U.S. International Trade Commission

Report on Internal Control for 2011

OIG-AR-12-03

November 10, 2011

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.

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, DC 20436

November 10, 2011 OIG-JJ-024

Commissioners:

This memorandum transmits the Independent Auditor's Report on Internal Controls (OIG-AR-12-03) associated with the audit of the Commission's financial statements for fiscal year 2011.

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 12 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, 2011, and the conclusions expressed in the report.

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

Sincerely,

Philip M. Heneghan
Inspector General

Castro & Company
Accountants • Consultants

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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, 2011, and have issued our report thereon dated November 8, 2011.

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 three deficiencies described below to be material weaknesses.

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, 2011.

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, 2011
Alexandria, VA

MATERIAL WEAKNESSES

I. Insufficient Resources and Personnel with Appropriate Skill Sets (Repeat Condition)

ITC management reported to the Office of Inspector General that ITC implemented all of the "Management Decisions" related to the recommendations from last year's Independent Auditor's Report on Internal Control. However, significant internal control weaknesses still exist and are identified in this report. The fact that a significant number of the findings were not corrected, but ITC management considered all Management Decisions complete relating to the prior year's internal control report recommendations, continues to highlight that ITC does not have adequate resources and personnel with appropriate skill sets and expertise to perform financial management accounting and reporting functions. However, we were able to determine that the fiscal year 2011 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.

Furthermore, ITC has not developed a program to cross train finance personnel in performing day-to-day financial management accounting and financial reporting tasks. Specifically, ITC did not have a systems accountant on staff with expertise in the accounting system. 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 complete, timely, and accurate manner.

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

> 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.

Without the adequate staffing levels and the proper skill sets, ITC will continue to encounter challenges in its accounting and financial reporting processes. 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 made recommendations in the prior year related to this issue that ITC management has undertaken certain actions to implement. Specifically, the ITC's *Supplement to the Strategic Human Capital Plan: Reorganization of Agency-wide Administrative Functions, 2009-2013*, discusses that ITC will establish a new Office of the Chief Financial Officer (OCFO) with a Chief Financial Officer (CFO) who reports directly to the Commission. The CFO will be a Senior Executive Service (SES) level position, with the requisite skills and Federal expertise to address the ITC's financial management and reporting challenges. The CFO will oversee the budget, procurement, accounting, financial management, financial reporting internal controls, risk management, and asset evaluation. In addition, the CFO will be responsible for the development of efficient financial and administrative reporting and data information systems. To enhance the CFO's likelihood of meeting the challenges of standing up a newly created division, all hiring decisions for the newly created positions (Director of Budget, Systems Accountant, Internal Auditor/Financial Controls Manager, Program Analysts, Financial Manager, Junior Contract Specialist, and Procurement Assistant) will not be finalized until a CFO is hired by the Commission.

ITC externally posted a position announcement for the CFO. Senior leadership is in the evaluation assessment phase of recruiting the CFO.

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

During our testing, we noted multiple issues surrounding the accounting for open obligations, accounts payable, and expenditures as summarized below, which further substantiates the finding reported above in Material Weakness I, *Insufficient Resources and Personnel with Appropriate Skill Sets*.

- Even though improvements were made over the prior fiscal year, sufficient documentation was not provided to support the validity of certain Undelivered Orders (UDO) balances (i.e. obligating documents, invoices). Additionally, invalid UDOs were still recorded in the general ledger for the majority of the fiscal year, even though the period of performance had expired and the final invoice had been received. We were unable to rely on our interim testing as of June 30, 2011 for the UDO balance, accounts payable (AP), and expenditures because of a significant number of testing exceptions, which required us to perform expanded testing related to all open obligations as of September 30, 2011. Since ITC did not perform an adequate data clean-up of the UDO and AP balances prior to June 30, 2011, management had to perform a significant data clean-up prior to year-end, where numerous UDOs were deobligated because the amounts were invalid.

- Accruals were not properly recorded throughout the fiscal year. To determine the amount to record as AP on the financial statements, ITC performed a review of open obligations as of September 30, 2011 to determine if an accrual was needed. The review consisted of contacting each Contracting Officer's Technical Representative (COTR) with a list of general ledger-generated open obligations and having the COTR state whether the obligations were valid. If the obligation was valid, the COTR should have provided an amount to accrue for AP as of September 30, 2011. However, ITC did not have a detailed, logical methodology to accrue expenses for goods/services that were received but not yet paid for as of September 30, 2011. We noted that certain accrued amounts were not supported by proper documentation such as an estimate of services received based on past services received and paid. We also noted that COTRs provided certain accrual amounts without clearly documenting an explanation on the methodology of why the amount should be accrued. Additionally, ITC frequently recorded the accrual (payable) when the invoice was received rather than when goods and/or services were received. Our interim testing performed as of June 30, 2011 also identified the same issues related to the recording of accruals.

