



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of the  
Inspector General

April 30, 2010

TO: Gary Gensler  
Chairman

FROM: A. Roy Lavik  
Inspector General 

SUBJECT: Semiannual Report of the Office of the Inspector General

Attached is the Semiannual Report of the Office of the Inspector General for the period from October 1, 2009 through March 31, 2010. This report is submitted to you in accordance with the requirements of Section 5 of the Inspector General Act of 1978, as amended.

I appreciate your continuing support of this office.

Attachment

OFFICE OF THE INSPECTOR GENERAL  
COMMODITY FUTURES TRADING COMMISSION

SEMIANNUAL REPORT  
FOR THE PERIOD FROM  
October 1, 2009 THROUGH March 31, 2010

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## EXECUTIVE SUMMARY

This semiannual report is issued by the Commodity Futures Trading Commission's (CFTC's) Office of Inspector General (OIG) pursuant to the Inspector General Act of 1978, as amended. It summarizes OIG's activities and accomplishments for the period October 1, 2009 through March 31, 2010. During this period, OIG completed two audits, completed one evaluation, issued an assessment of most serious management challenges, began one inspection, began planning one review, continued work on one review, began a procurement action, and initiated an update of one review. OIG also responded to Congressional inquiries and commented to Congressional staff on pending legislation and other issues. OIG reviewed proposed Division of Enforcement actions, as well as rules proposed by CFTC and by regulated entities, participated in training, monitored peer review activities, visited CFTC field offices, and participated in Government-wide OIG professional and cooperative meetings and activities. No investigations were pending, opened or completed during this reporting period. No significant problems, abuses or deficiencies regarding CFTC programs and operations were identified during the reporting period.

Highlights of OIG's completed and ongoing audit, evaluation, investigation and other projects include:

- OIG oversaw the completion of the fiscal year (FY) 2009 audit of the CFTC financial statements. For the fifth consecutive year, an independent public accounting firm reported that the CFTC financial statements were presented fairly, in all material respects, and in conformity with the U.S. generally accepted accounting principles for Federal agencies.
- OIG completed work on the FY 2009 audit of compliance with the Federal Managers' Financial Integrity Act (FMFIA). No significant issues were noted.
- OIG completed work on the FY 2009 Federal Information Security Management Act (FISMA) independent evaluation. No significant issues were noted.
- OIG issued its Assessment of the Most Serious Management Challenges Facing the CFTC: 1) Harmonization of CFTC and Securities and Exchange Commission (SEC) Overlapping Regulations; 2) CFTC's Regulatory Model for the Swaps Derivatives Market; and, 3) CFTC's Regulatory Responsibilities over the Potential Carbon Emission Trading Markets.
- On December 17, 2009, the Assistant Inspector General for Audits completed a detail to the International Trade Commission where he served as Acting Inspector General. The detail began on August 17, 2009.
- OIG began a new procurement to secure an Independent Public Accounting (IPA) firm to perform the CFTC financial statement audit for FY 2010. Allegations concerning possible misconduct relating to a prior procurement process, which the IG duly referred to the Integrity committee in March 2009, were pending at the close of this reporting period.

- OIG received an anonymous allegation regarding suspected improper disposal of surplus agency Information Technology (IT) equipment. In response, OIG began an inspection of the agency's efforts to account for and dispose of surplus IT equipment in FY 2009. This inspection is nearing completion.
- On its own initiative and in response to Congressional inquiry, OIG began an update of an earlier review of the need to reopen an agency field office on the West Coast.
- The OIG conducted about 80 interviews in connection with an ongoing review of the effect of the CT Pay system on recruitment and retention.
- The OIG began planning a new review that will involve an independent assessment of agency market surveillance communications with traders and market professionals.

## INTRODUCTION

### 1. CFTC Programs and Operations.

Congress created the Commodity Futures Trading Commission in 1974 as an independent agency with the mandate to regulate commodity futures and options markets in the United States. The Commission's mandate was renewed and/or expanded in 1978, 1982, 1986, 1992 and 1995. In December 2000, the Commission was reauthorized by Congress and the President through Fiscal Year 2005 with the passage of the Commodity Futures Modernization Act of 2000 (CFMA). In May of 2008, Congress reauthorized the CFTC through Fiscal Year 2013.

The CFTC is responsible for fostering the economic utility of futures markets by encouraging their competitiveness and efficiency, ensuring their integrity and protecting market participants against manipulation, abusive trade practices and fraud. Through effective oversight regulation, the CFTC enables the commodity futures markets better to serve their vital function in the nation's economy—providing a mechanism for price discovery and a means of offsetting price risks.

The CFTC operating divisions are: Office of the Chairman, Office of the Executive Director, Office of General Counsel, Division of Clearing and Intermediary Oversight, Division of Enforcement, Division of Market Oversight and Office of the Chief Economist. In addition to its headquarters office in Washington, DC, the CFTC maintains offices in Chicago, Illinois; Kansas City, Missouri; and New York, New York.

