

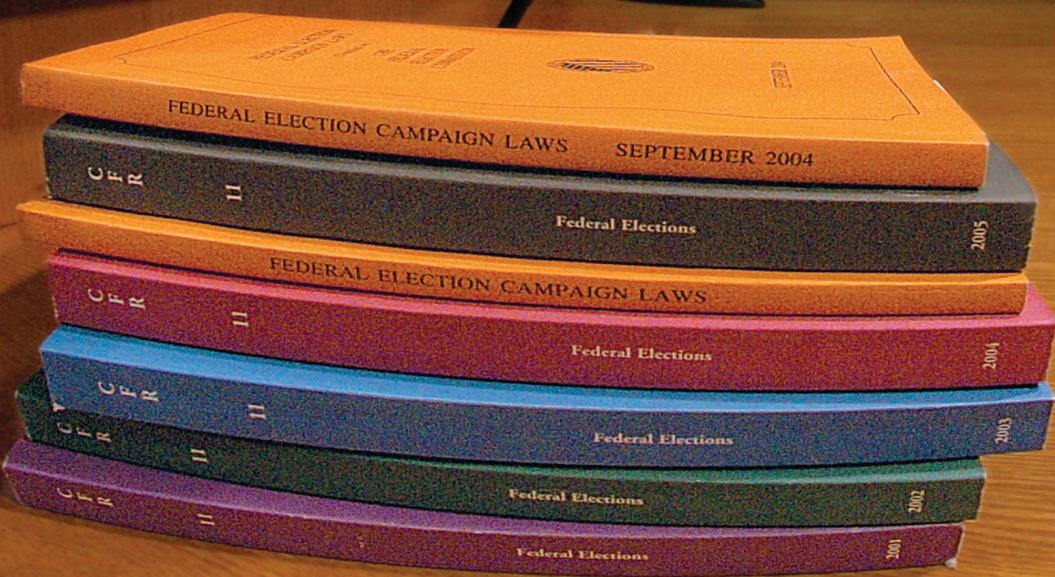
SUPREME COURT OF THE UNITED STATES

Syllabus

MCCONNELL, UNITED STATES SENATOR, ET AL. v. FEDERAL ELECTION COMMISSION ET AL.
APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

Argued September 8, 2003 — Decided December 10, 2003

The Bipartisan Campaign Reform Act of 2002 (BCRA) and the Federal Election Campaign Act of 1971 (FECA) are the primary federal enactments that have shaped the national politics of what has conceived to be the money campaign contribution.



Federal Election Commission Performance and Accountability Report

Fiscal Year 2005

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MESSAGE FROM THE CHAIRMAN

November 15, 2005

I am pleased to present the Federal Election Commission's (FEC) Performance and Accountability Report for fiscal year (FY) 2005. This report highlights our efforts to achieve the FEC's goals of disclosing campaign finance information efficiently and effectively, enforcing the provisions of the Federal Election Campaign Act, and overseeing the public funding of Presidential elections.

Two of the most important aspects of the FEC's mission are to make the campaign finance process more transparent and to make information more accessible to the electorate. To these ends, the FEC provides information to the public in a variety of ways. Reports filed by political committees (*e.g.* candidate campaigns, party committees, and political action committees) are available within 48 hours of their receipt by the FEC. The Commission's disclosure database, which contains millions of transactions, is available through the FEC's website. Citizens can access information on contributions by using a variety of search elements (*e.g.*, donor's name, recipient's name, date, amount, or geographic location).

The financial and performance data presented in this report are reliable, complete and accurate. Our employees continually assess the efficiency and effectiveness of our organizational processes and take corrective action when necessary. In accordance with the requirements of the Federal Managers' Financial Integrity Act, I hereby give a statement of assurance that management controls are in place and the Commission's financial systems conform to government standards. Our compliance with this Act is discussed more fully in Sections I and III of this Report.

The FEC received an unqualified (clean) opinion on its financial statements, except with respect to our cost allocation methodology for the Statement of Net Cost. There have been significant advancements in financial reporting and internal controls since last year's audit. We are committed to working both internally and externally with auditors to improve our management and fiscal processes. Corrective action plans will be developed and implemented to correct identified problems.