- ITC does not use a standardized numbering schema for all procurement actions. As a result, when a modification was created to an existing contract, a completely new obligation document was created that did not have a relationship to the original contract in the financial system. Invoices are often split between the different obligations, creating problems trying to map and reconcile the obligations and invoices in the general ledger.

- The Department of the Interior (DOI), National Business Center (NBC) financial management system requires the Designated Oracle Representative (DORs) and finance staff to enter data into fields where the headings do not properly correspond to the type of data being entered. The DORs are required to enter the price of the requisition in the quantity column and quantity in the price column, and finance staff are required to complete the "quantity" field in the payment screen as the payment amount. If the DOR has entered the quantity as "the total price of the contract" and the price as "1" in the requisition module, the payment will be debited to account 4801, "Undelivered Orders – Obligations, Unpaid," properly. However, if the DOR has entered the quantity in the quantity heading and the price in the price heading, then the UDO (4801) account is debited for the incorrect amount. Additionally, the format the DORs use for quantity and price also has a direct impact on the payment of invoices. If the DOR enters the quantity as a percentage, then whenever a payment is made, the percentage entered will be debited to the 4801 account instead of the approved payment amount.

By not having controls in place to detect and prevent the improper debiting of the 4801 account as a result of a payment, Undelivered Orders – Obligations, Unpaid may be misstated. For example, we noted that invoices were approved for payment and Finance entered the payments and they were paid by Treasury correctly. However, the DOR did not set the requisition up as unit quantity "as the total price of the contract." As a result, the UDO (4801) was debited for the incorrect amount. The debit was based on how the DOR set up the quantity. Currently, there are no controls in place to prevent and detect this type of error. This type of error might be caught when Finance tries to post a payment and there is not enough obligated in the DOI NBC financial system to make the payment. Finance contacts the DORs to determine how the quantity was entered and request that an adjustment be made to quantity. Afterwards, the previous payment that incorrectly reduced the obligation is taken out and reentered with the proper quantity so additional payments can be posted to the obligation.

In the prior fiscal years, we recommended to ITC management to document procedures to implement policies for monitoring obligations, operating expenses, and related AP on a routine basis. We reviewed ITC Management's Decision regarding this recommendation, and even though ITC management created policies, the policies were not always followed.

Additionally, in the prior fiscal years, we recommended to ITC management to train responsible personnel on how to monitor obligations, operating expenses, and AP to enhance compliance with the applicable requirements. We reviewed ITC Management's Decision regarding this recommendation, and even though ITC management provided training, the training was not sufficient because the internal controls were not in place throughout the fiscal year related to UDOs and AP. Obligation errors continued to occur, and the accrual methodology was not clearly documented to support the accruals recorded.

Finally, in the prior fiscal years, we recommended to ITC management to perform a data clean-up for all open obligations and AP documents to ensure that the balances are properly reported, with appropriate adjustments posted at the detailed general ledger level. We reviewed ITC Management's Decision regarding this recommendation, and even though ITC management stated that it completed a data clean-up, it was not thorough or sufficient, because we continued to note significant errors, and adjustments continued to not be posted at the detailed general ledger level.

The fact that the above internal control weaknesses related to the accounting for open obligations, accounts payable, and expenditures still exist, further substantiates the finding reported above in Material Weakness I, *Insufficient Resources and Personnel with Appropriate Skill Sets*.

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 a review of open obligations, expenditures, and accounts payable on a routine basis, financial data used to generate management reports or financial reports required by applicable laws and regulations may be over or understated.

Recommendations:

We recommend that ITC management:

1. Create an obligation folder for each open obligation.

2. Create a detailed checklist that identifies the contents to be included in each obligation folder, to include at a minimum, all obligation documents, invoices, and quarterly accrual amounts and methodologies.

3. Reconcile all open obligation folders to the general ledger.

4. Establish and implement quality control procedures for the open obligation reviews.

5. Establish and implement a standardized numbering schema to be used for all procurement actions.

6. Post financial transactions, including adjustments at the detailed general ledger transaction level, including accruals, deobligations, and refunds.

7. Research and correct all errors based on the unit difference between the DORs entered quantity and the Finance entered quantity.

8. Coordinate with the DOI NBC and request that the financial application be modified so that field headings correspond to the data being entered.