### 2. OIG Responsibilities.

The CFTC OIG was created in 1989 in accordance with the 1988 amendments to the Inspector General Act of 1978 (P.L. 95-452). OIG was established as an independent unit to:

- Promote economy, efficiency and effectiveness in the administration of CFTC programs and operations and detect and prevent fraud, waste and abuse in such programs and operations;
- Conduct and supervise audits and, where necessary, investigations relating to the administration of CFTC programs and operations;
- Review existing and proposed legislation, regulations and exchange rules and make recommendations concerning their impact on the economy and efficiency of CFTC programs and operations or the prevention and detection of fraud and abuse;
- Recommend policies for, and conduct, supervise, or coordinate other activities carried out or financed by such establishment for the purpose of promoting economy and efficiency in the administration of, or preventing and detecting fraud and abuse in, its programs and operations; and
- Keep the Chairman and Congress fully informed about any problems or deficiencies in the administration of CFTC programs and operations and provide recommendations for correction of these problems or deficiencies.

OIG is required to conduct, supervise and coordinate audits of CFTC programs and operations in accordance with generally accepted government auditing standards.<sup>1</sup> OIG is also required to recommend changes to existing and proposed CFTC programs and operations to promote economy, efficiency and effectiveness and to prevent and detect fraud and abuse.

The purpose of OIG audits generally is to ensure that:

- Funds have been expended in a manner consistent with related laws, regulations and policies;
- Resources have been managed effectively and efficiently;
- Stipulated program objectives have been achieved;
- Agency operations have not been subject to improper influence or corruption; and
- Resources have been safeguarded.

The OIG also conducts inspections, evaluations, and reviews from time to time. As stated in the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency:

An inspection is defined as a process that evaluates, reviews, studies, and/or analyzes the programs and activities of a Department/Agency for the purposes of providing

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<sup>1</sup> The publication titled *Government Audit Standards* (July 2007) was issued by the U.S. Government Accountability Office. The standards are available at <http://gao.gov/govaud/ybk01.htm>.

information to managers for decision making; making recommendations for improvements to programs, policies, or procedures; and identifying where administrative action may be necessary. Inspections may be used to provide factual and analytical information; monitor compliance; measure performance; assess the efficiency and effectiveness of programs and operations; share best practices; and inquire into allegations of fraud, waste, abuse, and mismanagement.<sup>2</sup>

OIG investigations are performed in accordance with the *Quality Standards for Investigations* issued by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency<sup>3</sup> and are performed in response to allegations and/or evidence indicating possible violations of law, regulations, or applicable standards, as well as other improper conduct in connection with the programs and operations of the Agency.

OIG operates independently of the Agency and has not experienced any interference from the CFTC Chairman in connection with the conduct of any investigation or audit, and our investigations have been pursued regardless of the rank or party affiliation of the target. OIG has also conducted audits without interference where it has perceived the opportunity to recommend improvement to futures regulation efforts, again without regard to the party affiliation of any Chairman.<sup>4</sup> No Chairman has interfered with OIG decisions regarding personnel actions, training, travel or other expenditures; however, a procurement process initiated in 2008 to secure the services of an external auditor to conduct the required CFTC financial statement audit has raised issues pertaining to IG independence as well as allegations requiring referral to the Integrity Committee, which referral was made by the IG in March 2009. The allegations were pending with the Integrity Committee at the end of this reporting period.

### **3. OIG Resources.**

The CFTC OIG consists of the Inspector General, the Assistant Inspector General for Audits (AIGA), an Attorney-Advisor and a secretary. The present Inspector General assumed his position on October 7, 1990. The AIGA joined the office in 1999, and the Attorney-Advisor joined in 2007. During this reporting period, the AIGA completed a detail as Acting Inspector General for the International Trade Commission (ITC). The AIGA served as Acting Inspector General at ITC from August 17, 2009 to December 17, 2009.

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<sup>2</sup> The publications titled *Quality Standards for Investigations* (December 2003) and *Quality Standards for Inspections* (January 2005) were jointly issued by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency. The two councils were later combined to form the Council of Inspectors General on Integrity and Efficiency. The standards are available at <http://www.ignet.gov/pande/standards1.html>.

<sup>3</sup> See fn.2.

<sup>4</sup> The Inspector General Act of 1978, as amended, states: "Neither the head of the establishment nor the officer next in rank below such head shall prevent or prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation...." 5 U.S.C. App. 3 sec. 3(a).



# COMPLETED AUDITS, REVIEWS, EVALUATIONS, and INSPECTIONS

## 1. Audit of CFTC Financial Statements for Fiscal Year 2009

### Objective.

In FY 2002, Congress passed the Accountability of Tax Dollars Act. The Act requires the CFTC, along with numerous other Federal entities, to have its financial statements audited annually. To this end, in 2009 the Acting Chairman selected Clifton Gunderson, an IPA, to provide the audit effort required to enable the contractor to render an opinion on the agency's financial statements for Fiscal Year 2009. The OIG accepted the Acting Chairman's selection under protest.