The FEC's 2005 Performance and Accountability Report demonstrates how well we performed during the year and shows our commitment to providing the high level of service the electorate expects and deserves from the Commission. I am very pleased to be able to share our progress with all of our stakeholders and look forward to reporting even more success in the years ahead.

Sincerely,



Scott E. Thomas
Chairman

HOW TO USE THIS REPORT

This Performance and Accountability Report (PAR) was produced to meet the requirements of the Accountability of Tax Dollars Act of 2002 and guidance from the Office of Management and Budget, which expanded the authorization granted under the Reports Consolidation Act of 2000 to require that virtually all Federal agencies prepare a PAR annually. It provides the Federal Election Commission's (FEC) financial and performance information for fiscal year (FY) 2005, enabling the President, the Congress, and the American people to assess the Commission's performance in meeting its mission. This report is available on the Commission's website at www.fec.gov (click on "About the FEC" and then "Budget"). This is the second PAR issued by the FEC.

The FY 2005 PAR is organized into the following three major sections:

- **Management's Discussion and Analysis** - provides an overview of the financial and performance information contained in the Performance and Financial Sections. It includes the Commission's assessment of the reliability and completeness of the information presented. Management's Discussion and Analysis provides an overview of the FEC organization, highlights its most important goals and results, and addresses issues affecting the Commission's future performance.
- **Performance Report** - provides a report on the FEC's accomplishments and results in meeting its goals and objectives, as required by the Government Performance and Results Act.
- **Auditor's Report and Financial Statements** - provides details on the FEC's finances, including the auditor's report and the Commission's financial statements.

The Commission's Strategic Plan, FY 2004 – 2009, and its annual performance plans, which form the basis for this report, are available on the FEC website at www.fec.gov (click on "About the FEC" and then "Budget").

In addition, the FEC prepares an *Annual Report* that covers the activities of each calendar year. *Annual Reports* for 1996 through 2004 are available on the FEC website at <http://www.fec.gov/pages/anreport.shtml>. The 2005 report will be published in the spring of 2006.

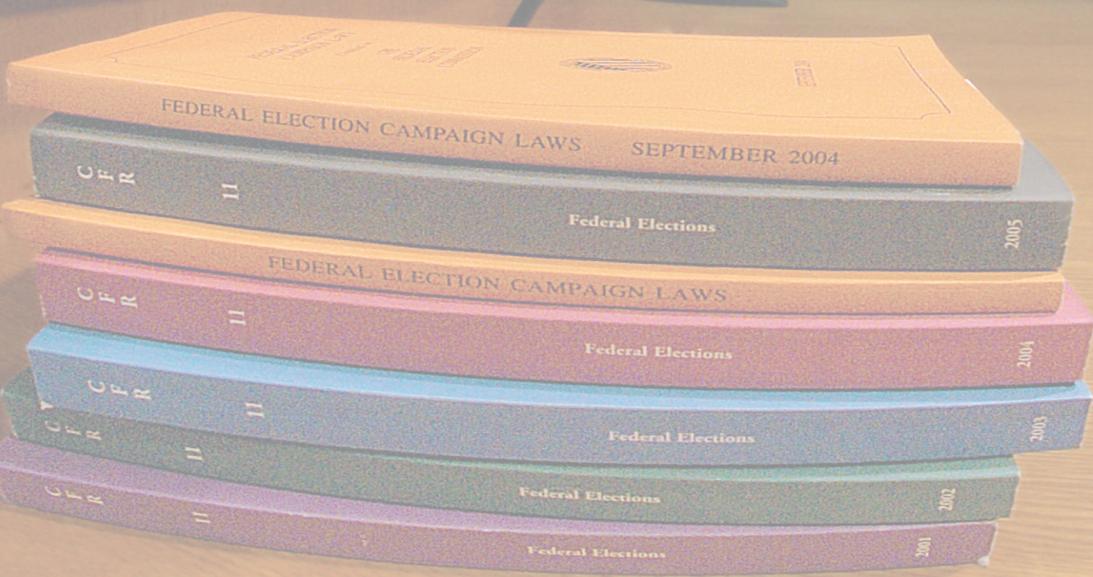
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SECTION I

