

COMMODITY FUTURES TRADING COMMISSION

**SEMIANNUAL REPORT  
OF THE**

**OFFICE OF THE  
INSPECTOR GENERAL**



FOR THE PERIOD ENDING MARCH 31, 2011



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of the  
Inspector General

April 29, 2011

TO: The Commission

FROM: A. Roy Lavik *ARL*  
Inspector General

SUBJECT: Semiannual Report of the Office of the Inspector General

Attached is the Office of the Inspector General's Semiannual Report (SAR) for the period from October 1, 2010 through March 31, 2011. This report is submitted to you in accordance with the requirements of Section 5 of the Inspector General Act of 1978, as amended. 5 USC App. 3 sec. 5.

The Dodd-Frank Act altered the relationship of the designated Federal entity Offices of Inspector General with the agency head by establishing that "head" of a designated Federal entity means "the board or commission of the designated Federal entity." P.L. 111-203, Title IX, Subtitle I, sec. 989B, 124 Stat. 1945 (codified at 5 USC App. 3 sec. 8G(a)(4)). We are submitting this report to the Chairman and to each Commissioner.

Under section 5(b) of the IG Act, the SAR shall be transmitted to the appropriate committees or subcommittees of the Congress within thirty days after receipt of the Semiannual report, together with a report by the head of the establishment conforming to the requirements of section 5(b) of the IG Act.

I appreciate your continuing support of this office.

**Recipients:**

**Gary Gensler  
Chairman**

**Jill E. Sommers  
Commissioner**

**Michael Dunn  
Commissioner**

**Scott D. O'Malia  
Commissioner**

**Bart Chilton  
Commissioner**

**Attachment: Semiannual Report for the CFTC OIG**

# OFFICE OF THE INSPECTOR GENERAL COMMODITY FUTURES TRADING COMMISSION

SEMIANNUAL REPORT  
FOR THE PERIOD FROM  
October 1, 2010 THROUGH March 31, 2011

## 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, 2010 through March 31, 2011. During this period, OIG completed one audit, one review, one evaluation, issued an assessment of most serious management challenges, and began one investigation. OIG reviewed proposed Division of Enforcement actions, as well as selected rules proposed by CFTC and by regulated entities, participated in training, conducted and submitted to peer review activities, visited CFTC field offices, and participated in Government-wide OIG professional and cooperative meetings and activities. One investigation was pending at the close of this 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 monitored the completion of the fiscal year (FY) 2010 audit of the CFTC financial statements. For the sixth consecutive year, an independent public accounting firm (IPA) 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 2010 review of compliance with the Federal Managers' Financial Integrity Act (FMFIA). No significant issues were noted.
- OIG completed work on the FY 2010 Federal Information Security Management Act (FISMA) independent evaluation. No significant issues were noted.
- We received an allegation of misconduct by staff and management in the Office of Proceedings. Due to an internal conflict, as well as staff resource concerns, we consulted within the OIG investigative community and found another OIG willing to conduct the investigation on our behalf. The investigation is ongoing. The Treasury Inspector General for Tax Administration is conducting the investigation.
- OIG issued its Assessment of the Most Serious Management Challenges Facing the CFTC: 1) Implementation of the Dodd-Frank Act; and 2) Human Resource Expansion and Management.

- OIG completed a peer review of the audit function for the Office of Inspector General for the Farm Credit Administration.
- OIG submitted to a peer review of our audit function, conducted by the Federal Election Commission Office of Inspector General. We failed, with a scope limitation.
- OIG hired on a temporary basis a former Inspector General to assist remediation efforts and assist with the implementation of recommendations contained in the peer review report for our audit function.
- At the request of the Chairman of the House Agriculture Committee and the Chairman of the Subcommittee on General Farm Commodities and Risk Management, OIG began an investigation into the CFTC's cost benefit analyses performed in connection with four proposed rules issued in accordance with the Dodd-Frank Act.