The specific objectives of this audit included determinations whether:

(1) The financial statements present fairly the financial position of the Commodity Futures Trading Commission in accordance with generally accepted accounting principles (GAAP) as promulgated by the Federal Accounting Standards Advisory Board (FASAB). The five financial statements, along with all corresponding notes to be audited include: (a) Balance Sheet; (b) Statement of Net Cost; (c) Statement of Changes in Net Position; (d) Statement of Budgetary Resources; and (e) Statement of Custodial Activity.

(2) Management's assertions about the effectiveness of its internal controls for achieving internal control objectives described in AU Section 319 and the Federal Managers Financial Integrity Act (FMFIA) are fairly stated in all material respects. The contractor makes this determination in part by obtaining an understanding of the internal control policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, and account balances. For those significant control policies and procedures that have been properly designed and placed in operation, the contractor performs sufficient tests to provide reasonable assurance as to whether the controls are effective and working as designed.

The IPA limits its internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin 07-04. Further, the IPA is not required to test all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to achieving efficient operations.

With respect to internal controls related to performance measures reported in the accountability report, the IPA obtains an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 07-04. The procedures are not required to provide assurance on internal controls over reported performance measures.

(3) The agency has complied with selected provisions of laws and regulations identified by OMB Bulletin 07-04 or the Inspector General, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. The IPA limits its tests of compliance to these provisions and need not test compliance with all laws and regulations applicable to the CFTC.

Clifton Gunderson rendered an opinion on the agency's financial statements for Fiscal Year 2009 in accordance with generally accepted auditing standards, Government Auditing Standards and OMB Bulletin 07-04.

#### Status.

For the fifth consecutive year, an independent public accounting firm reported that the CFTC financial statements were presented fairly in all material respects, and in conformity with the U.S. generally accepted accounting principles for Federal agencies. For the third consecutive year the Commission had no material weaknesses, and was compliant with laws and regulations. This includes compliance with the Federal Information Security Management Act. Furthermore, the CFTC financial management system is in substantial compliance with the Federal Financial Management Improvement Act of 1996 (although CFTC is not required to comply with FFMIA, it has elected to do so.) The financial statement audit report was issued on November 13, 2009.

## **2. Assessment of CFTC's Management Challenges**

#### Objective.

In addition to authorizing the agencies to provide financial and performance information in a more meaningful and useful format for Congress, the Reports Consolidation Act of 2000 also required the Inspector General to summarize the most serious management and performance challenges facing the CFTC and to assess the Agency's progress in addressing those challenges for inclusion in the annual Performance and Accountability Report (PAR).

#### Status.

The OIG prepared the required summary of the Agency's most serious management and performance challenges in accordance with the Reports Consolidation Act of 2000 for inclusion in the FY 2009 PAR, and also reported on status of the most serious management and performance challenges identified by the Inspector General in FY 2008. In FY 2008, the OIG identified two most serious management challenges: Modernization of Electronic Market Surveillance and Efficient Acquisition and Integration of Skilled Human Capital. During fiscal year 2009 the Agency addressed both issues. The Agency upgraded its servers and trade analysis systems to modernize and improve its surveillance of exchange traded futures and options contracts. As the Agency acquires additional regulatory responsibilities, we hope that the Agency is able to scale up its market surveillance capabilities. Since the start of FY 2009 the Agency has increased its staff by 100 new employees (a 21% increase). This dramatic influx of manpower should assist the Agency in meeting its expanding regulatory mission. The OIG is conducting a review of the recent recruitment in order to evaluate the effect of the CT pay

system on recruitment and retention, which review will examine the skill sets of this new talent pool.

For FY 2009, the OIG identified three “most serious” management challenges: Congressional demand that the CFTC and SEC harmonize their regulation of overlapping financial products; a decision on the CFTC’s regulatory model for the swaps derivatives market; and expansion of CFTC’s regulatory responsibilities over the potential carbon emission trading markets.

*Harmonization of CFTC and SEC Overlapping Regulations.* On June 17, 2009, the White House released a White Paper on Financial Regulatory Reform calling on the SEC and CFTC to “make recommendations to Congress for changes to statutes and regulations that would harmonize regulation of futures and securities.”<sup>5</sup> Specifically, the White House recommended “that the CFTC and the SEC complete a report to Congress by Sept. 30, 2009, that identifies all existing conflicts in statutes and regulations with respect to similar types of financial instruments and either explains why those differences are essential to achieve underlying policy objectives with respect to investor protection, market integrity, and price transparency or makes recommendations for changes to statutes and regulations that would eliminate the differences.”<sup>6</sup> In September 2009, the CFTC and SEC collaborated on an initial effort to begin implementation of the White House mandate, and released the required joint report on October 16, 2009. This effort identified numerous areas for operational coordination that will require substantial analysis and may yield a more efficient regulatory structure over the financial markets. The OIG looks forward to the resulting regulatory model that will define the future mission of this Agency.