III. Inadequate Controls Surrounding the Procurement Process (Repeat Condition, Modified)

We reviewed ITC Management's Decisions regarding the recommendations made in the prior year's internal control report, and even though ITC management stated that all actions related to procurement were completed, we noted numerous instances where procurement documents were not adequately documented to consistently demonstrate compliance with the requirements of the Federal Acquisition Regulation (FAR). For example, we noted instances where the procurement documents:

- Insufficiently explained the purpose of the services to be provided;

- Were inconsistent and contained errors related to funding amounts, delivery dates, and periods of performance;

- Lacked documentation to support the reason or amount for modifications, or were not signed by the contracting officer;

- Did not contain substantiation why the contracting officer determined to offer multiple vendors contracts from a single award solicitation;

- Did not contain substantiation why the contracting officer determined to add option years to a sole source contract without recompeting; and

- Sole source justification letters did not have the required content or proper approvals.

Section 4.801 General of the FAR states:

> (a) The head of each office performing contracting, contract administration, or paying functions shall establish files containing the records of all contractual actions.
> (b) The documentation in the files (see 4.803) shall be sufficient to constitute a complete history of the transaction for the purpose of—
> (1) Providing a complete background as a basis for informed decisions at each step in the acquisition process;
> (2) Supporting actions taken;
> (3) Providing information for reviews and investigations; and
> (4) Furnishing essential facts in the event of litigation or congressional inquiries.

The FAR is the primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services with appropriated funds. *Section 1.602 Contracting Officers, 1.602-1 Authority, of the FAR states, "*(b) No contract shall be entered into unless the contracting officer ensures that all requirements of law, executive orders, regulations, and all other applicable procedures, including clearances and approvals, have been met."

ITC contracting officers did not perform a sufficient review of the procurement documents prior to the release of the documents, which further contributed to the lack of adequate internal controls over the processing, approval, and documentation surrounding procurement efforts. Additionally, there has been significant turnover in senior officials in the procurement office, which has contributed to the inadequate internal controls over the procurement processes.

By not following the written policies and specific procedures for procurement efforts, ITC increases the risks of non-compliance with applicable laws and regulations, and the possibility that a material error or fraud may not be prevented or detected and corrected on a timely basis. The fact that the above internal control weaknesses related to procurement still exist, further substantiates the finding reported above in Material Weakness I, *Insufficient Resources and Personnel with Appropriate Skill Sets*.

Recommendations:

We recommend that ITC management:

9. Review all open ITC procurement files to ensure all FAR required documentation is in the contract file such as, requisitions, solicitation information, documentation of quotes, statements of work, all signed modifications, etc.

10. Reconcile the open ITC procurement files to the open obligation folders.

11. Provide additional training to all staff involved in the procurement cycle (e.g., requestors, procurement staff, and finance staff) to communicate what documentation is needed and considered adequate to support the procurement action.

SIGNIFICANT DEFICIENCY

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

During testing of ITC's financial reporting, we noted that major 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:

- A significant error was made in one of the notes related to undelivered orders in the original year-end draft financial statements. 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, contained errors, and did not always contain the signatures evidencing the review and approval for the reconciliation as required by the ITC Accounting Manual. For example, there were numerous errors on the year-end AP reconciliation, and it did not contain an approval by ITC management.

- A significant number of transactions were processed through the use of manual journal vouchers throughout the fiscal year, instead of posting the adjustments at the detailed transaction level in the general ledger. Certain of these manual journal vouchers contained errors. For example, ITC received refunds from vendors for erroneous payments, and the manual journal vouchers done to record the refunds were posted to the wrong accounts, and weren't posted to the general ledger at the transaction level. Although manual journal vouchers in and of themselves are not considered an issue, they do increase the risk for errors.

These errors occurred because of ineffective management reviews and approvals to ensure that transactions and adjustments were accurate and properly supported. 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.

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.

OMB Circular No. A-123, *Management's Responsibility for Internal Control* 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.

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.

Recommendations

We recommend that ITC management:

12. Document quality control procedures performed related to the review and approval of financial statements and related account reconciliations.

Chairman

UNITED STATES INTERNATIONAL TRADE COMMISSION

WASHINGTON, DC 20436

November 3, 2011

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

Dear Mr. Castro:

The draft Report on Internal Control identified three material weaknesses and a significant deficiency. I concur with your assessment that in the financial management area the Commission has insufficient resources and personnel with appropriate skill sets; inadequate controls over undelivered orders, accounts payable, and expenditures; and inadequate controls surrounding the procurement process. I also concur that we have inadequate internal controls over financial reporting.

