

# **Custodial Receivables Financial Reporting Challenges**

**March 24, 2016**

## Highlights

**Allowance for Loss has the potential to be unreliable.**

**Foregoing early referral to DoJ in favor of Treasury is not supported.**

**Agency Financial Report (AFR) can provide additional Custodial Receivables data and performance information.**

## Background

This report highlights challenges regarding the presentation of Custodial Receivables in the U.S. Commodity Futures Trading Commission (the CFTC) Agency Financial Report (AFR), and regarding collection efforts.

## What the OIG Found

CFTC's Financial Management Branch (FMB) policy deems all civil monetary sanctions (CMS) resulting from Division of Enforcement (Enforcement) efforts uncollectable unless there is evidence to the contrary. FMB relies on Enforcement collectability assessments to provide such evidence. Enforcement does not document use of a consistent standard for its collectability determinations because it only documents the basis for collectability determinations if a CMS is determined to be collectable. Enforcement and FMB's practices together do not document reliable collectability determinations for all CMS deemed uncollectable.

Enforcement and FMB's practices together also potentially impact CFTC's financial statements. FMB reports certain CMS penalties in the CFTC AFR as Custodial Receivables, net of any Allowance for Loss for uncollectable amounts (determined through the procedures described above). In the CFTC FY 2014 and FY 2015 financial statements, FMB reduced Custodial Receivables by an Allowance for Loss (amounts deemed uncollectable) exceeding \$1.4 billion, each year. The Allowance for Loss may be impacted because determinations that a CMS is uncollectable are not documented.

FMB refers all outstanding debts initially to the U.S. Department of Treasury (Treasury) for collection. Enforcement or Treasury may also refer debts to the Department of Justice (DoJ) for more robust collection efforts. Due to the failure to document reliable collectability determinations for all CMS deemed uncollectable, the decision to forego early referral to DoJ in favor of Treasury similarly is not supported for all CMS.

Federal policies call for agencies to collect data for performance measures in order to provide relevant information to decision-makers. The CFTC historically has not provided comprehensive CMS data and performance information in its AFR.

## What the OIG Recommends

We recommend the Office of the Executive Director in consultation with the Director of Enforcement, standardize procedures for collectability determinations, identify cases for routing first to the Department of Justice, and provide additional enforcement information in the AFR. Click [here](#) for a summary of management's comments and our evaluation of management's comments.



## **U.S. COMMODITY FUTURES TRADING COMMISSION**

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5110  
Facsimile: (202) 418-5522

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## **Background**

In order for the U.S. Commodity Futures Trading Commission (the CFTC) to fulfill its mission to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of certain commodity interests, including futures, swaps and options, the CFTC investigates, litigates, and adjudicates alleged violations of the Commodity Exchange Act (CEA) and Commission regulations. The CFTC's Division of Enforcement (Enforcement) conducts investigations of both individuals and companies. A civil monetary sanction (CMS) is an enforceable monetary sanction imposed by a court (judgment) order or Commission order. CMS consist of one or more of the following types: Civil Monetary Penalties (CMP), disgorgements, restitutions,<sup>1</sup> and pre-judgment interest. For Enforcement actions to be most successful, collection and distribution programs must function effectively. Enforcement is responsible for collectability determinations.

The Accountability of Tax Dollars Act of 2002 requires the CFTC to prepare and submit to the Congress and the Director of the Office of Management and Budget an audited financial statement for each fiscal year, covering all accounts and associated activities of each office, bureau, and activity of the agency. The Office of Inspector General (OIG) previously reported that financial statement audits by an Independent Public Accounting (IPA) firm expressed qualified opinions for the agency financial statements as of September 30, 2014 and FY 2015. The firm noted a material weakness in internal controls for financial reporting. The Chief Financial Officer, within the Office of the Executive Director, has the responsibility for preparing CFTC's annual Agency Financial Reports (AFR) and facilitating collection activities.

## **What the OIG Learned**

Our review of the CFTC's operating policies, presentation, and disclosure of custodial receivables in the FY 2014 AFR, Management Discussion and Analysis (MD&A), and notes to the financial statements identified the following accounting policy challenges which also affect the FY 2015 AFR.

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<sup>1</sup> We refer to restitution ordered to reimburse customers harmed through violations of the Commodity Exchange Act and Regulations. The restitution is owed to the customer, not the CFTC. Courts generally assign restitution collection responsibility to a receiver or a monitor. Because CFTC recognizes restitution claims to be unenforceable against the government, it is not reported as a custodial receivable; however, Enforcement performs collectability determinations as a matter of policy, recognizing that customer restitution should be paid, and victims made whole, prior to payment of other CMS.

1. Given that FMB's current policy<sup>2</sup> is to recognize custodial receivables (civil monetary penalties and disgorgement) as 100% uncollectable<sup>3</sup> unless Enforcement makes a determination that all or a portion of a receivable is collectable, and that Enforcement collectability determinations are not documented using standard measures (because only determinations of collectability are documented), FMB's and Enforcement's current practices do not document reliable collectability determinations for all CMS deemed uncollectable.
2. FMB reports in the CFTC AFR as Custodial Receivables certain CMS penalties imposed through Enforcement proceedings, net of any Custodial Receivables Allowance for Loss determined through the procedures described above. CMPs form the primary basis for the Custodial Receivables Allowance for Loss presented in Note 4. of the AFR. For the CFTC FY 2014 financial statements, CFTC reduced Custodial Receivables of \$1.620 billion by an Allowance for Loss (amounts deemed uncollectable) of \$1.617 billion. Likewise, for FY 2015, CFTC reduced Custodial Receivables of \$1.452 billion by an Allowance for Loss of \$1.449 billion. For the same reasons that Enforcement and FMB's practices together do not document reliable collectability determinations for all CMS (because only determinations of collectability are documented), they also do not support a reliable Custodial Receivables Allowance for Loss reported in the AFR.
3. CFTC in 1985 adopted Part 143 of the Commission regulations<sup>4</sup> to implement statutory authority to collect claims owed the United States arising from activities under the CFTC's jurisdiction, including certain CMS debt.<sup>5</sup> CFTC updated these regulations most recently in 2004.<sup>6</sup> FMB refers all outstanding debts initially to the U.S. Department of Treasury (Treasury), for collection. Enforcement or Treasury may also decide to transfer debts to the Department of Justice (DoJ) for further and more robust collection efforts. Due to the failure to document reliable collectability determinations when CMS is deemed uncollectable, said collectability determinations do not support the determination to forego early referral to DoJ in favor of Treasury in all instances, nor the decision to forego existing CFTC collection authority at Part 143 of the Commission Regulations.