*CFTC’s Regulatory Model for the Swaps Derivatives Market and the Need for Additional Human Capital.* Congressional action will determine the Agency’s need for additional human capital to regulate Over-the-Counter derivatives markets, including swaps (contracts that call for an exchange of cash between two participants based on an underlying rate or index, or the performance of an asset). The Congressional Budget Office estimates that up to 235 employees may be needed by fiscal year 2011 to regulate central counterparty clearing of swaps.<sup>7</sup> In our estimation, this would require a 40% increase over existing staffing levels--a considerable challenge for any organization. We believe both the intricacies of any forthcoming derivatives regulation and the acquisition of human capital to carry out the regulatory tasks will challenge the CFTC in the coming year.

*CFTC’s Regulatory Responsibilities over the Potential Carbon Emission Trading Markets.* Congress may soon move forward on new legislation to regulate carbon emissions trading. A recent Congressional Budget Office study projected that trading in carbon offsets could be a \$60 billion market in 2012.<sup>8</sup> Presuming Congress assigns regulatory responsibility to the CFTC, the CFTC will require additional staffing increases in order to absorb this additional regulatory

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<sup>5</sup> Financial Regulatory Reform: A New Foundation, p.14-15.  
[http://www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf) .

<sup>6</sup> *Id.*, pg. 50.

<sup>7</sup> H.R. 3795 Derivative Markets Transparency and Accountability Act of 2009 Congressional Budget Office Cost Estimate November 6, 2009 Page 3. <http://www.cbo.gov/ftpdocs/107xx/doc10703/hr3795hfs.pdf>.

<sup>8</sup> H.R. 2454 American Clean Energy and Security Act of 2009 Congressional Budget Office Cost Estimate June 5, 2009 Page 11.  
<http://www.cbo.gov/ftpdocs/102xx/doc10262/hr2454.pdf>.

responsibility. We believe the increased responsibility will challenge the CFTC in the coming year.

In November 2009 the OIG submitted the report to the Agency for inclusion in the PAR, and the Agency transmitted the PAR to OMB and Congress.

### **3. Audit of Compliance with the Federal Managers' Financial Integrity Act, FMFIA.**

#### Objective.

In support of OMB Circular A-123 (Revised), the Inspector General evaluates, provides technical assistance and advises the agency head as to whether the agency's review and evaluation process was conducted in accordance with the circular's requirements.

#### Status.

OIG reviewed all of the draft internal control reviews produced by agency staff and provided comments to the originating divisions. OIG offered its services to the CFTC Internal Control Committee as advisor and consultant on conducting and reporting on vulnerability assessments and internal control reviews. OIG reported the results of its review of the final submissions to the Chairman in its annual assurance letters to the Chairman. No significant issues were noted.

### **4. Evaluation of the CFTC Information Security Program and Practices, FISMA.**

#### Objective.

The Federal Information Security Management Act requires the Inspector General or his designee to perform annual independent evaluations of the information security program and practices of the agency.

#### Status.

To provide a comprehensive review of the Commission's security program, Office of Information Technology Services (OITS) and OIG worked jointly in gathering and interpreting information relating to the CFTC information security program. Using the information supplied by OITS staff, a contractor and the program managers, the Inspector General reviewed and analyzed the information and responded in tabular form to the questions raised by the OMB Guidance. Results of this effort were transmitted to the CFTC's Chief Information Officer (CIO) in November 2009, for combination with the CIO's assessment and inclusion in the Chairman's report to OMB. No significant issues were noted.

# **CURRENT AUDITS, REVIEWS, EVALUATIONS, and INSPECTIONS**

## **1. Review of the Effect of the CFTC Pay System on Recruitment and Retention.**

### Scope and Objective

This review will evaluate the effect of the CFTC pay scale on current recruitment and retention. Section 10702 of Public Law 107-171, the Farm Security and Rural Investment Act of 2002 (FSRIA) authorized CFTC to create its own pay system (CT pay system or CT pay). CFTC began paying employees under the new pay system in 2003. We are going to review retention during the past six years, as well as changes in recruitment that may be attributed to the new pay system. The objectives of this review are: to elicit employee and management views on how the CT pay system has effected recruitment and retention over the past six years, coupled with Agency data that will permit an informed analysis of the effect of the CT pay system.

### Status

During the reporting period, the OIG completed the planning stages of this review, researching applicable law and policy regarding the CT pay system and informally discussing the review with Agency management. The OIG completed 79 interviews of CFTC employees to get their views on whether and to what extent CT Pay influenced their decision to apply with CFTC, to accept a job offer, and to stay employed at CFTC.