Beginning with your reports on our 2009 financial statements, which highlighted the financial management deficiencies and challenges that the Commission faced, we began developing an aggressive and comprehensive strategy to address the findings. As a result of this strategy, during fiscal years 2010 and 2011the Commission made significant progress in a number of areas that we believe will result in achieving our goal of accountability over Commission assets and operations. For example, we gained control and accountability over the Commission's property accounts; we also drafted the first accounting manual; we established a Chief Financial Officer position and are currently evaluating candidates.

We recognize that we have much more to do to change the financial management culture here at the Commission and plan to implement each of your recommendations.

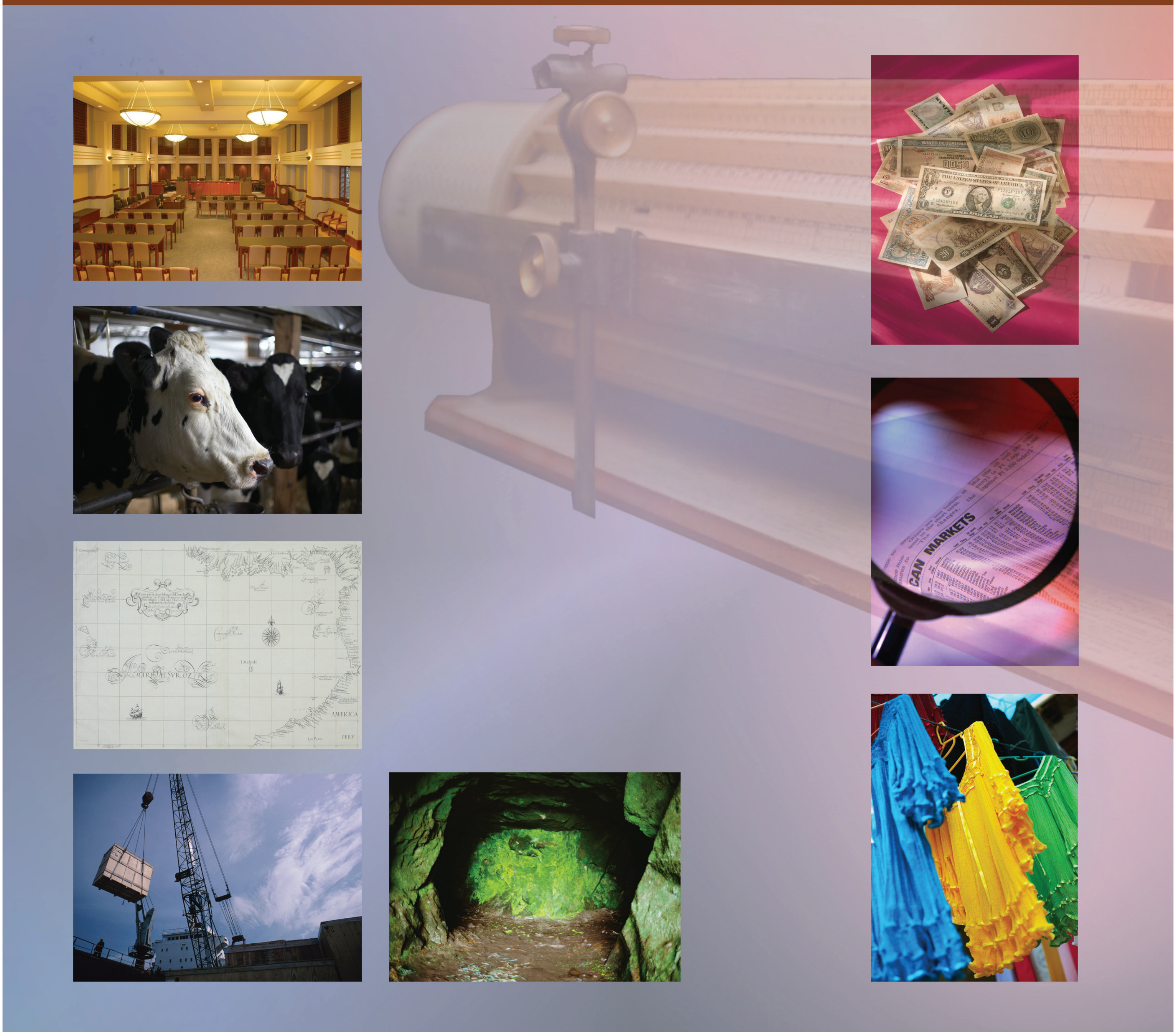
Sincerely,

Deanna Tanner Okun

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 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



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