Condition

USITC did not properly account for its internal use software, developed by their Information Technology Software Development and Maintenance contractor, Computech, under Contract GS-3F-0108K. The total cost of the software, $843,118, was placed into service in July 2015. When confirming the cost associated with the asset, we discovered that rather than capitalizing the costs as they occur and are billed by Computech, all costs are expensed when initially billed. Accounting then re-classified the expense into a capital asset account in one lump sum. This occurred once in Fiscal Year 2014 and once in Fiscal Year 2015. No re-classifications were made on a quarterly basis to capture the amount of costs to be capitalized.

Additionally, the determination of the amount of project costs that are to be capitalized was based upon an estimate, rather than actual cost. The COR made an estimate that 20% of the work being performed in the developmental stage of Fiscal Year 2014 was for the Preliminary Design phase, which is not capitalizable, leaving the remaining 80% to be capitalized.

Cause

Internal-use software development costs were not capitalized quarterly because the agency did not consistently track the costs of the project as they occurred, resulting in an annual process to re-class the capital expenditures from the operating expense account.

An estimate, rather than actual cost, was used to calculate the amount capitalizable for the project because

USITC did not set up a separate account to capture the costs associated with the preliminary design phase, which are to be expensed, from the costs associated with the software development phase, which are to be capitalized. As a result, when trying to determine which costs to capitalize, the agency was unable to break out the two categories of design/development costs, resulting in the use of an estimate.

Impact

Failing to capitalize costs associated with a capital project as they occur results in misstatements in quarterly financial reports. This practice also heightens the risk that the costs associated with the asset will be understated if costs are left out of the lump sum capitalization calculation.

Using an estimate, rather than actual cost, to track capital costs, results in an inaccurate representation of the cost. We believe the inaccuracy to be immaterial in this instance.

Recommendation 3:

We recommend that USITC amend its practices to ensure that all capital projects are properly recorded in the relevant asset account by the end of each quarter.

Risk

Moderate

Davis & Associates

Alexandria, Virginia
November 5, 2015

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, DC 20436

C084-NN-008

December 15, 2015

MEMORANDUM

TO: Philip M. Heneghan, Inspector General

FROM: Meredith M. Broadbent, Chairman Meredith M. Broadbent

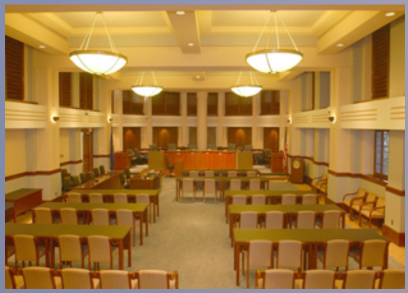
SUBJECT: Response to Draft Management Letter Report – FY 2015 Financial Statements

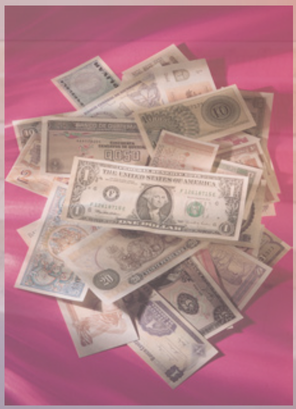
We have reviewed your transmittal of the management letter prepared by Davis and Associates, LLP related to the FY 2015 financial statement audit. I appreciate the opportunity to review the report and provide comments.

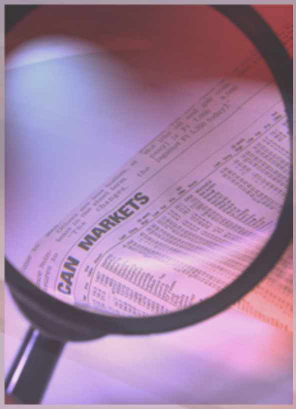
The report identified two areas for improvement associated with the calculation and recording of capitalized costs for internal use software. We agree with these findings and will develop management decisions to address the recommendations in the report.

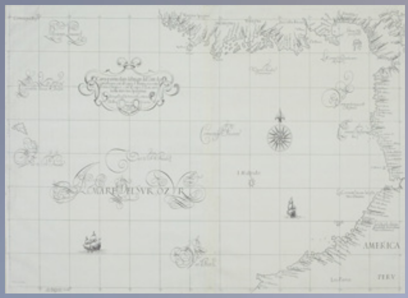
"Thacher's Calculating Instrument" developed by Edwin Thacher in the late 1870s. It is a cylindrical, rotating slide rule able to quickly perform complex mathematical calculations involving roots and powers quickly. The instrument was used by architects, engineers, and actuaries as a measuring device.

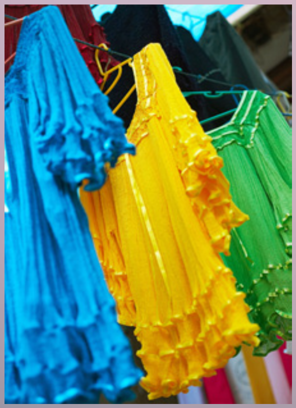
To Promote and Preserve
the Efficiency, Effectiveness, and Integrity of the
U.S. International Trade Commission











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