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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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OCTOBER 1, 1979

The Honorable Howard W. Cannon
Chairman, Committee on Commerce,
Science, and Transportation
United States Senate

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The Honorable Wendell H. Ford
Chairman, Subcommittee on Consumer
Committee on Commerce, Science,
and Transportation
United States Senate

Subject: [Fiscal Controls in the Federal Trade
Commission's Public Participation Program
Should Be Strengthened] (HRD-79-129)

Pursuant to your June 6, 1979, joint request, we have reviewed the Federal Trade Commission's (FTC's) fiscal controls over its Public Participation Program. You specifically asked us to (1) determine whether FTC's audits of the program have been made in accordance with generally accepted auditing standards, (2) determine whether the audited participants have made refunds to FTC for disallowed expenditures, and (3) make financial audits of some unaudited participants that received more than \$50,000 and some that received less than \$50,000.

On the basis of our review we believe that FTC's audit of program expenditures and its efforts to collect amounts disallowed in the audit were generally satisfactory. However, FTC can make its internal auditing of the program more effective by (1) increasing the scope of the audits to include periodic reviews of FTC determinations of participant eligibility (see p. 6) and (2) having the internal audit function report to a higher agency official, preferably the Chairman (see p. 7).

Also, FTC could strengthen program administration through (1) better direction and guidance to participants regarding accounting for reimbursable costs incurred under the program (see p. 9) and (2) closer attention to fiscal accounting of program funds (see p. 12).

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The matters in this report have been discussed with your offices.

SCOPE OF REVIEW

Our work was done at FTC's headquarters in Washington, D.C., and at program participants' offices in San Francisco, Cleveland, and Washington, D.C. We examined program records maintained by FTC and six participants, and interviewed FTC and participant personnel. We audited the expenditures of three participants that received more than \$50,000 each and three participants that received less than \$50,000 each.

As arranged with your offices, we did not verify the financial eligibility of participants because of time constraints and the lack of specific criteria or a "means test" for clearly determining whether participants could afford to participate without compensation under the program. This issue is being considered by a study sponsored by the Administrative Conference of the United States.

Our review covered the period from the program's start in fiscal year 1976 through June 30, 1979. The matters in this report were discussed with FTC officials, and they generally agreed with our findings and conclusions. Their comments are included in the report where appropriate.

BACKGROUND

In January 1975, the FTC Act (15 U.S.C. 41, et seq.) was amended by the Magnuson-Moss Warranty--FTC Improvement Act (Public Law 93-637, title II) to give (FTC authority to provide compensation to certain persons in order to participate in rulemaking proceedings.) The Congress established the compensation program to promote fuller participation by representatives who have an interest in FTC rulemaking proceedings, but could not afford to participate without cost reimbursement. The objective was to help assure that rules adopted in such proceedings would best serve the public interest. Specifically, section 18(h)(1) of the FTC Act states:

"The Commission may, pursuant to rules prescribed by it, provide compensation for reasonable attorneys fees, expert witness fees, and other costs of participating in a rulemaking proceeding under this section to any person (A) who has, or represents, an interest (i) which would not otherwise be adequately represented in such proceeding, and (ii) representation of which is necessary for a fair determination of the rulemaking proceeding taken as a whole, and (B) who is unable effectively to participate in such proceeding because such person cannot afford to pay costs of making oral presentations, conducting cross-examination, and making rebuttal submissions in such proceeding."

The aggregate amount of compensation paid in any fiscal year to persons (or their representatives) who would be regulated by a proposed rule may not exceed 25 percent of the total paid to all program participants during that year. Total program compensation paid to all participants in any fiscal year may not exceed \$1 million (sec. 18(h)(2) and (3) of the FTC Act).

The program is administered by FTC's Office of the General Counsel, which selects and determines the eligibility of participants. Fiscal accounting, payments to participants, and auditing for the program are performed by FTC's Division of Budget and Finance.