OFFICE OF THE INSPECTOR GENERAL  
COMMODITY FUTURES TRADING COMMISSION

SEMIANNUAL REPORT  
FOR THE PERIOD FROM  
October 1, 2010 THROUGH March 31, 2011

**TABLE OF CONTENTS**

EXECUTIVE SUMMARY ..... i

TABLE OF CONTENTS..... iii

INDEX OF IG ACT REPORTING ..... v

INTRODUCTION ..... 1

    CFTC Programs and Operations..... 1

    OIG Responsibilities..... 1

    OIG Resources ..... 3

COMPLETED AUDITS..... 3

    Audit of CFTC Financial Statements for Fiscal Year 2010..... 3

COMPLETED ASSESSMENTS, REVIEWS, EVALUATIONS, INSPECTIONS, and OTHER PROJECTS ..... 5

    Review of Compliance with the Federal Managers' Financial Integrity Act, FMFIA ..... 5

    Evaluation of the CFTC Information Security Program and Practices, FISMA ..... 5

    Assessment of CFTC's Management Challenges..... 5

CURRENT AUDITS, REVIEWS, EVALUATIONS, and INSPECTIONS ..... 8

AUDIT REPORTS and REVIEWS OVER SIX MONTHS OLD ..... 8

    Corrective Action not Completed..... 8

    Corrective Action Completed. .... 8

    Management Decision not Made. .... 8

INVESTIGATIONS ..... 9

SUMMARY OF MATTERS REFERRED TO PROSECUTORIAL AUTHORITIES ..... 10

CONGRESSIONAL INQUIRIES ..... 10

LEGISLATIVE, REGULATORY AND RULE REVIEWS..... 10

    Introduction and Summary. .... 10

Rule Reviews Initiated in Previous Reporting Periods.....	10
Rule Reviews Initiated this Reporting Period.....	11
Legislative Activities .....	11
PEER REVIEWS .....	11
SUMMARY OF EACH REPORT MADE TO THE AGENCY HEAD.....	12
REVISED MANAGEMENT DECISIONS .....	12
INSPECTOR GENERAL DISAGREEMENT .....	12
GAO LIAISON.....	12
STRATEGIC PLAN FOR THE OFFICE OF THE INSPECTOR GENERAL .....	13
Investigative Agenda .....	13
Legislative and Regulatory Review Agenda.....	13
Audit, Inspection, Evaluation and Review Agenda .....	14
Introduction.....	14
Annual Audit.....	14
Annual Review and Evaluation .....	15
Other Audits, Inspections, Evaluations, Reviews and Projects .....	15
Resources Required .....	16
CONTACTING THE OFFICE OF THE INSPECTOR GENERAL.....	16
Table 1 – Reports Issued with Questioned Costs.....	17
Table 2 – Reports Issued with Recommendations .....	18
APPENDIX – PEER REVIEWS .....	1

<b>INDEX OF IG ACT REPORTING REQUIREMENTS</b>
---

Section 4(a)(2) ..... Review of legislation and regulations.....10

Section 5(a)(1) ..... Significant problems, abuses and deficiencies..... 1

Section 5(a)(2) ..... Recommendations with respect to significant problems..... 1

Section 5(a)(3) ..... Significant recommendations that have not been completed..... 8

Section 5(a)(4) ..... Matters referred to prosecutorial authorities..... 10

Section 5(a)(5) ..... Summary of instances where information was refused.....12

Section 5(a)(6) ..... Completed audit reports.....3

Section 5(a)(7) ..... Significant audit reports.....3

Section 5(a)(8) ..... Statistical Table—Questioned Costs..... 17

Section 5(a)(9) ..... Statistical Table—Funds Recommended for Better Use.....18

Section 5(a)(10) ..... Audit reports lacking management decision.....8

Section 5(a)(11) ..... Significant revised management decisions.....12

Section 5(a)(12) ..... Significant management decisions where the IG disagrees.....12

Section 5(a)(13) ..... Information described under the Federal Financial Management..... 4  
..... Improvement Act of 1996.....

Section 6(b)(2) ..... Summary of reports to Chairman where assistance was refused.....12



# OFFICE OF THE INSPECTOR GENERAL COMMODITY FUTURES TRADING COMMISSION

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## 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. On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), P.L. 111-203, which expanded CFTC's jurisdiction and authorities.