Management's Discussion and Analysis

Section I.A: Mission and Organizational Structure

Introduction to the Federal Election Commission

The Federal Election Commission (FEC) was created to strengthen the integrity of the electoral process by ensuring that the campaign finance process is fully disclosed and that the campaign finance laws are effectively and fairly enforced. In addition to administering and enforcing the limits, prohibitions, and reporting requirements of the Federal Election Campaign Act (FECA), the Commission also administers and oversees the Presidential public funding program, which is funded by the \$3 tax checkoff provided on Federal tax returns. Through the public funding program, the Federal government provides matching funds to candidates seeking their party's Presidential nomination, financing for Presidential nominating conventions, and grants to Presidential nominees for the general election campaigns.

History of the Federal Election Commission

Concerns about campaign financing first surfaced in 1791, when groups supporting and opposing Alexander Hamilton published competing newspapers to sway the voters. Campaign finance legislation dates back to President Theodore Roosevelt's efforts in 1905, but it was not until 1971 that Congress enacted the FECA, which provided for an enforcement mechanism for campaign finance legislation. Congress created the FEC in 1974 as the independent regulatory agency to administer and enforce the FECA.

Congress amended the FECA in 1976 after the Supreme Court case *Buckley v. Valeo*. The Court upheld contribution limits because they served the government's interest in safeguarding the integrity of elections by preventing even the appearance of corruption of public officials. However, the Court overturned expenditure limits, stating: "It is clear that a primary effect of these expenditure limitations is to restrict the quantity of campaign speech by individuals, groups and candidates. The restrictions...limit political expression at the core of our electoral process and of First Amendment freedoms." The Court also sustained other public funding provisions and upheld disclosure and recordkeeping requirements. However, the Court found that the method of appointing FEC Commissioners violated the constitutional principle of separation of powers, since Congress, not the President, appointed four of the Commissioners, who exercised executive powers. Now the six commissioners are appointed by the President with the advice and consent of the Senate.

The most recent amendments to the FECA were passed in 2002. Among other things, the Bipartisan Campaign Reform Act of 2002 (BCRA or McCain-Feingold) banned national parties from raising or spending non-Federal funds (often called "soft money"), restricted so-called issue ads, increased the contribution limits, and indexed certain limits for inflation. The BCRA was challenged in court within days of its passage into law. The Supreme Court, in *McConnell v. FEC*, upheld most of the challenged provisions of the BCRA, including its two principal features: the control of soft money and the regulation of electioneering communications. The Court found unconstitutional other BCRA provisions banning contributions from minors and requiring party committees to choose whether to make coordinated or independent expenditures on behalf of their nominees.

How the FEC Accomplishes Its Mission

MISSION

To assure that the campaign finance process is fully disclosed and that the rules are effectively and fairly enforced, fostering the electorate's faith in the integrity of the nation's political process.

The FEC strives to foster and maintain an attitude of voluntary compliance with the rules of the campaign finance process through three major programs:

- *Public Disclosure* - facilitates public disclosure of campaign finance activity and provides information and policy guidance on the law and Commission regulations to the public, press, and the regulated community;
- *Compliance* - enforces the FECA through audits, investigations, and civil litigation; and
- *Public Financing* - implements the public funding programs for Presidential campaigns and conventions. This includes certification and audits of participating candidates and committees and enforcement of public funding legislation.

Public Disclosure- Keeping the Public Informed

The disclosure of the sources and amounts of funds used to finance Federal elections is one of the most important of the FEC's duties. The Commission makes the financial reports of all Federal political committees accessible to the general public, thus providing an added incentive for the regulated community to comply with the campaign finance law.

The sheer volume of data available to the public is staggering. The Commission defines its work in the context of election cycles, which include the preceding and actual election years, i.e., calendar years (CYs) 2005 and 2006 constitute the 2006 election cycle. In the 2004 election cycle, over 8,000 political committees filed approximately 95,000 reports containing information concerning nearly 3 million itemized contributions, as well as millions of other itemized disbursements, receipts, and other payments previously not entered into Commission databases.