Despite the \$1 million statutory ceiling for any fiscal year, the Congress authorized funding for participant compensation of only \$500,000 for each of fiscal years 1976, 1977, and 1978. An additional \$125,000 was authorized for the transition quarter (July-Sept.) in 1976. (The Congress authorized \$750,000 for fiscal year 1979, and FTC has requested the same amount for fiscal year 1980.) As of June 30, 1979, FTC had obligated \$317,784--42 percent of the fiscal year 1979 authorization. (According to an FTC official, fiscal year 1979 obligations will probably not exceed \$375,000--50 percent of the total authorization.)

In addition to participant compensation costs, the program incurs costs for administrative support, which includes three full-time employees and some part-time support staff. FTC estimated that the total cost of administering the Public Participation Program for fiscal year 1979 would be about \$93,000.) Total appropriations for all of FTC's operations for fiscal years 1978 and 1979 were \$62.1 million and \$65.3 million, respectively.

From the program's inception in fiscal year 1976 through June 30, 1979, FTC provided about \$1.9 million to 64 participants. This number of participants includes some organizations more than once because they participated in some rule-making proceedings on their own and in other proceedings jointly. For example, participation by the Consumers Union is counted three times--once for its Washington, D.C, office's participation in two rulemaking proceedings (food advertising and funeral industry); once for its San Francisco office's participation with another organization in children's advertising proceedings; and once for its San Francisco office's participation with another organization in health spa proceedings.

The table on the following page shows program funding and activity by fiscal year. Fiscal year 1976 data include the transition quarter.

As of June 30, 1979, FTC had made 90 funding agreements with the 64 participants (11 of which participated in more than one rulemaking proceeding) to participate in 18 rule-making proceedings. (See enc. I.)

FTC Public Participation Program
Funding and Activity Data
Fiscal Year 1976 Through June 30, 1979

<u>Funding and activity</u>	<u>Total</u>	<u>Fiscal years funded</u>			
		<u>1979</u> <u>(note a)</u>	<u>1978</u>	<u>1977</u>	<u>1976</u> <u>(note b)</u>
Authorized funding	\$2,375,000	\$750,000	\$500,000	\$500,000	\$625,000
Payments	1,667,297	194,445	458,997	478,729	535,126
Unpaid obligations	<u>202,619</u>	<u>123,339</u>	<u>48,454</u>	<u>19,262</u>	<u>11,564</u>
Total obligations (note c)	<u>\$1,869,916</u>	<u>\$317,784</u>	<u>\$507,451</u>	<u>\$497,991</u>	<u>\$546,690</u>

Participants funded

1st time participants	64	21	11	6	26
Prior FY participants	-	<u>14</u>	<u>11</u>	<u>11</u>	-
Total participants	-	<u>35</u>	<u>22</u>	<u>17</u>	<u>26</u>

a/Nine months--Oct. 1, 1978, to June 30, 1979.

b/Fifteen months--July 1, 1975, to Sept. 30, 1976.

c/The obligation amounts shown are from FTC's financial records as of June 30, 1979. Some adjustments are pending based on an FTC audit of the financial records.

FTC INTERNAL AUDITING
CAN BE MADE MORE EFFECTIVE

In a Federal agency, the internal auditor has a vital role--reviewing and reporting on various programs and operations, including administration of financial activities. The internal audit function can supplement routine management controls through its independent approach and methods of review. The function is an important management tool that complements other elements of internal control.

Although FTC's audit of payments for the Public Participation Program has been generally satisfactory, the scope of the audits should be expanded to consider the eligibility of program participants. Moreover, the independence and objectivity of the internal auditors could be better assured if they reported to a higher organizational level. They currently report to the Deputy Director of the Budget and Finance Division, who is responsible for administering payments under the program.

FTC audits should include review of
participant eligibility determinations

(The scope of FTC's internal audits of the Public Participation Program has been limited to examining financial transactions. These audits have concentrated on determining whether cost reimbursements claimed by participants are reasonable and allowable under FTC's agreements with the participants.

FTC's audits have not included a review of program participant eligibility determinations, a major consideration in auditing compliance with legal requirements. FTC's Office of the General Counsel determines the eligibility of each applicant on the basis of information furnished by the applicant. However, FTC does not have specific criteria for determining whether an applicant is financially unable to participate in a rulemaking proceeding and thus is eligible for program participation.)