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 recent Dodd-Frank Act authorized the CFTC to regulate swap dealers, increase transparency and improve pricing in the derivatives marketplace, and lower risk to the American public.

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 OIG also conducts inspections, evaluations, and reviews from time to time. As stated in the 2011 *Quality Standards for Inspection and Evaluation* issued by the Council of Inspectors General for Integrity and Efficiency (CIGIE):

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 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 and are performed in response to allegations and/or evidence

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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>.

<sup>2</sup> *Quality Standards for Inspection and Evaluation*, page i. <http://www.ignet.gov/pande/standards/oeistds11.pdf>.

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.<sup>3</sup>

OIG operates independently of the Agency and has not experienced any interference from the CFTC Chairman in connection with the conduct of any investigation, inspection, evaluation, review, or audit, and our investigations have been pursued regardless of the rank or party affiliation of the target. OIG has also conducted audits, inspections, evaluations, and reviews 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>

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

The CFTC OIG consists of the Inspector General, a Senior Program Analyst, an Attorney-Advisor, and a secretary. The present Inspector General assumed his position on October 7, 1990. The Senior Program Analyst has been with the office since 1999, and the Attorney-Advisor joined in 2007.

## **COMPLETED AUDITS**

### **1. Audit of CFTC Financial Statements for Fiscal Year 2010**

#### Objective.

In FY 2002, Congress passed the Accountability of Tax Dollars Act (ATDA). The ATDA requires the CFTC, along with numerous other Federal entities, to have its financial statements audited annually. To this end, following a formal procurement, the Inspector General in 2010 selected KPMG LLP, 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 2010.

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.

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<sup>3</sup> The publication titled *Quality Standards for Investigations* (December 2003) was issued by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency and subsequently adopted by the CIGIE. The standards are available at <http://www.ignet.gov/pande/standards/invstds.pdf>.

<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).

(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 (and revisions). 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.

KPMG rendered an opinion on the agency's financial statements for Fiscal Year 2010 in accordance with generally accepted auditing standards, Government Auditing Standards and OMB Bulletin 07-04.

#### Status.

For the sixth 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 10, 2010.

## **COMPLETED ASSESSMENTS, REVIEWS, EVALUATIONS, INSPECTIONS, and OTHER PROJECTS**

### **1. Review 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. 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.

### **2. 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 review 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 2010, for combination with the CIO's assessment and inclusion in the Chairman's report to OMB. No significant issues were noted.

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

#### Objective.

The Reports Consolidation Act of 2000 requires 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. The statement of most serious management and performance challenges is published in the annual Performance and Accountability Report (PAR) and on our website at

<http://www.cftc.gov/About/OfficeoftheInspectorGeneral/index.htm>.

### 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 2010 PAR, and also reported on status of the most serious management and performance challenges identified by the Inspector General in FY 2009.

FY 2009 Management Challenges identified by the OIG. In FY 2009, the OIG identified three most serious management challenges: 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. During fiscal year 2010 the Agency addressed all three issues, making substantial progress on all challenges.

*Harmonization of CFTC and Securities and Exchange Commission (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.' Specifically, the White House recommended 'that the CFTC and SEC complete a report to Congress by September 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. The CFTC jointly with SEC issued a substantial Harmonization Report in October 2009, identifying areas where the respective regulatory regimes for futures and securities could be better aligned to streamline the regulation of novel derivative products and to avoid duplicative regulation. In November 2009, CFTC and SEC issued two joint orders to clarify their respective jurisdiction with respect to certain security index products and to allow additional products to underlie security futures products. Most of the statutory recommendations set forth in the October 2009 Report were included in the Dodd-Frank Act, and the agencies are now proceeding to implement those new authorities.