These reports are filed electronically, except for Senate reports and reports from other committees with less than \$50,000 in activity. Paper reports filed by political committees are available on the Commission's website within 48 hours of their receipt, and almost immediately for electronically filed reports. Interested citizens can select a profile of a committee's financial activity for each election cycle. Citizens also can access information on contributions by using a variety of search elements (e.g., donor's name, recipient's name, date, amount, or geographic location).

In addition to campaign finance reports, the FEC makes available on its website and through the Public Disclosure office items such as statistical summaries of reported campaign activities,

information on closed enforcement actions, audit reports and Commission meeting agenda items, and other public documents. The FEC also discloses information by issuing press releases covering statistical information and the agency's activities.

The FEC's disclosure program includes not only the review and placement of information on the public record, but also educational outreach, including campaign finance workshops and seminars, a toll-free line for consumer requests, and automatic fax transmission of FEC publications 24-hours-a-day, 7-days-a-week.

Compliance - Interpreting and Enforcing the Law

The Commission has exclusive jurisdiction over the civil enforcement of Federal campaign finance law. The FEC reviews each report filed by Federal candidates and committees to ensure that they have complied with the contribution and disclosure requirements. FEC staff may generate enforcement actions called Matters Under Review (MURs) when it appears that a violation of the law has occurred. In addition, individuals and groups outside the agency may initiate MURs by filing complaints. Other government agencies may also refer enforcement matters to the FEC. If four of the six Commissioners vote to find reason to believe that a violation of the law has occurred, the Office of the General Counsel, Office of Administrative Review or the Office of Alternative Dispute Resolution will investigate the matter. If the investigation reveals a violation of the law, the Commission attempts to resolve the matter by reaching a conciliation agreement with the respondents. The agreement may require the candidate or committee to pay a civil penalty and take other remedial steps. If an agreement cannot be reached, the Commission may file suit against the appropriate persons in a U.S. District Court. As required by law, the Commission keeps enforcement matters strictly confidential until they are concluded. Once the Commission has resolved and closed a MUR, the pertinent documents are placed on the public record.

Public Financing – Funding Presidential Elections

Every Presidential election since 1976 has utilized public funds. Public funds are provided through two programs: (1) grants are given to party conventions and candidates running in the general election, and (2) matching funds are given to candidates running in the party primaries. The FEC administers the public funding program by determining which candidates and committees are eligible to receive the funds and in what amounts. The Secretary of the Treasury makes the payments. Committees receiving public funds must keep detailed records of their financial activities. After the elections, the FEC audits each publicly funded committee. If an audit reveals that a committee has exceeded the spending limits or used public funds for impermissible purposes, the committee must pay back an appropriate amount to the U.S. Treasury.