An FTC official told us that, because the criteria for determining participants' financial eligibility are vague, auditors would have difficulty evaluating judgments by the General Counsel's Office.

By establishing specific criteria for determining financial eligibility, FTC would provide a consistent basis for making eligibility determinations. Reviews by FTC's auditors would help ensure that the determinations are reasonable and consistent.

Recommendation to
the Chairman, FTC

We recommend that the Chairman (1) establish criteria for determining financial eligibility of Public Participation Program applicants and (2) require internal auditors to periodically review eligibility determinations.

Organizational relocation of auditors
could strengthen audit independence

Internal auditors in Federal agencies should be located so that they are independent of the officials who are directly responsible for operations they review. To be adequately independent, internal auditors should be responsible to the highest practical organizational level, preferably the agency head. Such organizational placement of internal auditors is necessary to ensure that their opinions, conclusions, judgments, and recommendations will be impartial.

FTC's three internal auditors are directly supervised by the Deputy Director of the Division of Budget and Finance, who is also responsible for fiscal functions subject to audit, including processing claims for reimbursement from participants in the Public Participation Program. According to FTC's Deputy Executive Director, FTC realizes that, ideally, internal auditors should report directly to the agency's highest level. He explained that, because of FTC's relatively small size and staffing limitations, the Budget and Finance Division has been the best base for the auditors. He said that FTC would consider this matter in future organizational planning.

We do not have any examples to show that an FTC auditor's independence was improperly curtailed. However, the independence and objectivity of auditors may be inhibited when they are subordinate to agency officials (such as fiscal officers) whose functional responsibilities are regularly subject to audit.) Therefore, to ensure the independence of the internal

auditors, FTC's audit functions should be located at an organizational level higher than the Division of Budget and Finance.

Recommendation to
the Chairman, FTC

We recommend that the Chairman relocate the internal audit functions to the highest practical organizational level.

FTC AUDITS OF PROGRAM EXPENDITURES

As of June 30, 1979, FTC had completed seven audits covering \$677,593, or 40.6 percent of total payments to participants in the Public Participation Program. FTC's audit guidelines state that the purpose of the audits is to determine whether costs claimed are reasonable, allowable, and allocable under the participants' agreements with FTC. The guidelines provide instructions for verifying charges for labor, fringe benefits, indirect costs, travel, and other direct costs. In reviewing the audit workpapers of the seven audits, we found that the work performed in six of them generally satisfied auditing standards applicable to the scope of the audits.

The workpapers for the other audit were incomplete. However, the audit report indicates that a comprehensive review was made that identified areas for program improvements and resulted in refunds of \$1,671 for unallowable costs.

Of the \$677,593 audited, FTC's auditors initially disallowed \$31,513 paid to seven participants. This amount was later reduced to \$21,247 based on additional justification submitted by the participants. Of the \$21,247 disallowed, 59.3 percent was for labor charges, 33.6 percent for overhead charges, and 7.1 percent for travel and other expenses. Reasons for the disallowances were:

	<u>Percent of total disallowed</u>
Costs not actually incurred and/or supporting records insufficient	73.2
Duplicate billings	19.8
Costs not applicable	4.0
Costs exceeding FTC's maximum allowable labor cost rates	2.8
Computation errors	<u>.2</u>
	<u>100.0</u>

Where FTC identified unallowable charges to the program, it requested refunds from the participants within 30 days of the date that the audit reports were finalized. As of September 7, 1979, FTC had collected \$9,353 of the outstanding \$21,247. The other \$11,894 has been appealed by the two participants involved, and their appeals are under consideration by FTC.

REIMBURSEMENT CLAIMS NOT
ADEQUATELY SUPPORTED

We audited payments made to six unaudited program participants, including three that received more than \$50,000 each and three that received less than \$50,000 each. As of June 30, 1979, these six participants had received a total of \$352,485.

Our review indicated that, because (FTC's guidance to program participants for claiming reimbursement for indirect costs (overhead) were not clear, reimbursement claims for these costs were not properly established.) Three of the six participants did not maintain sufficient accounting records to support their reimbursement claim charges for labor; therefore, the appropriateness of the claims for these charges could not be determined.

