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Office of the
Inspector General

TO: Sharon Brown-Hruska
Acting Chairman

FROM: A. Roy Lavik
Inspector General

DATE: November 12, 2004

SUBJECT: Inspector General's Assessment Of The Most Serious Management Challenges Facing CFTC.

This letter is submitted in response to an October 18, 2002 memorandum from Mark Everson, Deputy Director for Management of the Office of Management and Budget. Part III of that memorandum entitled, "Financial Section (c) An Inspector General (IG) Summary of Serious Management Challenges" requires the Inspector General to provide a summary of the management challenges facing the agency that the IG considers to be serious and a brief assessment of the agency's progress in addressing those challenges.

Background

On January 24, 2000, Congress enacted the *Reports Consolidation Act of 2000* to provide financial and performance information in a more meaningful and useful format for Congress, the President, and the public. Included in the Act is the requirement that the Inspector General of each Federal agency summarize what he or she considers to be the most serious management and performance challenges facing the agency and assess the agency's progress in addressing those challenges. In accordance, with the *Reports Consolidation Act of 2000*, I am submitting, for the first time, my annual assessment of the major management challenges confronting the Commodity Futures Trading Commission (CFTC).

Congress left the determination and threshold of what constitutes a most serious challenge to the discretion of the Inspector General. As a result, I applied the following definition in preparing my statement:

> Serious management challenges are mission critical area or programs that have the potential for a perennial weakness or vulnerability that, without substantial management attention, would seriously impact agency operations or strategic goals.

In Fiscal Year 2002, Congress passed the Accountability of Tax Dollars Act. This Act requires CFTC, along with numerous other federal entities, to have its financial statements audited annually. Fiscal Year 2004 is the first fiscal year that the CFTC's financial statements were audited. On January 15, 2004 the Office of Inspector General (OIG) hired an independent public accounting firm, KPMG, to conduct an audit of the CFTC's financial statements. I am pleased to say that the audit resulted in an unqualified audit opinion. This letter relied on the data contained in the audited financial statements as well as the agency's Performance and Accountability Report (PAR).

Serious Management Challenges

The OIG reviewed all the management challenges listed by program areas as well as external challenges mentioned in the PAR. As a result of our review, the OIG concludes that management fairly stated the challenges faced by the agency and identified in the PAR. Nonetheless, the OIG identifies two management challenges that we consider to be the most serious management challenges facing the agency. Although the PAR identified challenges by program areas, the OIG adopted a broader, agency-wide, perspective in selecting two summary management challenges.

We have combined the agency's *Challenges in the Marketplace* and *Technological Challenges* into one challenge that we describe as Technological Responses To Industry Dynamics. In addition, Human Resource Planning to achieve *Optimal Staffing (stated in the PAR)* is the second of the two management challenges that the OIG considers to be the most serious management challenges facing the CFTC. These two management challenges in no way diminish other challenges identified by the agency but they ought to guide the agency's efforts in the near future.

I. Technological Responses To Industry Dynamics

In the last decade, 815 new futures and option contracts were approved or certified by the CFTC. During that same time period exchange traded futures and options volume has dramatically increased to over one billion futures and options contracts traded annually on exchanges monitored by the CFTC. During the same period and continuing into the foreseeable future, it is doubtful that the agency's budget will experience an equal increase. Consequently, the OIG's concern is that management ought to devote the necessary resources to dramatically improve its use of technology to assist existing and future employees with their oversight responsibilities mandated by the Commodity Futures Modernization Act of 2000 (CFMA)

The CFMA under section 3(b) charged the agency with the promotion of responsible innovation and fair competition. Our review of the PAR leads us to conclude that the novel and complex issues raised by this mandate will challenge the agency to efficiently use its skilled economists and attorneys to evaluate innovative products likely to be introduced to the marketplace -- possibly via an electronic trading platform. Furthermore, the OIG recognizes that the agency has responded to this challenge by initiating the development of a new integrated surveillance system with the goal of increasing the productivity of staff in the Division of Market Oversight and Division of Enforcement. Such quick response is to be applauded; however, all new systems are fraught with the danger of delays and incorrect specifications, especially a new electronic market surveillance system for a rapidly growing industry such as the futures and options industry. The OIG will actively monitor management's efforts to deliver an effective technological solution to meet its mandates under the CFMA.

Critical and appropriate observation by the OIG can spur the agency to embrace and successfully meet the technological challenges it faces from continued success of exchange traded futures and options products. In fact, the OIG has worked, proactively, with the Division of Enforcement in its efforts to adopt the electronic enforcement modernization project–E-Law, which will significantly increase the productivity of CFTC attorneys. The agency will soon adopt a new Asset Management Program to manage agency's assets throughout their lifecycle from requisition to surplus, which should aid the agency to save time, money, and safeguard its assets. This proposed electronic Asset Management system is a direct remedy for a finding (Lack Of Internal Controls For Fixed Assets) in the financial statement audit issued concurrently with this letter.

II. Human Resource Planning

By March 2006, current estimates are that over twenty percent of CFTC staff will be eligible for retirement. This is a significant problem which requires a great deal of planning. The OIG is heartened by the agency's decision to establish a Human Capital Team and engage a consulting firm to assist it to catalogue current skills of existing employees and propose possible pathways for meeting this potential deficit that is likely to occur in Fiscal Year 2006.

In accordance with GAO's challenge to the executive branch to extend its evaluative horizon, the OIG is challenging this agency to focus not just on the present fiscal year human resource needs but broaden its evaluative envelope to include future trends and challenges. Proper succession planning and management efforts can help an organization become what it needs to be, rather than simply to recreate the existing organization. The agency must focus on strengthening both current and future organizational capacity to meet future externally imposed challenges. It must address specific human capital challenges, such as diversity, leadership capacity, and retention. Also, as stated in the PAR, the agency is challenged to effectively coordinate its staff with other government agencies, such as, the Department of the Treasury and the Securities and Exchange Commission.

In summary, the OIG's review of the PAR and familiarity with the organization lead us to conclude that the agency has clearly recognized the management challenges it is likely to face in Fiscal Year 2005. We believe that plans presently in place can properly address the challenges stated in the PAR. We look forward to evaluating the success of the agency in satisfying its regulatory mandates.