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<sup>2</sup> FY 2014 and FY 2015 Civil Monetary Sanctions Cycle Memo.

<sup>3</sup> The agency performs a valuation of collectability on a quarterly basis, at which time the Allowance for Loss is set for each debt.

<sup>4</sup> 17 CFR Part 143.

<sup>5</sup> 50 FR 5383 (Feb. 8, 1985) ("These rules are intended to ensure fair and expeditious collection of unpaid claims").

<sup>6</sup> 69 FR 52995 (Aug. 31, 2004). CFTC also adopted a Privacy Act Records System Notice for its Debt Collection Files, last published in 2011. 76 FR 5974 (Feb. 2, 2011). CFTC's Records Disposition Schedule (Jan 4, 2016), states that debt collection records must be maintained for six years after final payment or cancellation (longer if required business use). <http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/recordsdispositionschedule.pdf>.

4. OMB Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*<sup>7</sup> calls for agencies to collect data for performance measures in order to provide relevant information to decision-makers and other stakeholders. As a leading practice, other federal agencies include discussion of this data in the MD&A [enforcement] section of the AFR. We noted the CFTC's AFR can provide additional custodial receivables data and performance information such as age, type, damages, collection and settlement rates, or assigned collection entities which decision makers may find beneficial. Compared with similar federal agencies, the CFTC historically has provided less comprehensive data and performance information to users who would be interested in how well the CFTC's enforcement actions perform against those who violate the CEA and regulations. Another transparency opportunity for enforcement actions relates to restitution orders. While the CFTC does not report restitution activity in its financial statements,<sup>8</sup> it is not prohibited from providing further discussion of this significant activity in the MD&A section of the AFR. For the case matters we reviewed, there was \$1.428 billion<sup>9</sup> in restitution orders where only CMS penalties assessed were discussed in the MD&A section of the AFR.

The [appendices](#) that follow discuss in detail these issues and provide relevant federal agency reports as reference.

## What the OIG Recommends

We recommend the Office of the Executive Director in consultation with the Division of Enforcement:

1. Standardize procedures to evidence collectability determinations and to better support the presentation of an Allowance for Loss;
2. Identify most promising cases to route first to the Department of Justice;
3. Provide additional enforcement data and performance information in the AFR.

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<sup>7</sup> OMB A-129, Section IV. A.2.

<sup>8</sup> See footnote 1.

<sup>9</sup> Some case matters held multiple defendants liable but the debt will be collected only once.

## Summary of Management Comments

Management expressed concern regarding possible interpretation of the report. Specifically, management would take issue with any indication that current financial reporting of custodial receivables are unreliable<sup>10</sup> or unsupported,<sup>11</sup> or that current practices may have diminished the collection potential of debts or collection rates.<sup>12</sup> Also, management expressed concern that, in noting that Enforcement could aggressively identify cases with potential to route first to the Department of Justice (DoJ), our report questioned the adequacy of collection activities of the U. S. Department of Treasury (Treasury).<sup>13</sup> We appreciate these concerns and thank Enforcement for providing the opportunity to address them in our footnotes here.<sup>14</sup>

That said, FMB and Enforcement stated they will work collaboratively to enhance current procedures and methodologies to improve the transparency and documentation of support for financial reporting and custodial receivables collection decisions, and will consider additional performance reporting regarding its enforcement activities.

In reference to recommendation 1, management acknowledged there may be opportunities for improvement in the documentation and transparency of the analysis that supports Enforcement's preliminary collectability assessments and FMB's

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<sup>10</sup> The word “unreliable” appears once in our report. Our summary sheet states: “Allowance for Loss has the potential to be unreliable.” Because CFTC’s Allowance for Loss is based on collectability determinations that are not documented, this statement is true. We are not aware of any scenario where undocumented statements regarding collectability can be deemed reliable on their face.

<sup>11</sup> Management appears to conflate “unsupported” with “unsupportable.” We do not state that current financial reporting of custodial receivables is unsupportable (i.e., cannot be supported). We respectfully clarify here that the financial reporting of custodial receivables is unsupported by documented collectability determinations.

<sup>12</sup> *Managing Federal Receivables* (May 2005, rev’d 2015) (*MFR*), Department of the Treasury Financial Management Service, states (at page 1-9): “Each agency shall ensure that . . . the full range of available and appropriate delinquent debt collection techniques are used” At Appendix 1 (page 11) we quote from *MFR* the “key factors” Treasury has instructed agencies to consider in determining which collection techniques to use. Rather than documenting consideration of the steps set out in *MFR*, Enforcement refers all debt to Treasury, and we maintain this practice “may diminish the collection potential of debts and negatively affect collection rates.” We presume the purpose of Treasury’s detailed instructions to agencies (in *MFR*) is to enhance collection results.