We have not yet finished analyzing the propriety of the participants' charges to the program in these cases. Our analysis should be completed in October 1979, at which time we will submit our findings to FTC for consideration.

Guidance for claiming overhead costs needs clarification

FTC's written agreements with program participants provide that only overhead costs actually incurred are reimbursable. Overhead includes such items as heat, light, space, telephone, and indirect administrative costs. However, FTC's booklet "Applying for Reimbursement for FTC Rulemaking Participation" provides that reimbursement for overhead costs may be claimed at a "flat percentage (25%)" of each employee's hourly rate. This booklet is provided to participants as an instructional guide.

Five of the six program participants we reviewed had claimed and were reimbursed for overhead costs on the basis of a flat percentage rate. Although FTC has not yet audited these six participants, in completed audits, FTC has disallowed reimbursements for overhead claims that were not based on evidence of actual costs.

FTC officials said that the agency originally adopted the policy for use of a flat overhead rate because it considered the allocation of actual overhead costs to the program too burdensome for small organizations. The amount claimed for overhead reimbursement on the basis of a flat rate in the case of FTC's Public Participation Program will increase in proportion to direct labor costs incurred rather than in proportion to the actual overhead applicable to participation under FTC's agreement. This method could provide a disincentive for participants to minimize the direct cost base.

In the area of Government procurement contracts, we have held that the use of fixed overhead rates established in advance and applied to some element of direct cost under cost-reimbursement-type contracts fell within the statutory cost-plus-a-percentage-of-cost prohibition of the Armed Services Procurement Act (10 U.S.C. 2306). See 35 Comp. Gen. 434 (1956). 1/ As indicated in that decision, the purpose

1/A similar prohibition is contained in the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 254(b)), which applies to cost-reimbursement-type procurement contracts of civil agencies.

of this statutory prohibition regarding Government procurement contracts is to remove the temptation for a contractor to increase his profit by carelessly or deliberately increasing his direct costs.

FTC should revise its instructions to emphasize that all overhead reimbursement claims must be based on actual costs and that each participant must submit full details to support its claim. Small organizations could itemize each of their indirect costs, such as office rent and utilities, and justify the portion allocated to participation under their FTC agreement.

Recommendation to
the Chairman, FTC

We recommend that the Chairman revise the program instructions to provide adequate guidance on allowability and accounting for indirect cost claims.

We discussed this matter with FTC officials; they agreed to revise FTC's program instructions to require that claims for indirect costs be based on actual costs and be fully supported by an acceptable accounting method.

Reimbursement claims for labor
costs need better substantiation

FTC's program guidelines require participants to support their claims for labor costs by having all personnel sign statements attesting to the number of hours worked, the nature of the work, and the hourly rate. Only three of the six participants we audited had labor time sheets that adequately supported their claims. The other three maintained time sheets to support only part of their labor charges.

We discussed this matter with FTC officials, who said that they will revise their instructions to participants to emphasize the importance of maintaining adequate records to support reimbursement claims for labor costs. Improvements in this area should facilitate FTC closeout audits at participant locations.

FISCAL ACCOUNTING NEEDS
CLOSER ATTENTION

(FTC needs to improve its fiscal procedures to assure that unpaid obligations in FTC's accounts at the end of the fiscal year are being adequately reconciled to obligation documents and validated. Also, accounting procedures need strengthening to assure that costs for the Public Participation Program are properly charged to the applicable fiscal year appropriation.)

End of year validation of
obligations should be strengthened

The GAO Policy and Procedures Manual for Guidance of Federal Agencies (title VII, ch. 4) requires each agency to review its obligation documents as of the end of each fiscal year to determine whether all obligations meet the criteria of valid obligations as set forth in the Supplemental Appropriation Act of 1955 (31 U.S.C. 200). The workpapers and records on which such determinations are based must be retained in the agency to facilitate audit.

FTC's workpapers on its validation of obligations for the Public Participation Program for fiscal years 1977 and 1978 did not clearly demonstrate that yearend obligations were reconciled to valid obligation documents. Therefore, we were not able to determine the adequacy of FTC's validations of yearend obligations for those years.