How the FEC is Organized

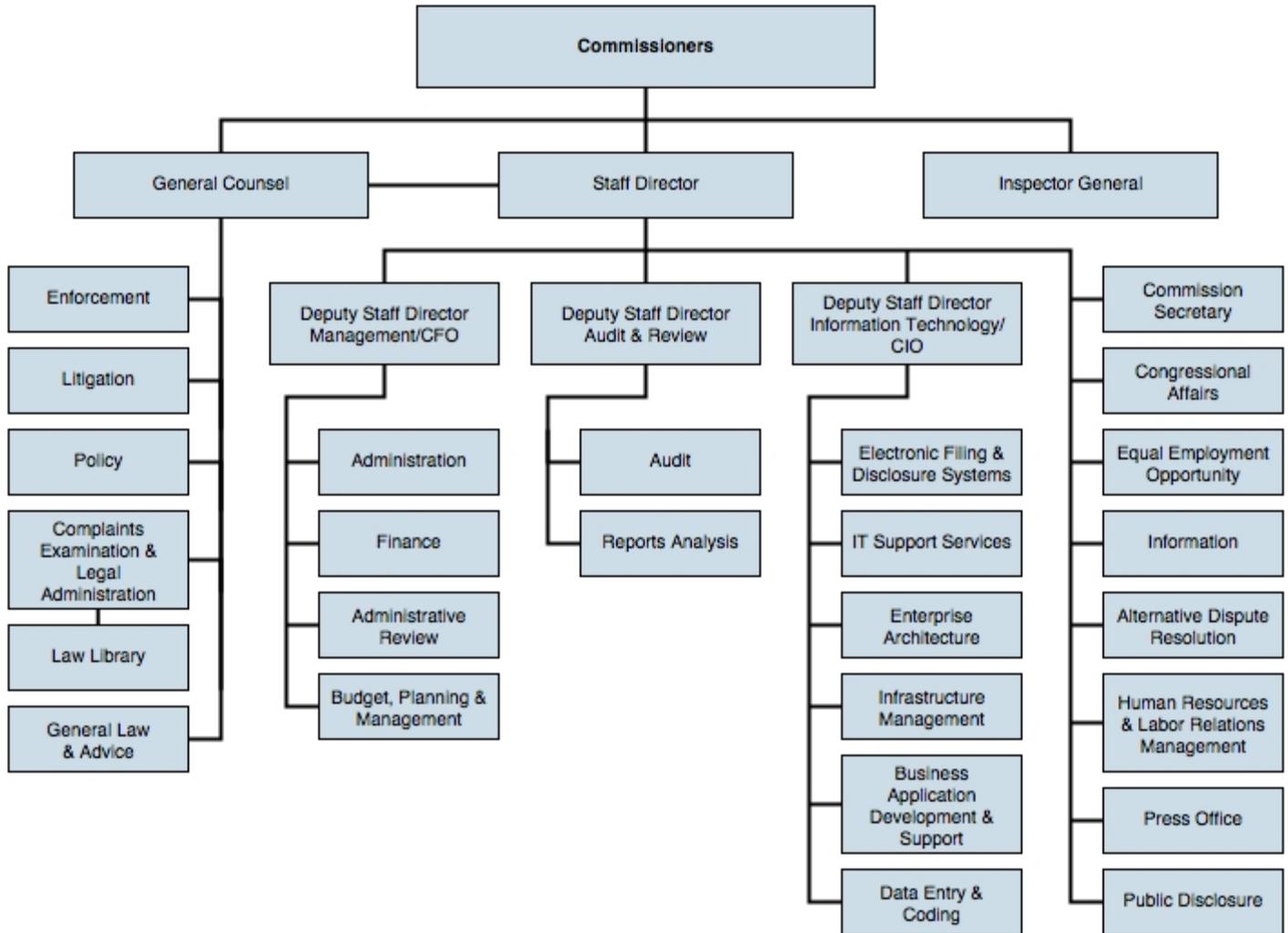


Figure 1 – FEC Organizational Chart

Commissioners

The FEC is structured to foster bipartisan decision making. Its work is directed by six Commissioners, who are appointed by the President with the advice and consent of the Senate. The Commissioners serve full time and are responsible for administering and enforcing the FECA. They generally meet twice weekly, once in a closed session to discuss matters that, by law, must remain confidential, and once in a meeting open to the public. At these meetings, they formulate policy and vote on significant legal and administrative matters. Each member serves a six-year term, and two seats are subject to appointment every two years. By law, no more than three Commissioners can be members of the same political party, and at least four votes are required for any official Commission action. Chairmanship of the Commission rotates among the members each year, with no member serving as Chairman more than once during his or her term.

Three offices support the Commissioners in accomplishing the FEC’s mission. Brief

descriptions of the Office of the General Counsel, the Office of the Staff Director, and the Office of Inspector General follow:

Office of General Counsel

The General Counsel position was created by the FECA in 1974. The Office of General Counsel consists of five organizational units:

- Policy Division - drafts, for Commission consideration, advisory opinions and regulations, as well as other legal memoranda interpreting the Federal campaign finance law. It also provides legal advice in response to legislative inquiries, legal reviews for all FEC publications, and training to Commission staff concerning changes in the law.
- Enforcement Division - investigates alleged violations of the law, negotiates conciliation agreements, and recommends civil penalties for individuals and entities that have violated the FECA.
- Litigation Division - handles all civil litigation arising out of any legal actions brought by or against the Commission. It is the exclusive representative of the Commission before the Federal district and circuit courts, and before the Supreme Court with respect to matters involving public financing of Presidential campaigns and conventions.
- General Law and Advice Division - responsible for processing all audit and repayment matters, as well as handling debt settlements, administrative terminations, and administrative fines matters. It also handles all administrative law, disclosure, Freedom of Information Act, Privacy Act, and employment and labor law matters, and administers FEC's Ethics in Government Act program.
- Office of Complaints Examination and Legal Administration - provides central docketing functions, administrative information technology (IT), and information services, and tracks performance data for the Office of General Counsel.