<sup>13</sup> *MFR* (page 6-3) states: “Debts based in whole or in part on conduct in violation of the antitrust laws or involving fraud, the presentation of a false claim, or misrepresentation on the part of the debtor or any party having an interest in the claim must be referred to the Department of Justice (DOJ) for action.” We realize Enforcement currently does not have sufficient resources to undertake complex collection efforts; we recommend they aggressively identify cases with potential to route first to the Department of Justice (as required in *MFR*). We are not inferring any deficiency on the part of Treasury with regard to collection efforts, or otherwise.

<sup>14</sup> See fn. 10-13, above.

determination as to the appropriate Allowance for Loss on custodial receivables. As such, FMB and Enforcement will work collaboratively to standardize the procedures for this process to ensure clear and consistent documentation.

In reference to recommendation 2, management is already increasing referrals to DoJ, and FMB and Enforcement will work collaboratively to document and further refine the methodology and process by which cases are identified for referral to DoJ versus Treasury.

In reference to recommendation 3, the Commission will consider additional performance reporting regarding its enforcement activities; however, management indicated its preference to report such information in CFTC's Annual Performance Report (APR), as only high-level summary performance information is generally included in an Agency Financial Report (AFR).

The Management comments in their entirety are presented in [Appendix III](#).

## **Evaluation of Management Comments**

Management's planned actions are responsive to each of the recommendations made. Since management did not provide a date of action, the OIG will evaluate progress made as part of the FY 2016 financial statement audit scheduled for reporting during November 2016.

In reference to recommendation 1, the OIG agrees that FMB and Enforcement, working collaboratively to standardize the procedures to ensure clear and consistent documentation, should better evidence the presentation of an Allowance for Loss. Our report focuses on the *underlying documentation* necessary to substantiate a material amount reported as uncollectable in the CFTC's AFR. Without documentation, the CFTC cannot support a reported Allowance for Loss.

In reference to recommendation 2, we are encouraged that the CFTC will refine the methodology and process by which cases are identified for referral to DoJ versus Treasury.<sup>15</sup> We emphasize the methodology should consider not only which collection technique(s) to use but also timing, as referrals to DoJ in some cases have occurred

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<sup>15</sup> Management cited previous audit reports which focused on and encouraged timelier referral of CFTC debts to Treasury. We would note the most recent audit dates to 2005 (GAO-05-670, Aug. 2005), while *MFR* (page 6-11 to 6-12) recommends: "An agency should periodically (e.g., every three to five years) evaluate the soundness of its strategies and collection activity."



almost 2 years after judgment orders. While resource concerns are real (throughout the federal government), aggressive collection responsibilities remain with the CFTC.<sup>16</sup> If resource constraints are the primary driver for current collection processes, then the CFTC may seek to supplement its collection process with experts on a fee basis that have a non-budgetary implication.

In reference to recommendation 3, we agree with management's intention to carefully consider how to present any additional performance information so that it is helpful to the reader and not misleading, whether in the Annual Performance Report and/or the Agency Financial Report. We would note that current reporting does not disclose collection rates nor the age of penalties assessed; we believe this information would be useful to readers. We agree there is no legal recourse against the government with respect to customer restitution and concur with CFTC's proposal "to identify the appropriate reporting for restitution in the MD&A section of the AFR."

## **Our Objective, Scope, and Methodology**

Our objective was to assess the reporting of custodial receivables in the CFTC's AFR. We evaluated 56 case matters<sup>17</sup> which dictate the accounting for \$1.587 billion or 98% of the gross custodial receivables as of September 30, 2014. In the notes to the financial statements, gross custodial receivables were approximately \$1.620 billion with an Allowance for Loss of \$1.617 billion.

We assessed the 2014 AFR as well as results of the IPA work papers to gain an understanding of the audit work conducted and all recommendations made relevant to the audit topic. We reconciled Custodial Receivables accounting records to judgment orders in the CFTC's Practice Manager (PM) application to determine the completeness of account balances and reconciled FY 2014 supporting case matters to matters supporting the FY 2015 year-end balance. Approximately \$1.1 billion of the FY 2014 case matters rolled over into the FY 2015 year-end balance. We also evaluated case matters' legal documentation and assessed organizational policies and procedures in place to assess the fairness of the Allowance for Loss for the Custodial Receivables. Further, we interviewed and surveyed work groups identified to assess leading practices of similar

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<sup>16</sup> OMB Circular No. A-129 (cited in *MFR*, page 1-11), requires each agency to "assign to the agency CFO . . . responsibility for . . . implementation of . . . debt collection." The *MFR* (page 6-3) makes clear that agencies have primary responsibility to collect non-tax receivables, including fines and penalties.

<sup>17</sup> These 56 case matters support the Civil Monetary Penalties, Fines, and Administrative Fees amount in Note 4 of the FY 2014 financial statements.

federal agencies related to disclosure and discussion of enforcement activities and custodial receivables to compare as a reference.

Our scope also considered applicable federal criteria, laws and regulations, and internal controls. Specifically, we reviewed and analyzed the Office of Management and Budget (OMB) and Federal Accounting Standards Advisory Board (FASAB) guidance to identify the CFTC's responsibilities for implementing, overseeing, and providing guidance for the agency's financial reporting program requirements. In addition, we evaluated federal statutes and documented control activities applicable to the subject audit.

We conducted this review from July 2015 to March 2016 in accordance with the Council of the Inspectors General on Integrity and Efficiency *Quality Standards for Inspection and Evaluation*. We used data from the Practice Manager application. Since we reconciled CMS amounts to judgment orders, we concluded that PM data was sufficiently reliable for our conclusions and recommendations.

The report will be published on the OIG webpage and a synopsis will be presented in the March 31, 2016 *Semiannual Report to Congress*. If you have any questions, please contact Miguel A. Castillo, Assistant Inspector General for Audits, at (202) 418-5084 or Branco Garcia, lead auditor, at (202) 418-5013.