## **2. Inspection of CFTC's Disposal of Surplus Information Technology Equipment.**

### Scope and Objective

In Fiscal Year 2009 the Commodity Futures Trading Commission(CFTC) initiated a technology refresh of all IT equipment provided to employees. The replaced equipment became surplus equipment. Once an agency declares personal property to be in excess of their need, the property is transferred to the General Services Administration(GSA) which then follows established guidelines stated in the Federal Management Regulation (FMR)<sup>9</sup> for disposing surplus equipment. Alternatively, Executive Order 12999<sup>10</sup> permits an agency to donate excess electronic equipment directly to needy schools, which the agency elected to do for IT assets in the New York, Chicago, and Kansas City offices.

The objectives of this inspection are to verify that the agency has properly accounted for and disposed selected surplus equipment related to the information technology refresh, and to review the internal controls associated with the disposal process for agency IT assets. This

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<sup>9</sup> See Federal Management Regulation (FMR) (41 CFR Part 102 Subchapter B "Personal Property"). For donation of surplus personal property see 41 CFR Part 102-37.

<sup>10</sup> See Executive Order 12999 signed by William J. Clinton The White House, April 17, 1996.

inspection was motivated by our receipt of an anonymous allegation. (For additional details regarding the allegation, see the section on investigations beginning on page 13.)

### Status

During the reporting period, the AIGA completed the bulk of the work associated with this inspection, examining transfer data for 1196 IT assets consisting of personal computers, laptops, servers, and enclosures. At this time 1,184 or 99% of the selected sample of surplus assets have been accounted for; however, work is continuing and results are preliminary. In addition, the OIG is examining agency internal controls to document that applicable disposal procedures, such as sanitization of hard drives, are complete prior to disposal.

### **3. Update of the Review of the Need for a Los Angeles Office.**

#### Scope and Objective

In 2006, the CFTC OIG issued a report titled “Review of the Need for a Western Regional Office in Los Angeles.” That report recommended, among other things, that the Commission review the feasibility of reestablishing the former Los Angeles field office. That recommendation initially was not carried out largely due to budgetary constraints. In January 2008, partially in response to a Congressional inquiry, CFTC OIG updated its analysis and issued a follow-up report which reiterated the earlier recommendation. In January 2009, the Acting Chairman issued a decision declining to implement the recommendation generally due to cost considerations, and requested that the Division of Enforcement provide productivity information to the OIG on a yearly basis so that OIG may remain apprised of enforcement efforts on the West Coast.

The Division of Enforcement recently provided the requested yearly report to the OIG. In addition, the OIG received a Congressional inquiry seeking updated information on our office’s open and unimplemented recommendations. While we believe an update is warranted in order to adequately consider the information provided by the Division of Enforcement and to respond to the Congressional inquiry, we also believe an update is in order due to recent increases in agency funding as well as current legislative proposals that could greatly expand the CFTC’s jurisdiction and mission. Presuming the Agency grows in size and in responsibility, we believe such growth will add to the reasons to open additional CFTC Offices on the West Coast and possibly other areas as well.

Our objective is to analyze current Enforcement information and to compare current productivity with productivity levels when the CFTC enjoyed the presence of a field office in Los Angeles. We will also discuss recent increases in funding as well as proposed legislation. We will make recommendations as warranted.

### Status

The Division of Enforcement produced current enforcement statistics on March 26, and at the end of the reporting period we were continuing to analyze the data.

#### **4. Review of CFTC's Documentation of Market Surveillance Communications.**

##### Scope and Objective

We intend to conduct an independent review of market surveillance operations at CFTC, specifically informal communications between agency staff and traders with large open positions approaching expiration. This review is motivated by concerns voiced by agency staff as well as the United States Government Accountability Office (GAO).

GAO has noted with concern the apparent absence of documentation of certain communications by CFTC market surveillance staff. In 2007 the GAO remarked:

CFTC staff routinely make inquiries about traders with large open positions approaching expiration, but formal records of their findings are only kept in cases where there is evidence of improper trading. If [Large Trader Reporting System] data reveal that a trader has a large open market position that could disrupt markets if it were not closed before expiration, CFTC staff would contact the trader to determine why the trader had the position and what plans the trader had to close the position before expiration or to ensure that the trader was able to take delivery. If the traders provided a reasonable explanation for the position and a reasonable delivery or liquidation strategy, staff said that no further action would be required. CFTC staff said they would document such contacts on the basis of their importance in either informal notes, e-mails to supervisors, or informal memorandums [sic]. No formal record would be made of the inquiry, according to one CFTC official, unless there was a signal indicating improper trading activity. Without such data, CFTC's measures of the effectiveness of its actions to combat fraud and manipulation in the markets will not reflect this surveillance activity, and CFTC management might miss opportunities to both identify trends in activities or markets and better target its limited resources.