Office of the Staff Director

The Staff Director position also was created by the FECA in 1974. The Staff Director is supported by a Deputy Staff Director for Management/Chief Financial Officer, a Deputy Staff Director for Audit & Review, and a Deputy Staff Director for Information Technology/Chief Information Officer. The Commission's work is supported by several staff offices, including the Administration Division; Office of Congressional, Legislative and Intergovernmental Affairs; Office of Equal Employment Opportunity and Special Programs; Office of Human Resources and Labor Relations; Office of Budget, Planning and Management; and the Press Office.

Program offices under the Office of the Staff Director include:

- Office of Administrative Review - established in 2000 after statutory amendments permitted the Commission to impose civil money penalties for violations of certain reporting

requirements. Under the civil monetary penalties program, if the Commissioners issue a “reason to believe” finding that a committee failed to file or filed late a required report or notice it will notify the committee of its finding and the amount of the proposed civil money penalty. Within 40 days, the committee may challenge the “reason to believe” finding. This office evaluates these challenges and may recommend that the Commission: (1) uphold the finding and civil money penalty; (2) uphold the finding, but modify or waive the civil money penalty; (3) determine that no violation occurred; or (4) terminate its proceedings. The office also serves as the Commission’s liaison with the U.S. Department of the Treasury on debt collection matters involving unpaid civil money penalties under this program.

- Audit Division - evaluates the matching fund submissions of Presidential primary candidates and determines the amount of contributions that may be matched with Federal funds. As required by law, it audits all public funding recipients. It also audits those committees that, according to FEC determinations, have not met the threshold requirements for substantial compliance with the law. The division’s resources are also used in the Commission’s investigations of complaints.
- Reports Analysis Division - provides committee officials with technical assistance in complying with reporting requirements and conducts detailed examinations of the campaign finance reports filed by political committees. Due to limited resources in compliance, the review of reports represents the only full scrutiny of 100% of all committee filings. Each committee has an analyst assigned, who assists the committee and seeks to ensure voluntary compliance with the law and full, accurate disclosure. The division also performs the first part of the late and non-filing programs, referring committees to the Office of Administrative Review for final action, and refers debt settlement and administrative termination actions to the Office of General Counsel for final legal action.
- Information Technology Division - provides internal IT support, operates the electronic filing system, and enters information into the FEC database from all reports filed by political committees and other entities. It is responsible for operating and maintaining the FEC website that is now the main source of information and disclosure of campaign finance data. The division is also responsible for the computer programs that sort and organize campaign finance data into indexes. These indexes permit a detailed analysis of campaign finance activity and provide a tool for monitoring contribution limits. The indexes are available on the website. The division publishes the Reports on Financial Activity series of periodic studies on campaign finance and generates statistics for other publications.
- Commission Secretary - responsible for all administrative matters relating to Commission meetings, as well as Commission votes taken outside of the meetings. This includes preparing meeting agendas, agenda documents, Sunshine Act notices, meeting minutes, and vote certifications. The Secretary also logs, circulates, and tracks numerous materials not related to Commission meetings and records the Commissioners' votes on these matters. All matters on which a vote is taken are entered into the Secretary's database.
- Information Division - provides general educational assistance to candidates, committees, and others involved in elections through the Internet, e-mail, letters, telephone conversations,

publications, and conferences. To foster voluntary compliance with the FECA, the FEC engages in proactive outreach and educational efforts, such as seminars and reminder notice mailings before each major filing period.