*CFTC's Regulatory Model for the Swaps Derivatives Market.* We believed that both the intricacies of any forthcoming derivatives regulation and the acquisition of human capital to carry out the regulatory tasks would challenge the CFTC in the coming year. The Commission employed 605 FTE in FY 2010, up from 498 FTE in FY 2009. The Commission states in order to be as timely and substantively prepared as possible to meet the needs of the Human Capital requirements of the Dodd-Frank Act, it has:

- Engaged all offices to identify and implement business process changes that will shorten the time to hire new staff;

- Granted Divisions and Offices FTE ceilings that allow them to identify priority hires and make selections according to their greatest needs;
- Considered recruitment alternatives, such as combining vacancy announcements and making multiple selections if applicants are of high quality;
- Built on past cooperative efforts to target underrepresented groups, to continue to enhance diversity recruiting for its workforce; and,
- Developed a process to ensure it identifies detailed job requirements as quickly as possible as it implements financial reform legislation to guide the content and tactics of the recruiting actions.

*CFTC's Regulatory Responsibilities over the Potential Carbon Emission Trading Markets.*

Anticipated legislation regulating carbon emission trading and assigning regulatory duties to the Commission did not materialize. On June 26, 2009, the House passed the American Clean Energy and Security Act—H.R. 2454—that set forth new legislation to regulate carbon emission trading; however, the Senate did not act on this proposed legislation. The Dodd-Frank Act required the Commission to lead an interagency working group tasked with organization and completion of a study of regulatory oversight of potential carbon markets, with a report due to Congress in January 2011. Staff convened the interagency group and began work on the study, which was completed and issued on January 18 of this year.

FY 2010 Most Serious Management Challenges. For FY 2010, the OIG identified two “most serious” management challenges:

*Implementation of the Dodd-Frank Act.* On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Pub. L. 111-203, 124 Stat. 1376 (2010). Title VII of the Dodd-Frank Act amended the Commodity Exchange Act (CEA) to establish a comprehensive new regulatory framework for swaps and security-based swaps. In order to enact the Dodd-Frank Act, the Commission has identified 30 areas where rules will be necessary. Many of these rules will require or result in cooperative efforts with the Securities and Exchange Commission or other federal agencies. In addition, the Dodd-Frank Act calls for numerous studies and other undertakings by the Commission, some also with cooperation from other agencies. The Commission recognizes that many of the new rules required under Dodd-Frank must be adopted within 180 days. The magnitude of this undertaking under a compressed timeline during FY 2011 presents a serious management challenge. Since enactment of the Dodd-Frank Act, CFTC has published more than 50 proposed rules, notices, or other requests related to the new law. Chairman Gensler, however, has determined that the statutory deadline set in Dodd-Frank will not be met, and has announced his intention to publish final rules in three stages, with the third stage to take place in the Fall of 2011.

*Human Resource Expansion and Management.* The Commission’s new responsibilities under Dodd-Frank significantly increased its workload. By the end of fiscal year 2010, the Commission had on-board 687 employees, which is 58 below the 745 FTE CFTC requested to carry out our

pre-Dodd-Frank authorities. We viewed the possibility of a rapid and dramatic increase in new employees to address new rules over newly regulated markets, such as swaps, a significant management challenge during Fiscal Year 2011. We also view the management of existing staff to take on additional tasks to present a formidable management challenge.

In November 2010 the OIG submitted the report to the Agency for inclusion in the PAR, and the Agency transmitted the PAR to OMB and Congress.

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

At the end of this reporting period, there were no ongoing audits, reviews, evaluations, or inspections. At the end of this reporting period, we were in the process of updating our audit procedures. In addition, at the end of this reporting period significant staff resources were devoted to an investigation requested by the Chairman of the House Agriculture Committee and the Chairman of the Subcommittee on General Farm Commodities and Risk Management regarding cost benefit analyses under the Dodd-Frank Act.