A. Roy Lavik, Inspector General  
Judith A. Ringle, Deputy Inspector General

## Appendix I: Collectability Determinations not Documented and Allowances for Loss not Supported

Given that Enforcement collectability determinations are not all documented using standard measures, that FMB's policy is to recognize custodial receivables (civil monetary penalties) as 100% uncollectable unless Enforcement makes a determination that all or a portion of a receivable is collectable, FMB's and Enforcement's current practice does not document a reliable collectability determination. Because the collectability determination is used to calculate the Custodial Receivables Allowance for Loss for uncollectable CMS in the AFR to the CFTC financial statements, the Allowance for Loss is also not supported.

For the case matters under review, Chief Trial Attorneys (CTAs) documented their basis for collectability for only 2 cases associated with civil monetary penalties (CMP). Enforcement acknowledges that collectability determinations are not documented, but asserts that, regardless of documentation, the CTAs by necessity consider in all cases the issues of ability to pay, willingness to pay, and the availability of other sources from which to secure payment. Nevertheless, as noted in Illustration 1, Enforcement's Practice Manager System requires documentation only for sanctions with perceived collection potential; and that requirement, standing alone, shows that a non-standard method is used.<sup>18</sup>

### Illustration 1 - Practice Manager Screenshot



The screenshot shows a software interface with a menu bar (File, Edit, Tools, View, Window, Help) and a toolbar (Matters, New, Refresh, Print, Desktop, Search). Below the toolbar are tabs: General, Other Details, Final Judgment, Related Entities, Files. The main content area has sub-tabs: Order Information, Non Monetary Sanctions, CMP, Restitution, Disgorgement, Collection, OFM Only. The active tab is 'CMP', showing a form titled 'Monetary Sanctions including CMP and Disgorgement'. The form contains the question 'In your opinion, will we ever collect any actual money for the sanctions?' with a dropdown menu set to 'No'. Below this is a text input field for 'If so, how much?' and a text area for 'Explain your basis for believing that we will actually collect at least a portion of the sanctions'. A red arrow points to the 'No' dropdown option.

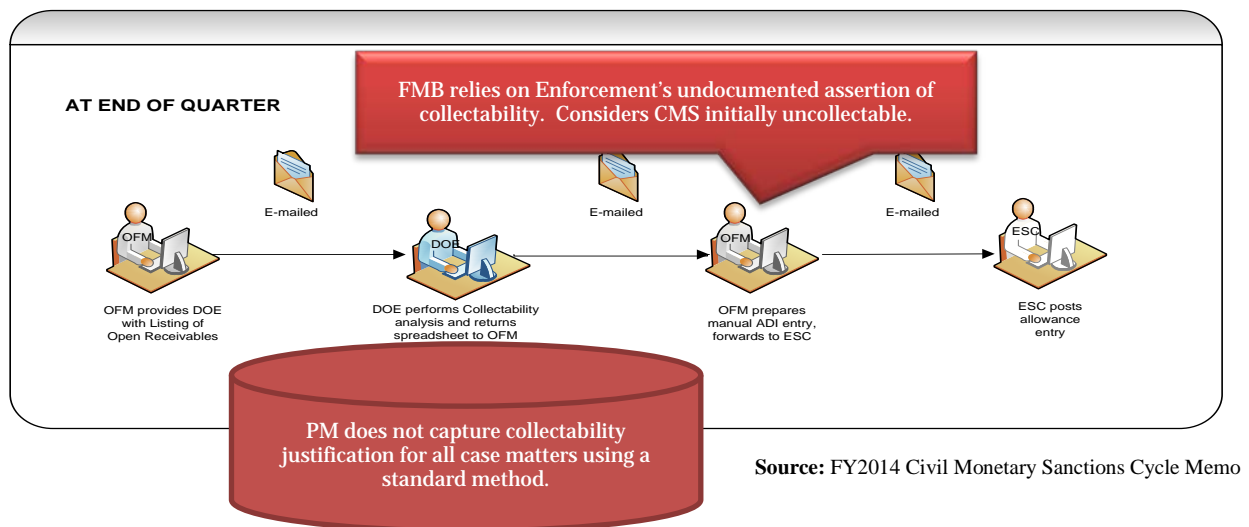
Source: Division of Enforcement Practice Manager System

FMB relies on Enforcement's undocumented assessment of collectability (when CMS is deemed uncollectable) rather than requiring an explanation backed by evidence using

<sup>18</sup> According to Statement of Federal Financial Accounting Standards 1 (SFFAS 1): Accounting for Selected Assets and Liabilities, losses due to uncollectable amounts should be measured through a systematic methodology.

standardized collection metrics<sup>19</sup> for all case matters. Specifically, FMB’s related internal control document states Enforcement “assesses the collectability of each new CMS debt based on knowledge of the financial profile of the debtor” and Enforcement’s procedure manual also requires CTAs to assess collectability based on evidence of the debtor financial profile. Neither addresses standardized metrics for evidencing collectability and its application to all case matters supporting the Custodial Receivables Allowance for Loss<sup>20</sup>. More concerning is FMB’s related internal control narrative that opens the door for passive collection activities. Specifically, FMB’s FY 2014 and FY 2015 CMS Cycle Memo states “All CMS debts are considered uncollectable unless there is evidence to the contrary. Uncollectable debt balances are adjusted to zero for reporting purposes.” Illustration 2 depicts the control gap in the current process.