- Alternative Dispute Resolution Office - provides parties in enforcement actions with an alternative method for resolving complaints that have been filed against them or for addressing issues identified in the course of an FEC audit. The program is designed to promote compliance with FECA and Commission regulations and to reduce the cost of processing complaints by encouraging settlements outside the FEC's normal enforcement track.
- Public Disclosure Division - processes incoming campaign finance reports from Federal political committees. These reports are available to the public in the Public Records Office at FEC headquarters, located at 999 E Street, N.W., Washington, DC. The Division also faxes and mails copies of reports to requestors.

Office of the Inspector General

The Office of the Inspector General, established in 1988 under amendments to the Inspector General Act, is independent and reports to both the Commissioners and the Congress. The FEC's Inspector General has two major responsibilities: to conduct internal audits and investigations to detect fraud, waste and abuse within the agency and to improve the economy and effectiveness of agency operations. The Inspector General is required to report its activities to Congress on a semiannual basis. These reports include descriptions of any serious problems or deficiencies in agency operations, as well as corrective steps taken by the agency.

Section 1.B: Performance Goals, Objectives, and Results

Highlights

The FEC pursues three major goals:

Goal 1: Allow the public to make informed choices in the electoral process through the full disclosure of the sources of candidate campaign funding.

Goal 2: Foster an attitude of voluntary compliance with the disclosure and limitations provisions of the FECA through enforcement of the Act in a timely, consistent, and comprehensive manner.

Goal 3: Limit the influence of personal wealth and special interest groups on the outcome of Presidential elections by offering public funding of campaigns.

Goal 1 – Informed Choices

Since its inception, the FEC has been committed to providing the public information on campaign financing in a timely and useful manner. Key indicators for Goal 1 are:

- Making reports filed with the FEC will be available to the public within 48 hours.
- Reviewing all reports and statements received.
- Responding to data requests from the press, public, and committees within 72 hours.

The FEC has been able to achieve its goal of making reports filed with the FEC available to the public within 48 hours. To accomplish this, the staff is scheduled to be in the office on evenings and weekends when reports are due. This ensures coverage for phone calls from all time zones and mail deliveries. The Public Disclosure office also works closely with the IT Division to ensure that all equipment and programs are functioning properly.

During the last year, the Reports Analysis Division was able to meet or exceed its goals in reviewing all reports and statements received. The existing backlog of reports to review is at its lowest point for comparable non-election year periods. These goals were met due to efforts made to: 1) replace staffing vacancies slots rapidly; 2) improve training capabilities; 3) better coordinate RAD business activities with other FEC divisions and offices; 4) establish more defined roles for each of the division's branches; and 5) continually review processes and procedures used to conduct division activities.

The FEC has also achieved its goal of responding to information requests within 72 hours. The agency maintains a staff of information specialists and press spokespersons that is sufficient to respond efficiently to the large number of inquiries that often arise during elections and at other times when the public interest focuses on the FEC. The agency further ensures that FEC staff members are well trained and informed about recent legal developments and agency actions and that staff has access to the resources needed to respond to inquiries. Staff members strive to respond to inquiries during the same day that calls are received. Response time may be affected by the nature and complexity of the request, equipment malfunctions, call volume, and staffing issues.

Goal 2 – Ensure Compliance

The FEC is dedicated to demonstrating to the public and the election community that the FECA is fairly and swiftly enforced, thereby encouraging a high level of voluntary compliance with the FECA. Key indicators for Goal 2 are:

- Referring committees found to have questionable activity for audit or enforcement action.
- Meet deadlines for issuance of advisory opinions and filing litigation pleadings
- Maintain an average active enforcement caseload in excess of 50% of total caseload and close more than 50% of enforcement cases with substantive Commission action

During FY 2005, the Office of General Counsel was able to meet deadlines for issuance of advisory opinions and filing litigation pleadings. OGC was also able to process or close more

than 50% of enforcement cases with substantive commission action and was able to maintain more than 50% active cases. The FEC uses the Enforcement Priority System to prioritize cases to ensure that resources are efficiently and effectively utilized. Cases are put on a timetable depending on the substance and procedural posture of the case. Meetings are held on a regular basis to discuss the progress of the case. Fiscal year 2005 was the first full fiscal year that OGC operated under its reorganization. New procedures were implemented, processes streamlined, and highly-qualified attorneys were actively recruited.