CFTC staff added that all surveillance projects and activities that require a minimum number of hours of work are tracked by quarterly statistical reports, including those futures expirations with large trader or deliverable supply problems. They said that expirations are routinely monitored by economists and reviewed with their supervisors through weekly surveillance reports. Economists are responsible for the analytical review of cash and futures market developments, including the assessment of supply and demand factors, basis and spread relationships, the adequacy of deliverable supply, large trader positions and position changes, large trader histories, and the potential for group trader activity. CFTC staff said that their economists keep their supervisors and the commission informed of potential problems as they arise.<sup>11</sup>

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<sup>11</sup> Commodity Futures Trading Commission: Trends in Energy Derivatives Markets Raise Questions about CFTC's Oversight, GAO-08-25, pages 49-50.

We intend to take an independent look at CFTC market surveillance communications and documentation. We are interested in finding out more about how the process works, whether current internal procedures exist and are followed by staff, and whether increased documentation would improve operations and increase transparency, without resulting in undue burden taking into account current staffing levels. We are also interested in the legal ramifications of the creation of a database of market surveillance. We will make recommendations as appropriate.

#### Status

This review is in the initial planning and research stages.

## **AUDIT REPORTS and REVIEWS OVER SIX MONTHS OLD**

### **1. Corrective Action not Completed.**

There were no instances of audit reports over six months old where corrective action had not been completed.

### **2. Corrective Action Completed.**

There were no instances of reports issued before the commencement of the reporting period for which corrective action had been completed by the end of the reporting period.

### **3. Management Decision not Made.**

There are no instances of a report issued before the commencement of the reporting period for which a management decision had not been made by the end of the reporting period. In 2006, the CFTC OIG issued a report titled "Review of the Need for a Western Regional Office in Los Angeles." That report recommended, among other things, that the Commission review the feasibility of reestablishing the former Los Angeles field office. That recommendation was not carried out largely due to budget constraints. In January 2008, partially in response to a Congressional inquiry, CFTC OIG updated its analysis and on March 12, 2008, issued a follow-up report which reiterated the earlier recommendation. In January 2009, the Acting Chairman issued a decision declining to implement the recommendation generally due to cost considerations, but asked the Agency to revisit the issue on a yearly basis. In light of increased funding for FY09, as well as further consultation with regulators, we renew the recommendation.



## **INVESTIGATIONS**

The Inspector General Act of 1978, as amended, provides that the Inspector General may receive and investigate complaints or information from the Commission's employees and other sources concerning the possible existence of an activity constituting a violation of law, rules or regulations, or mismanagement, abuse of authority, or gross waste of funds, or a substantial and specific danger to the public health and safety.

No investigations were pending as of the beginning of the reporting period. No investigations were opened during this period. In December 2009, this Office received an anonymous allegation of improper disposal of surplus IT equipment. The allegation did not name any CFTC employees involved in the alleged improper disposal, nor did it allege specific dates, but it did allege both that computer equipment was taken improperly by CFTC employees, and that CFTC computer equipment was surplused without prior "sanitization" (i.e., the process by which information is removed prior to disposal of computer equipment). Because the allegation was vague, and because the source could not be contacted for more information, we decided it would be most appropriate to conduct an inspection. The inspection is ongoing. (For additional details regarding the inspection, see the section on current audits, reviews, evaluations, and inspections beginning on page 9.)

## **SUMMARY OF MATTERS REFERRED TO PROSECUTORIAL AUTHORITIES**

No matters were referred to prosecutorial authorities during the reporting period. In accordance with section 11(d)(4) of the Inspector General Act of 1978, as amended, an allegation relating to supposed misconduct within the OIG was referred to the Integrity Committee of the Council of the Inspectors General on Integrity and Efficiency in a prior reporting period. The allegation was pending at the close of this reporting period.

## **CONGRESSIONAL INQUIRIES**

OIG fielded multiple requests for assistance from members of Congress and staff during the reporting period. Issues addressed included recent OIG activities, recent agency activities, and proposed and pending legislation affecting the OIG and the agency.

## LEGISLATIVE, REGULATORY AND RULE REVIEWS

### 1. Introduction and Summary.

As specified in Section 4(a)(2) of the Inspector General Act of 1978, OIG reviews the impact of existing and proposed legislation and regulations on CFTC programs and operations and makes recommendations regarding more effective or efficient alternatives or protections against fraud and abuse. OIG also reviews all exchange rule proposals circulated to senior staff at CFTC.

OIG notified the responsible Divisions as to any concerns with draft and final documents relating to legislation, rules or investigations. Formal comments were not filed with the Commission during this reporting period.

### 2. Rule Reviews Initiated in Previous Reporting Periods.

There were no rule reviews initiated in previous reporting periods which were continued into this reporting period.

### 3. Rule Reviews Initiated this Reporting Period.

No rule reviews were initiated during this reporting period.

### 4. Legislative Activities.

OIG tracked legislation impacting programs and operations of the CFTC, and made contact with Congressional staff concerning various agency and IG issues as appropriate. The IG serves on the legislation committee for the Council of Inspectors General on Integrity and Efficiency, which comments on proposed amendments to the IG Act and other legislation affecting the IG community.