### Illustration 2 – Enforcement and FMB Control Gap



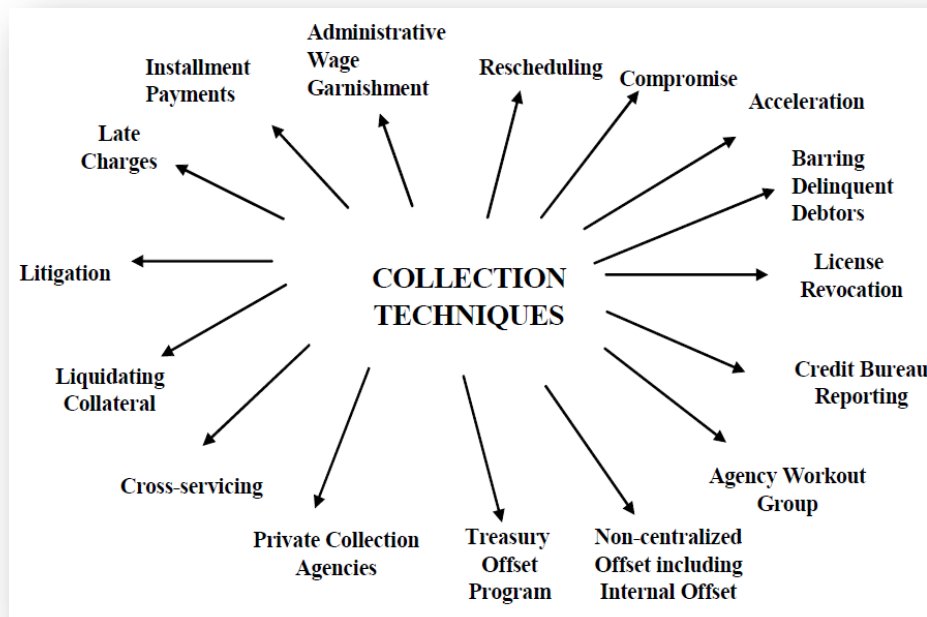
Further, for custodial receivables presented on its annual balance sheet (civil monetary penalties and disgorgements), the CFTC initially refers these debts to the U.S. Treasury (Treasury) for collection. Either Enforcement or Treasury may also decide to transfer the debt to the Department of Justice for further civil action. Although the historically low Treasury collection rates corroborate the Custodial Receivables Allowance for Loss,

<sup>19</sup> According to Statement of Federal Financial Accounting Standards 1 (SFFAS 1): Accounting for Selected Assets and Liabilities, collectability can be determined based on factors such as: (a) the debtor’s ability to pay, (b) the debtor’s payment record and willingness to pay, and (c) the probable recovery of amounts from secondary sources, including liens, garnishments, cross collections and other applicable collection tools.

<sup>20</sup> Statement of Federal Financial Accounting Standards 1 (SFFAS 1): Accounting for Selected Assets and Liabilities, conveys that agencies should disclose the major categories of receivables by amount and type, the methodology used to estimate the allowance for uncollectable amounts, and the total allowance.

our review of the nature of debts and available collection methods<sup>21</sup> suggests that principal reliance on Treasury's collection service may diminish the collection potential of debts and negatively affect collection rates. Specifically, when determining the appropriate collection technique to use, Treasury guidance conveys a number of additional collection techniques as depicted below:

### Illustration 3 – Federal Agency Collection Technique or Tool



Key factors to consider when determining the technique or tool to use include:

- Whether the agency is required by law to use the debt collection tool;
- The size and age of the debt;
- The type of debt, particularly whether commercial or consumer;
- The availability of the debt collection tool. For example, the Treasury Offset Program is not available until the agency knows the debtor's taxpayer identifying number;
- The requirements for use of the debt collection tool, such as dollar thresholds;
- Whether one tool can be used concurrently with another tool, such as private collection agencies and the Treasury Offset Program;
- The time and resources required to use the collection tool;
- The feasibility of using each tool, including any legal or contractual constraints; and

<sup>21</sup> MFR, page 6-10 to 6-11, and OMB A-129, Policies for Federal Credit Programs and Non-Tax Receivables, Section IV and V.

- The cost of each tool relative to the size of the debt. The costs would include administrative costs, as well as fees charged by a private collection agency<sup>22</sup>. The agency should weigh costs against the probability of collecting the debt.<sup>23</sup>

We also noted that Enforcement could aggressively identify cases with potential to route first to the Department of Justice (DoJ).<sup>24</sup> While all cases reviewed meet the debt threshold for referral to DoJ (\$100 Thousand), we noted only 11 of 80 (14%) defendants associated with cases under our review were referred to DoJ to collect CMPs totaling \$91.8 million (6% of \$1.587 billion). In September 2015, as a procedural change, Enforcement teams were asked to provide all available financial information to be included in the referral packages to DoJ.

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<sup>22</sup> According to *Managing Federal Receivables*, Department of the Treasury Financial Management Service, May 2005, private fees are deducted from the collected amounts by statute, not from agency appropriated funds.

<sup>23</sup> *Managing Federal Receivables*, Department of the Treasury Financial Management Service, May 2005 and OMB A-129, Policies for Federal Credit Programs and Non-Tax Receivables, Section IV and V.

<sup>24</sup> 31 CFR Part 901.1, *Aggressive Agency Collection Activity* states “Federal agencies shall aggressively collect all debts arising out of activities of, or referred or transferred for collection services to, that agency.” Aggressive actions include contracting for collection services.

## **Appendix II: Agency Financial Report Can Provide Additional Custodial Receivable Data and Performance Information**

According to OMB Circular No. A-129, *Policies for Federal Credit Programs and Non-tax Receivables*, Section IV. *Managing The Federal Government's Receivables*, agencies shall prepare, in accordance with the CFO Act and OMB guidance, annual financial statements that include information about loan programs and other receivables. Agencies should also collect data for program performance measures, including both measures of programmatic effectiveness in achieving its policy goals, and financial performance measures such as the rate of loan principal repayment, delinquency rates, default rates, recovery rates, comparisons of actual to expected subsidy costs, and administrative costs, consistent with the Government Performance and Results Act (GPRA) Modernization Act of 2010 and Fair Credit Reporting Act. In addition, OMB Circular No. A-136 *Financial Reporting Requirements*, dated September 18, 2014, calls for transparency in financial performance reporting.