End of year validation of obligations is important to ensure adequate controls over funds, provide essential management information, and facilitate the preparation of accurate statements and reports. Such validations also ensure that appropriated funds reserved for obligations that are no longer valid are released for reversion to the Treasury.

We discussed this matter with the Deputy Director of the Budget and Finance Division, who told us that FTC validates its obligations at the end of each fiscal year. However, he agreed that FTC needs to prepare and maintain better records of its obligation validation work.

After our discussions, FTC reviewed its open obligations for the Public Participation Program and deobligated about \$42,617, some of which (\$9,142) had been outstanding since fiscal year 1976.

Recommendation to
the Chairman, FTC

We recommend that the Chairman ensure that yearend validations of obligations are properly made and documented as required.

The Deputy Director of Budget and Finance told us that FTC will review its procedures for yearend validation of its obligations and, where necessary, make improvements to ensure that the validation work and its documentation comply more fully with the GAO Manual.

Program costs not always charged to
applicable fiscal year appropriations

FTC has not always charged costs under the Public Participation Program to the applicable fiscal year appropriation. In two instances totaling about \$3,800, FTC used prior year appropriations to pay costs incurred in later fiscal years. In at least 15 other instances, program charges were apparently handled in the same way. The total amount involved in these instances was not readily determinable from FTC's accounting records.

Since a fiscal year appropriation is available for use only during the year it was authorized, this practice resulted in inaccurate accounting of fiscal year program costs.

Some participants are funded for activities chargeable to more than one fiscal year appropriation, and their claims for cost reimbursement have not always provided a clear reference to the specific authorization and fiscal year that the charges relate to. This poses a bookkeeping problem in terms of recording expenditures against the related appropriation. A reimbursement claim form that readily identifies the proper fiscal year account with the related charges would help FTC to record the transaction against the correct account. We discussed this matter

with FTC program officials; they told us that a new claim form for participant cost reimbursement is being developed which will require information that specifically relates charges to the applicable fiscal year.

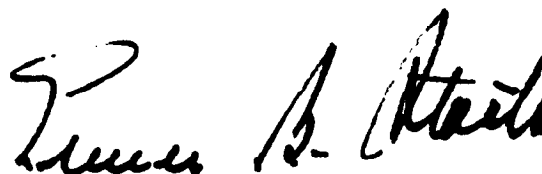
Recommendation to
the Chairman, FTC

We recommend the Chairman strengthen FTC's accounting practice so that program costs are charged to the applicable fiscal year appropriation.

The Deputy Director of Budget and Finance said that FTC would take steps to see that erroneous recordings of payments do not recur. He added that FTC would review the cases that we brought to its attention and, where warranted, correct the accounting records.

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As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days after it is issued. At that time we will send copies to interested parties and make copies available to others upon request.



Comptroller General
of the United States

Enclosure

PUBLIC PARTICIPATION INFTC RULEMAKING PROCEEDINGS

Fiscal year 1976 through third
quarter fiscal year 1979 (6/30/79)

<u>Rulemaking proceedings</u>	<u>Participants</u>	<u>Approved funding (note a)</u>
Antacid over-the-counter drugs	3	\$ 136,030
Care labeling (revised)	1	57,293
Children's advertising	11	317,507
Unfair credit practices	2	141,986
Food advertising	10	154,375
Funeral industry	9	140,069
Health spas	2	87,319
Hearing aids	2	95,880
Mobile homes	5	154,559
Ophthalmic goods and services	5	127,418
Over-the-counter drugs	3	100,932
Prescription drugs	1	2,070
Preservation of consumers' claims and defenses	1	3,093
Protein supplements	3	33,431
Standards and certification	18	125,703
Thermal insulation	6	96,327
Used motor vehicles	5	130,291
Vocational schools	3	33,654
Total	<u>90</u>	<u>\$1,937,937</u>

a/Approved funding is the amount initially estimated and approved for each participation agreement. These amounts are initially recorded as obligations against the appropriation, and are later adjusted when actual costs are recorded. Total actual obligations for this participation as of June 30, 1979, per FTC's automated data processing system balances totaled \$1,869,916, for which a breakdown by rulemaking proceeding was not readily available.