## PEER REVIEWS

An important function in each Agency OIG is the peer review process. The Inspector General community's annual report, *A Progress Report to the President, Fiscal Year 2007*,<sup>12</sup> described the processes for audits and investigative peer reviews as follows:

*Government Auditing Standards* require that audit organizations conducting audits of Federal agencies undergo peer reviews every 3 years. The IG community has

<sup>12</sup> <http://www.ignet.gov/randp/fy07apr.pdf>.

implemented a process to meet this requirement. The purpose of the peer review is to determine whether the reviewed audit organization's internal quality control systems are adequate and provide reasonable assurance that applicable auditing standards, policies and procedures are met.

Similarly, investigative peer reviews are conducted to ensure compliance with the requirements of the *Quality Standards for Investigations* and determine whether adequate internal safeguards and management procedures exist to ensure that law enforcement powers are properly exercised.<sup>13</sup>

During this reporting period, OIG continued to monitor the government-wide OIG peer review schedules as communicated by the Council of the Inspectors General on Integrity and Efficiency. OIG discussed scheduling issues with our partner OIG offices as appropriate. No peer reviews were begun or completed during this reporting period.

## **SUMMARY OF EACH REPORT MADE TO THE AGENCY HEAD**

No reports were made to the Agency head under section 6(b)(2) concerning information or assistance unreasonably refused or not provided (mandated under section 5(a)(5) of the Act).

## **REVISED MANAGEMENT DECISIONS**

No management decisions were revised during the reporting period.

## **INSPECTOR GENERAL DISAGREEMENT**

The Inspector General did not disagree with any management decisions on OIG recommendations during the reporting period.

## **GAO LIAISON**

OIG is charged with providing policy direction for, and conducting, supervising, and coordinating audits and investigations relating to CFTC programs and operations. In addition, OIG is required to recommend policies for, and conduct, supervise, and coordinate with other Federal agencies, state and local governmental agencies, and nongovernmental entities, audits, investigations, and evaluations regarding the economy, efficiency, and effectiveness of CFTC programs and operations.

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<sup>13</sup> Id. at p.19.

GAO also conducts audits of CFTC activities, and OIG plans its audits so as not to duplicate GAO's efforts. Moreover, OIG in its audit activities identifies the goals of each audit and the methods of reaching the goals so as to minimize the requirements placed on CFTC resources. During this reporting period the OIG participated in an Inspectors General discussion with GAO on matters of common interest.

## **STRATEGIC PLAN FOR THE OFFICE OF THE INSPECTOR GENERAL**

### **1. Investigative Agenda.**

The Inspector General Act of 1978, as amended, provides that the Inspector General may receive and investigate complaints or information from the Commission's employees concerning the possible existence of an activity constituting a violation of law, rules or regulations, or mismanagement, gross waste of funds, abuse of authority or a substantial and specific danger to the public health and safety.

OIG has to date conducted only a reactive investigative program chiefly relying on unsolicited employee complaints as the source of investigative leads. However, allegations and complaints are also received from the general public and Congress. This reactive program has resulted in only a handful of investigations per year. This strategy was followed because OIG believed that an independent regulatory agency such as the CFTC, without grant money or substantial contracts to award, was not likely to generate a substantial investigative workload.

To insure that employee complaints could easily reach OIG, a 24-hour hotline was established in February 1993 to receive complaints. The hotline phone number is (202)418-5510.

Because of the necessarily reactive nature of OIG's investigative program, no investigative agenda has been established.

### **2. Legislative and Regulatory Review Agenda.**

Because of the importance of this activity in a financial and economic regulatory agency, OIG reviews proposed and final CFTC regulations, legislation and selected exchange rules using six basic criteria: Whether the agency: (1) has identified specifically the problem(s) to be addressed by the proposal; (2) has defined through case study or data analysis a clear link between the proposed solution and the identified problem(s); (3) has specified clearly the means to effectively and efficiently enforce the proposal; (4) has assessed the likely efficiency and effectiveness of alternative solutions; (5) can reasonably document that the proposal will yield positive net benefits over the long term; and (6) has met the requirements of the Regulatory Flexibility Act and the Paperwork Reduction Act.

The Regulatory Flexibility Act requires the agency to evaluate the impact of its regulations on small entities. The Paperwork Reduction Act requires the agency to manage effectively and efficiently its information collections so that they are the least burdensome necessary to achieve the stipulated objectives.

Because OIG does not initiate legislation or, generally, regulations, OIG legislative and regulatory review program is reactive to the legislative and regulatory proposals developed by others. Accordingly, no independent legislative and regulatory review agenda has been established.