## **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 FY10, 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. During this period, we received a request from the Chairman of the House Committee on Agriculture and from the Chairman of the House Subcommittee on General Farm Commodities and Risk Management, for an investigation into cost-benefit analyses performed by the CFTC in connection with four proposed rules under the Dodd-Frank Act:

1. Further Defining “Swap Dealer”, “Security-based Swap Dealer”, “Major Swap Participant,” “Major Security-based Swap Participant,” and “Eligible Contract Participant, 75 FR 80174 (December 21, 2010) (Joint proposed rule; proposed interpretations)<sup>5</sup>;
2. Confirmation, Portfolio Reconciliation, Compression Requirements for Swap Dealers and Major Swap Participants, 75 FR 81519 (December 28, 2010) (Notice of proposed rulemaking);
3. Core Principles and Other Requirements for Designated Contract Markets, 75 FR 80572 (December 22, 2010) (Notice of proposed rulemaking);
4. Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 FR 71397 (November 23, 2010) (Notice of proposed rulemaking).

In addition to specifying four rules for examination, the Chairman of the House Committee on Agriculture and the Chairman of the Subcommittee on General Farm Commodities and Risk Management set out eight areas of specific inquiry to be addressed, but did not allege specific violations of any statute, rule or policy, and did not name any specific targets. Accordingly, we treated this as an administrative inquiry rather than a criminal investigation or an investigation designed to support recommended adverse action against any individual. Our work was ongoing at the end of the reporting period.

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<sup>5</sup> The Commission published this proposed rule jointly with the Securities and Exchange Commission, in consultation with the Board of Governors of the Federal Reserve System. 75 FR 80174 (December 21, 2010).

During this reporting period, we also received an allegation of misconduct involving staff and management in the Office of Proceedings. Due to an internal conflict within the OIG, as well as resource concerns, we reached out to the OIG investigative community and obtained consent from the Treasury Inspector General for Tax Administration (TIGTA) to conduct this investigation. The CFTC entered into a formal Economy Act<sup>6</sup> agreement with TIGTA, and the investigation was ongoing at the close of this reporting period.

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

No matters were referred to prosecutorial authorities during the 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 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.

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<sup>6</sup> The Economy Act (31 U.S.C. 1535) authorizes agencies to enter into agreements to obtain supplies or services by interagency acquisition.

### 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>7</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 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>8</sup>

Section 989C of the Dodd-Frank Act implemented a requirement to include in each OIG semiannual report an appendix containing

- the results of any peer review conducted by another Office of Inspector General during the reporting period; or if no peer review was conducted within that reporting period, a statement identifying the date of the last peer review conducted by another Office of Inspector General;
- a list of any outstanding recommendations from any peer review conducted by another Office of Inspector General that have not been fully implemented, including a statement describing the status of the implementation and why implementation is not complete; and

<sup>7</sup> <http://www.ignet.gov/randp/fy07apr.pdf>.

<sup>8</sup> Id. at p.19.

- a list of any peer reviews conducted by the Inspector General of another Office of the Inspector General during the reporting period, including a list of any outstanding recommendations made from any previous peer review (including any peer review conducted before the reporting period) that remain outstanding or have not been fully implemented.

During this reporting period, the OIG underwent a peer review of its audit function by the Federal Election Commission Office of Inspector General. We were given a rating of “fail with a scope limitation.” The recommendations are listed in an Appendix to this Semiannual Report, along with our required statement.

During this reporting period, OIG conducted a peer review of the audit function for the Farm Credit Administration Office of Inspector General, awarding a rating of “Pass.” There are no outstanding recommendations made from any previous peer review conducted by the CFTC Office of Inspector General that remain outstanding or have not been fully implemented.

In addition, OIG continued to monitor the government-wide OIG peer review schedules as communicated by the Council of the Inspectors General on Integrity and Efficiency, and participated in working groups and training pertaining to the peer review process.

## **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.

GAO also conducts audits of CFTC activities, and OIG plans its audits, inspections, evaluations, reviews, and investigations 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, Inspection, Evaluation and Review Agenda**

#### **a. Introduction**

The primary objectives of the OIG audit, inspection, evaluation and review 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, review, evaluation, and inspection 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 Audit**

The following required audit is 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.

**c. Annual Review and Evaluation**

We will perform the following review and evaluation on an annual basis:

**Review 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 Management Act, 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.