However, the CFTC's AFR can provide additional custodial receivables data and performance information resulting from enforcement actions such as age, type, damages, collection rate, or settlement rate by assigned collection entity. While the CFTC considers added relevant information optional, enhanced data and performance information provides various stakeholders the informed ability to assess how well the CFTC's enforcement actions perform against those who improperly engage in commodity futures, swaps and option trading and those who improperly market futures, swaps and options contracts.

We benchmarked CMS performance indicators of the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation (FDIC). As depicted in Illustration 4, the SEC measures not only judgment ordered amounts but also collected amounts presented over a period of fiscal years. Stakeholders can readily calculate percentage of collections; 34% the lowest in six fiscal years. SEC presents this information in the MD&A.

### Illustration 4 - SEC FY 2014 APR Performance Indicator

PERFORMANCE INDICATOR (OUTPUT) 2.3.5 Disgorgement and penalties ordered and the amounts collected						
<b>Description:</b> In addition to other types of relief, the SEC may seek orders requiring parties to disgorge any money obtained through wrongdoing. The SEC is also empowered to seek civil penalties for violations of the securities laws. In some cases, the SEC will seek to obtain large monetary sanctions even in instances where the prospects of collecting on a judgment are slight. The rationale for seeking monetary relief in these circumstances is that such relief, even when likely uncollectible, might become collectible in the future based on the defendant's changed circumstances, and also because such relief can serve to deter others from violating the securities laws. Where appropriate, the SEC has sought to return disgorged funds to harmed investors. Funds not returned to investors are sent to the Treasury or the Investor Protection Fund established pursuant to Section 21F(g) of the Securities Exchange Act of 1934. This indicator lists disgorgement and penalties ordered as a result of SEC cases in each fiscal year and the amounts collected in those actions as of the end of FY 2014. The indicator for collected amounts could change over time based on various factors.						
Fiscal Year	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014 Actual
Ordered amounts (in millions)	2,442	2,846	2,806	3,104	3,424	4,166
Collected amounts (in millions)	1,895	1,793	1,454	1,069	1,919	2,109
<b>Responsible Division/Office:</b> Division of Enforcement	69%	63%	52%	34%	56%	51%
<b>Data Source:</b> DELPHI						

Likewise, the FDIC classifies CMS enforcement actions by distinct type in the MD&A. Illustration 5 shows restitutions and various types of CMPs are presented distinctly.

### Illustration 5 - FDIC FY 2014 APR Performance Indicator

<b>Sec. 8b Cease-and-Desist Actions</b>	<b>57</b>	<b>83</b>	<b>129</b>
Notices of Charges Issued	1	2	0
Orders to Pay <b>Restitution</b>	7	11	9
Consent Orders	48	70	120
Personal Cease and Desist Orders	1	0	0
<b>Sec. 8e Removal/Prohibition of Director or Officer</b>	<b>101</b>	<b>113</b>	<b>116</b>
Notices of Intention to Remove/Prohibit	4	14	8
Consent Orders	97	99	108
<b>Sec. 8g Suspension/Removal When Charged With Crime</b>	<b>2</b>	<b>0</b>	<b>0</b>
<b>Civil Money Penalties Issued</b>	<b>66</b>	<b>94</b>	<b>170</b>
Sec. 7a Call Report Penalties	0	0	1
Sec. 8i Civil Money Penalties	62	81	164
Sec. 8i Civil Money Penalty Notices of Assessment	4	13	5

**Source:** FDIC FY2014 Annual Report

Another transparency opportunity for enforcement actions relates to restitutions. While the CFTC does not report restitution activity in its financial statements because it recognizes them unenforceable against the government, it is not prohibited from providing further discussion of this significant activity in the MD&A section and notes to the financial statements of the AFR.



For the 56 case matters where data was made available, there was \$1.428 billion in restitutions. Court appointed receivers were associated with 12 case matters, three case matters were associated with bankruptcy proceedings, and others were assigned to National Futures Association (NFA) as court monitor without collection enforcement authority. We noted in:

- 1 of 56 cases, the court ordered the CFTC to collect \$9.4 million dollars as restitution. The CFTC referred this matter to the Department of Justice for collection of this debt owed victims.
- 42 of 56 cases the court appointed NFA as monitor to collect \$148 million in restitutions. Per these court orders, the NFA may and sometimes have referred de minimis restitutions to the CFTC to treat as civil monetary penalties.

These activities are not fully visible to a stakeholder of the AFR as the CFTC only discusses assessed penalty amounts in the enforcement MD&A section of the AFR.

## **Appendix III: Management Comments**



## U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre  
1155 21st Street, NW, Washington, DC 20581  
Telephone: (202) 418-5000  
Facsimile: (202) 418-5521  
[www.cftc.gov](http://www.cftc.gov)

**TO:** Miguel A. Castillo  
Assistant Inspector General for Audits

**FROM:** Anthony C. Thompson  
Executive Director

Mary Jean Buhler  
Chief Financial Officer

Aitan Goelman  
Director, Division of Enforcement

**DATE:** March 18, 2016

**SUBJECT:** Management's Response to OIG Review of Custodial Receivables

Thank you for the opportunity to comment on the Office of the Inspector General's (OIG) draft report, *Custodial Receivables Financial Reporting Challenges* (Report Number: 15AU05), regarding recording and reporting on custodial collections of civil monetary sanctions (the "Report"). We appreciate the dialogue we have had on the issues and your willingness to correct factual errors that were noted by the Commission in previous drafts of the report.

CFTC Management has significant concerns about the underlying premise of the Report, specifically that the practices of the Financial Management Branch ("FMB") and the Division of Enforcement with respect to the financial reporting of custodial receivables are unreliable or unsupported, or that these practices may have diminished the collection potential of debts or collection rates. The Report does not provide support to show that meaningful assets went uncollected in case matters that would demonstrate that FMB's financial reporting of custodial receivables is unreliable. We also have concerns about the appropriateness of the findings that question the adequacy of the collection activities of the Department of Treasury ("Treasury") on behalf of the Commission and suggest that more effective collection would have occurred if the Department of Justice ("DoJ") was handling more of the collection work for the CFTC.