### **3. Audit Agenda.**

#### **a. Introduction**

The primary objectives of the OIG audit agenda is to promote long-term efficiency and effectiveness in the administration and operation of the Commission and to protect against fraud and abuse. The audit agenda and priorities for OIG are determined based on the following factors:

- Adequacy of internal control systems as indicated by vulnerability assessments and internal control reviews recommended by OMB Circular A-123;
- Changes in the program conditions or particular vulnerability of the organization, program, activity, or function to problems or deficiencies;
- Current and potential dollar magnitude and likely benefits of a review on the efficiency or effectiveness of CFTC programs and operations;
- Management priorities and improvements that may be possible;
- Results of audits of CFTC programs and operations by other Federal agencies; and
- Availability of audit resources and the potential opportunity costs to the agency.

#### **b. Annual Audits**

The following required audits are performed on an annual basis.

##### **Audit of CFTC Financial Statements.**

In FY 2002, Congress passed the Accountability of Tax Dollars Act. The Act requires the CFTC, along with numerous other Federal entities, to have its financial statements audited annually. To this end, OIG has engaged a contractor to provide the audit effort required to enable the contractor to render an opinion on the agency's financial statements for each fiscal

year in accordance with generally accepted auditing standards, Government Auditing Standards and OMB Bulletin 07-04.

#### Audit of Compliance with the Federal Managers' Financial Integrity Act, FMFIA.

In support of OMB Circular A-123 (Revised), the Inspector General will evaluate, provide technical assistance and advise the agency head as to whether the agency's review and evaluation process was conducted in accordance with the circular's requirements.

#### Evaluation of the CFTC Information Security Program and Practices, FISMA.

The Federal Information Security Management Act requires the Inspector General or his designee to perform annual independent evaluations of the information security program and practices of the agency.

#### **c. Other Audits.**

OIG intends to focus the balance of its audit resources on the review of the management and operation of the agency and compliance with Congressional mandates. In the near future, OIG intends to complete the ongoing audits previously discussed beginning page 9. In the longer term, the OIG intends to continue to monitor the agency's use of contractors from time to time, with an emphasis on contracts for IT services.

In addition, OIG intends to focus its efforts with a view to auditing or reviewing activities relating to the most serious management challenges facing the CFTC. OIG issues an assessment of the most serious management challenges each year for publication in the CFTC Performance and Accountability Report. In the past four years, OIG has identified as management challenges including following areas of concern:

- Efficient Acquisition and Integration of Skilled Human Capital
- Modernization of Electronic Market Surveillance
- Expansion of CFTC Oversight into New Markets
- Industry Consolidations
- Harmonization of CFTC and Securities and Exchange Commission (SEC) Overlapping Regulations;
- CFTC's Regulatory Model for the Swaps Derivatives Market; and
- CFTC's Regulatory Responsibilities over the Potential Carbon Emission Trading Markets

OIG will seek to identify issues and to conduct audits and reviews relating to these management challenges. Finally, OIG will stand ready to respond to meritorious issues and audit requests as they are received from Congress, the Agency and members of the public or any other source.

#### **d. Resources Required**

OIG estimates that approximately one-half staff year of effort will be devoted over each of the next five years to the “Annual Audits” described above. All other ongoing Audits will consume up to one and a half staff years. Because OIG resources can be diverted at any time to an investigation or audit that responds to current concerns or allegations and must be completed in a timely fashion in order to be of assistance to the Agency or Congress, it is impossible to forecast with complete accuracy how resources will be utilized from year to year.

<p style="text-align: center;"><b>CONTACTING THE OFFICE OF THE INSPECTOR GENERAL</b></p>
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OIG is located at 1155 21st Street, N.W., Washington, D.C. 20581. Regular business hours are between 8:30 AM and 5:00 PM, Monday through Friday, except Federal holidays. The telephone number is (202)418-5110. The facsimile number is (202)418-5522. The hotline number is (202)418-5510. The OIG web page is located at <http://www.cftc.gov/About/OfficeoftheInspectorGeneral/index.htm>.

**Table 1**

**Reports Issued with Questioned Costs  
(October 1, 2009 – March 31, 2010)**

		Dollar Value Thousands		
	Number	Questioned	Unsupported	
A.	For which no management decision has been made by the commencement of the reporting period	0	0	0
B.	Which were issued during the reporting period	0	0	0
	Subtotals (A + B)	0	0	0
C.	For which a management decision was made during the reporting period	0	0	0
( I )	dollar value of disallowed costs	0	0	0
( ii )	dollar value of costs not disallowed	0	0	0
D.	For which no management decision has been made by the end of the reporting period	0	0	0



<b>Table 2</b>
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**Reports Issued with Recommendations  
That Funds be Put to Better Use  
(October 1, 2009 – March 31, 2010)**

	Number	<u>Dollar Value</u> Thousands
A. For which no management decision has been made by the commencement of the reporting period	0	0
B. Which were issued during the reporting period	0	0
Subtotals (A + B)	0	0
C. For which a management decision was made during the reporting period	0	0
(i) dollar value of recommendations that were agreed to by management	0	0
(ii) dollar value of recommendations that were not agreed to by management	0	0
D. For which no management decision has been made by the end of the reporting period	0	0