**d. Other Audits, Inspections, Evaluations, Reviews and Projects**

OIG will spend the coming months implementing the recommendations contained in the peer review report issued by the Federal Election Commission Office of Inspector General. No audits will be performed – other than by fully qualified contract auditors -- until the deficiencies identified in the peer review are cured. We hope to implement all recommendations by September 30, 2011.

Looking to the long term, the OIG intends to focus the balance of its resources on the review of the management and operation of the agency and compliance with Congressional mandates. OIG plans to concentrate its efforts in reviewing activities relating to the most serious management challenges facing the CFTC.

In addition, OIG is aware of the immense regulatory undertaking required under the Dodd-Frank Act. OIG will seek to identify issues and to conduct inspections, reviews, investigations and other activities relating to these management and regulatory challenges. Finally, OIG will stand ready to respond to issues and requests as they are received from Congress, the Agency and members of the public or any other source.

At the close of the last reporting period, OIG reported that a previously intended examination of communications between CFTC staff and large traders had been tabled due to our workload during this prior reporting period. This review continues to be tabled.

**e. 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 audit, the annual review, and the annual evaluation described above. Revision of the CFTC OIG audit procedures and other remediation-related tasks, and all other investigations, inspections, evaluations, review and other projects will consume up to two and a half staff years. Because OIG resources can be diverted at any time to an investigation or audit, inspection, evaluation, review or project 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. In accordance with a recommendation contained in the recent peer review, we will seek to hire an experienced auditor.

<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, 2010 – March 31, 2011)**

		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, 2010 – March 31, 2011)**

	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

## APPENDIX – PEER REVIEWS

In accordance with Section 989C of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), Pub. L. 111-203, 124 Stat. 1376 (2010), we are including an appendix containing:

- the results of any peer review conducted by another Office of Inspector General during the reporting period; or if no peer review was conducted within that reporting period, a statement identifying the date of the last peer review conducted by another Office of Inspector General;
- a list of any outstanding recommendations from any peer review conducted by another Office of Inspector General that have not been fully implemented, including a statement describing the status of the implementation and why implementation is not complete; and
- a list of any peer reviews conducted by the Inspector General of another Office of the Inspector General during the reporting period, including a list of any outstanding recommendations made from any previous peer review (including any peer review conducted before the reporting period) that remain outstanding or have not been fully implemented.

### Peer Review of the CFTC OIG Audit Function performed by the Federal Election Commission OIG.

On March 31, 2010, the Federal Election Commission Office of Inspector General (FEC OIG) issued a peer review of the audit function for the CFTC OIG.<sup>1</sup> CFTC OIG received a rating of “fail, with a scope limitation.”

We agree with FEC OIG’s recommendations for improving our conduct of audits in accordance with generally accepted government auditing standards (GAGAS) and are in the process of implementing all of them. However, we disagree with a number of FEC OIG findings that resulted from their conclusion that the two audits examined during their peer review were intended to be GAGAS audits. CFTC OIG’s prior semiannual reports and internal records clearly contradict their conclusion that these were intended to be GAGAS audits.

In the peer review report, FEC OIG made 29 recommendations. One recommendation – that we post all reports on the IG website within three days of issuance – has already been implemented. We estimate implementation of the remaining 28 recommendations by May 30, 2011. To assist us in addressing the remaining 28 recommendations, we have temporarily hired a former Inspector General and former Chair of the Peer Review Committee for the Executive Council on Integrity and Efficiency. Specifically, we are revising CFTC OIG policies and procedures and implementing internal controls to prevent recurrence of the problems identified by FEC OIG. In addition, barring budget limitations, we will permanently hire a senior level

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<sup>1</sup> The peer review report is available at:  
[http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig\\_peerreview.pdf](http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/oig_peerreview.pdf).

official to manage CFTC's audits and to facilitate the conduct of GAGAS audits. The 28 FEC  
OIG recommendations that remain outstanding and we are addressing are:

- 1.a.1 improve its quality control processes, including documented policies and procedures, to ensure that initial and subsequent assessments and decisions to perform work as audits, inspections, investigations or limited reviews are adequately documented and retained in the audit file; and
- 1.a.2 ensure audit reports fully and accurately reflect the performance standards and include modified or unmodified GAGAS compliance statements, as appropriate;
- 1.b.1 amend current policies and procedures to better define supervisory review processes, including which are optional and which are mandatory, to ensure compliance with GAGAS;
- 1.b.2 document and enforce control processes to ensure supervisory review is performed independently of those planning, performing and reporting audit results;
- 1.b.3 ensure staff assigned supervisory review responsibilities have adequate knowledge, skills, ability and training to perform the task;
- 1.b.4 document and enforce quality processes to ensure independent referencing is performed and all comments or questions resolved prior to final report release;
- 1.b.5 ensure adequate documentation is retained to support the fact that independent referencing was performed;
- 1.b.6 consider outsourcing independent referencing to another OIG or contractor to ensure adequate separation between those performing audit work and referencing of reports;
- 1.b.7 consider transitioning to electronic workpapers to support adequate segregation of duties between those conducting audits and those performing supervisory review;
- 1.c.1 comply with GAS 3.11 and "include policies and procedures for identifying and resolving external impairments as part of their quality control system for compliance with GAS independence requirements";
- 1.c.2 formally document its policies and procedures for assessing and reporting potential internal independence impairments in accordance with GAS 3.08;
- 1.d.1 plan, conduct, and monitor analysis of monitoring procedures, at least annually, to evaluate adherence to professional standards, whether the quality control system has been appropriately designed; and whether quality policies and procedures are operating effectively and complied with in practice;
- 2.a.1 prepare workpaper files for all OIG work products at the time work is performed and retain them in accordance with OIG and National Archives and Records Administration (NARA) record retention standards;

- 2.a.2 obtain and maintain adequate documentation on the dates workpapers are prepared and reviewed;
- 2.a.3 Ensure all workpapers are prepared and approved prior to the issuance of the final reports to the CFTC;
- 2.b.1 take steps necessary to ensure the staff meets their responsibilities for CPE requirements and maintain documentation, as described by GAS, supporting CPE hours earned;
- 2.b.2 Staff required to comply with the GAS standards should include the requirement in their annual performance plans and monitor progress towards meeting the training objectives quarterly;
- 2.b.3 Staff should only record CPEs for training that qualify as CPE under GAS;
- 2.b.4 Adequate funds for training should be requested in order to meet the training requirements. The current annual budget of \$5,000 for all staff may not be sufficient;
- 2.b.5 The centralized spreadsheet should be reviewed quarterly to ensure staff are on track to meet annual and biennial training requirements, as well as verify that adequate documentation to support CPEs reported in the spreadsheet are maintained;
- 2.d.1 conduct adequate audit planning and sufficiently assess internal controls, audit risk, and user needs;
- 2.d.2 plan and perform audit testing to meet GAS requirements and user needs;
- 2.d.3 clearly document planning decisions and deviations from GAS in the audit file and report;
- 2.d.4 employ an experienced auditor to augment the current non-audit OIG staff;
- 2.e.1 require staff attend audit training to ensure they plan for, obtain, and prepare adequate audit evidence to comply with the GAS standards;
- 2.e.2 develop findings and clearly document the communication of the findings to management, and management's agreement or disagreement with the findings;
- 2.e.3 retain the information on communicated findings, management's response, corrective actions taken by management, and OIG verification of corrective actions in the audit file, and also include the information in the audit report, where applicable;
- 2.f.1 maintain a checklist devised from the peer review guidance for each audit file to ensure all audit reports issued by the office contain adequate disclosures to support GAGAS reporting standards.

### Peer Review of the Audit Function of the Farm Credit Administration Office of Inspector General

During the reporting period, the CFTC OIG completed a peer review of the audit function of the Farm Credit Administration Office of Inspector General (FCA OIG). FCA OIG received a

peer review rating of *pass*. At the end of the reporting period, there were no outstanding recommendations.



**THE INSPECTOR GENERAL  
NEEDS YOUR HELP TO  
ASSURE THE INTEGRITY OF  
CFTC'S PROGRAMS**

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