That said, in the spirit of cooperation and good governance, and as noted below, FMB and Enforcement will work collaboratively to enhance current procedures and methodologies to improve the transparency and documentation of support for financial reporting and custodial receivables collection decisions and will consider additional performance reporting regarding its enforcement activities. We set forth below specific comments and responses to OIG's recommendations and the findings made in the Report.

**OIG Recommendation 1: Standardize procedures to evidence collectability determinations and to better support the presentation of an Allowance for Loss.**

***Management Response:*** The Commission's allowance for loss on custodial receivables is presented in conformance with OMB Circular A-136, *Financial Reporting Requirements*. Division of Enforcement

staff provide an initial opinion as to the collectability of all judgments, based on knowledge of the financial profile of the debtor obtained through the course of the investigation and litigation of each case (including efforts to identify and freeze assets at the beginning of cases, when any remaining assets are most likely to be recoverable) and supported by relevant documents and information. The assessment of the potential collectability of a judgment requires consideration and evidence of ability to pay, willingness to pay, and the availability from other sources from which to secure payment. In addition, Enforcement transparently and specifically addresses where it believes there may be assets available for collection; receivables are only considered uncollectable where there is no evidence of assets against which to collect. Accordingly, it is not correct to say that the assessment of collectability is not supported or to infer that the practices of FMB and Enforcement may have diminished the collection potential of debts or negatively affected collection rates. To the extent that the Report implies that collectable amounts were left uncollected, the Report does not provide support for this conclusion. However, there may be opportunities for improvement in the documentation and transparency of the analysis that supports Enforcement's preliminary collectability assessment<sup>1</sup> and FMB's determination as to the appropriate allowance for loss on custodial receivables. FMB and Enforcement will work collaboratively to standardize the procedures for this process to ensure clear and consistent documentation.

**OIG Recommendation 2: Identify most promising cases to route first to the Department of Justice.**

*Management Response:* The Commission has not received, and the Report does not reflect, supporting evidence that would corroborate the assertion that “principal reliance on Treasury’s collection service may diminish the collection potential of debts and negatively affect collection rates.” Report at 8. The CFTC, through FMB, sends an initial dunning letter to each of its debtors, regardless of the related collectability determination, in accordance with the Debt Collection Improvement Act (DCIA) and other federal collection regulations. This initial dunning letter serves as the Commission’s initial debt collection activity, after which time it refers debts to the Treasury or DoJ if debts are not collected in a timely manner. The Commission notes that there have been six reports issued by the Government Accountability Office (GAO) and the OIG on its collection activities since it signed the cross-servicing agreement with Treasury in fiscal year 1999.<sup>2</sup> In its 1999 audit report, GAO stated “CFTC officials told us that they are considering whether to enter into an agreement with Treasury under which CFTC would refer unpaid debt to Treasury for collection in accordance with the Debt Collection Improvement Act of 1996” and “CFTC can refer unpaid fines to the Treasury Department and the Attorney General for centralized debt collection.”<sup>3</sup> In its 2001 audit report, the CFTC’s OIG recommended that CFTC “send uncollected civil monetary penalties more than 180 days past their due date to Treasury at least once a month.”<sup>4</sup> In its 2001 follow-up audit report, GAO recommended that CFTC “take steps to ensure that delinquent fines are promptly referred to FMS.”<sup>5</sup> In its 2003 follow-up audit report, GAO noted that CFTC “was actively pursuing collections on all its uncollected cases, primarily through the Departments of Treasury and Justice,” therefore indicating that using Treasury and Justice as CFTC’s primary collection vehicles was acceptable.<sup>6</sup> In its 2004 follow-up audit report, the CFTC’s OIG “determined that for the period from

<sup>1</sup> The assessment is preliminary because, as discussed below, the Commission refers all judgments to either Treasury or DoJ for actual collection work in accordance with the DCIA and Treasury guidance.

<sup>2</sup> (1) *Money Penalties: Securities and Futures Regulators Collect Many Fines But Need to Better Use Industrywide Data* (GAO/IGD-99-8, Nov. 2, 1998); (2) *CFTC: Most Fines Collected, but Improvements Needed in the Use of Treasury’s Collection Service* (GAO-01-900, July 16, 2001); (3) *GAO, SEC and CFTC Fines Follow-up: Collection Programs Are Improving, but Further Steps are Warranted* (GAO-03-795, July 15, 2003); (4) *SEC and CFTC Penalties: Continued Progress Made in Collection Efforts, but Greater SEC Management Attention Is Needed* (GAO-05-670, August 31, 2005); (5) *Audit of Civil Monetary Penalty Collections* (CFTC OIG Audit Report A-01-01, April 27, 2001); and (6) *Follow-Up Audit Of Civil Monetary Penalty Collections* (CFTC OIG Audit Report A-04-04, September 23, 2004)

<sup>3</sup> GAO/IGD-99-8, 5 and 11.

<sup>4</sup> A-01-01, 6.

<sup>5</sup> GAO-01-900, 27.

<sup>6</sup> GAO-03-795, 23.

2001 through 2004, CFTC had consistently complied with DCIA by referring delinquent debt to FMS within the allowable 180 days for collection services.<sup>7</sup> In its 2005 follow-up audit report, GAO reported that CFTC had fully addressed its 2001 recommendation “that CFTC take steps to ensure that delinquent CMPs were promptly referred to FMS.”<sup>8</sup> The primary focus of each of these reports has been on timelier referral of CFTC debts to Treasury.

We note that the guidance cited in the Report encourages agencies to refer debts to Treasury,<sup>9</sup> and Treasury is authorized to utilize the same collection techniques available to the Commission (which the Commission is not adequately resourced to employ on its own).<sup>10</sup> The Report cites no evidence to suggest that Treasury’s collection activities are inadequate or that DoJ would be more effective than Treasury.<sup>11</sup> Nor does the Report support the inference that collection directly by the CFTC would result in any meaningful greater collection. *Cf.* Report at 3. For the CFTC to engage in collection of debts, despite the government already dedicating resources to that work at Treasury and DoJ, the CFTC would have to divert and re-allocate constrained resources presently committed to other mission-driven functions, such as resources dedicated to investigations and litigations to stop on-going fraud and to protect market integrity from acts of manipulation, disruptive trading, and other market abuses. Moreover, the CFTC does refer appropriate debts directly to DoJ without first referring them to Treasury; as the Report notes, 14% of defendants in the cases reviewed by OIG were referred to DoJ for litigation. In FY 2015 and FY 2016, to date, the rate of referral to DoJ has only increased. However, FMB and Enforcement will work collaboratively to document and further refine the methodology and process by which cases are identified for referral to DoJ versus Treasury.

**OIG Recommendation 3: Provide additional enforcement data and performance information in the AFR.**

*Management Response:* The Commission will consider additional performance reporting regarding its enforcement activities. However, such reporting would be more appropriately included in CFTC’s Annual Performance Report (APR) as only high-level summary performance information is generally included in an Agency Financial Report (AFR). The examples provided in Illustrations 4 and 5 of the Report are excerpts taken from Securities and Exchange Commission (SEC) and Federal Deposit Insurance Corporation (FDIC) reports that are not AFR-equivalent reports.<sup>12</sup> It will be necessary to carefully consider how to present any additional performance information so that it is helpful to the reader and not misleading. For example, the Report’s focus on custodial receivables omits presentation of collections information for judgments entered and paid within the same fiscal year; the collection rate of all judgments entered in a fiscal year is significantly higher than for receivables only,<sup>13</sup> as the most

<sup>7</sup> Summary of OIG A-04-04 by GAO in report GAO-05-670, 32.

<sup>8</sup> GAO-05-670, 32.

<sup>9</sup> Department of the Treasury Financial Management Service, *Managing Federal Receivables* (May 2005), at 6-27 (noting that the Debt Collection Improvement Act requires that debt collection activities be consolidated within the government, to the extent possible, to minimize costs, including through the Cross-Servicing Program operated by Treasury’s Fiscal Service).

<sup>10</sup> *See id.* at 6-10, 6-31–6-32.

<sup>11</sup> Relevant federal regulations reflect that agencies are authorized, indeed, encouraged, to utilize the debt collection services of Treasury and DoJ rather than undertaking their own collection efforts. *See, e.g.*, 31 C.F.R. § 901.1(d).

<sup>12</sup> *See* (1) SEC FY 2014 Annual Performance Report submitted as part of its FY 2016 Congressional Budget Justification (“SEC FY 2014 APR”), available at <http://www.sec.gov/about/reports/secfy16congbudgetjust.pdf>, at 43; and (2) FDIC Annual Report at [https://www.fdic.gov/about/strategic/report/2014annualreport/index\\_pdf.html](https://www.fdic.gov/about/strategic/report/2014annualreport/index_pdf.html), at 115 (Appendix). According to the transmittal memo from the Chairman on page 2 of the FDIC report, the Annual Report is in the format of a Performance and Accountability Report, not an AFR.

<sup>13</sup> For example, in FY 2014, 39% of all judgments entered were collected that year, whereas less than 1% of custodial receivables were deemed collectable; for FY 2015, the collection rate was 92%, due primarily to a number of large penalties imposed against financial institutions in connection with benchmark and forex manipulation cases, as compared to, again, less than 1% of custodial receivables deemed collectable.

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collectable judgments are typically paid promptly.<sup>14</sup> In addition, any discussion of collection performance must note that because Commission policy is to impose civil monetary penalties without regard to a defendant's ability to pay,<sup>15</sup> CFTC collection rates will generally be lower than that of other agencies, like the SEC, that do consider ability to pay in setting penalty amounts.<sup>16</sup>

In lieu of an APR, Treasury's Bureau of the Fiscal Service reports performance information on its collection activities as part of its annual budget justification.<sup>17</sup> In response to this audit recommendation, the Commission will engage with Treasury as appropriate to ascertain whether Treasury's performance measures related to its collection activities incorporate CFTC debt collection activity at the appropriate level of reporting to enable the public to understand the government's efforts to collect delinquent debts.

Regarding reporting on restitution, there is no legal recourse against the government with respect to restitution so information on restitution is not appropriate for inclusion in the notes to the financial statements since it fails the rights and obligations management assertion and may confuse readers regarding the Commission's ability to enforce collection. However, FMB and Enforcement will work collaboratively to identify the appropriate reporting for restitution in the Management's Discussion and Analysis section of the AFR.

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Thank you again for the opportunity to comment on this Report in advance of its publication. Please do not hesitate to contact us if you need additional information or wish to discuss any of our comments in further detail.

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<sup>14</sup> Notably, the SEC's APR presents collections information in this format, noting ordered amounts and collected amounts by fiscal year. *See, e.g.*, SEC FY 2014 APR at 43.

<sup>15</sup> *See* CFTC Policy Statement Relating to the Commission's Authority to Impose Civil Money Penalties and Futures Self-Regulatory Organization's Authority to Impose Sanctions; Penalty Guidelines [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,265 at 42,246 (Nov. 1994).

<sup>16</sup> *See, e.g.*, 15 USC § 78u-2(d).

<sup>17</sup> *See* FY 2017 budget submission at <http://www.treasury.gov/about/budget-performance/Pages/cj-index.aspx>.