Several factors influenced these indicators by increasing OGC's workload. First, because the 2004 elections were the first to be regulated under the BCRA, the agency had no well-established precedents regarding cases arising from alleged violations of BCRA provisions; therefore cases dealing with the BCRA issues were given the highest priority. Second, during FY 2005 the Commission received 182 complaints, which is among the largest number of complaints and referrals filed during a single fiscal year. Finally, the agency handled a large number of cases during FY 2005 because the fiscal year covered a Presidential election year, which typically precipitates an increase in the number of complaints filed.

Goal 3 – Provide Public Funding for Presidential Elections

The FEC is committed to implementing the public funding provisions of the campaign finance law and successfully administering the public funding program. Key indicators for Goal 3 are:

- Establishing the eligibility of candidates for matching funds in a timely manner.
- Ensuring that all Federal funds disbursed in Presidential elections are properly certified eligible candidates and accounted for.

Each primary candidate requesting public funding must prepare candidate letter of agreements and certifications and present a threshold submission verifying the receipt of contributions greater than \$5,000 in each of twenty states to qualify for public funding. The Audit Division and OGC review the letter for completeness immediately upon its receipt, and any discrepancies are discussed with the committee. The committee then makes the requested changes and/or additions. The threshold submissions are reviewed by temporary staff hired for that purpose. Then the submission is reviewed by the Deputy Assistant Staff Director and undergo a referencing process by a member of the Audit staff. The review of threshold submissions is completed within 15 business days of receipt. To date, all threshold submissions have been completed within the 15-day time frame except in cases where the 20-state threshold has not been met and additional time is given to the committee to correct the problem, which may include submitting additional contributors.

To ensure that all public funds disbursed in Federal elections are properly certified and accounted, funds for nominating conventions and general election candidates are disbursed only after the proper documentation has been received and reviewed. In both cases, a letter similar to the primary candidate letter of agreements and certifications is presented by the committees and is reviewed in the same manner as the primary letter. Primary candidates make monthly submission requests that are reviewed by temporary staff in the same manner as the threshold submission. Submission review must be completed by the end of the month in order to certify

payments to the Department of Treasury for payment on the first business day of the following month. All submission reviews were completed on a timely basis.

One factor that has affected the primary payments is a shortfall in the Fund that results in candidates receiving only a portion of the funds to which they are entitled. Although the full amount is certified to the Department of the Treasury, a *pro rata* payment is made when the balance in the Fund is not sufficient to make the full payment.

The agency's goal is to release all audit reports to the public by December 31 of the year after the election. In some cases, the report is made public by placement on an open session agenda prior to December 31; however, the Commission's discussion of the report may delay final approval until after December 31. This goal has been met in all but one case, which occurred in the 2000 election cycle. In that instance, the goal was not met due to the complexity of the audit, which is still in the litigation phase today.

Performance Data Collection and Reporting

As a result of the pattern of campaign financing, not all data is collected or available on a fiscal year basis. Therefore, an assessment of FEC performance can best be determined by comparing trends from election cycle to election cycle. Assurance of the accuracy of performance data reported is achieved through data verification processes inherent in the recurring use and updates of the data. FEC analysts, managers, and executives verify the data on an ongoing basis. The data received a final review by budget and program branch chiefs with budget and performance responsibilities prior to submission and underwent final review by the Staff Director. The Data Sources and Quality discussion in Part II of this report provides additional information about the FEC's actions to ensure the accuracy of data, which are documented in the Data Verification and Validation sections of the FEC's annual performance budgets and reports. In several areas, the volume received did not match expectation, so the reporting on those measures focuses on meeting FEC targets, e.g. processing all reports filed regardless of volume received.

Limitations on Performance Data Collection and Reporting

The Commission defines its work in the context of election cycles. An election cycle consists of the preceding and actual election years, i.e., calendar years 2003 and 2004 constitute the 2004 election cycle. An election cycle, therefore, spans three fiscal years (i.e., the 2004 cycle begins in FY 2003 and ends in FY 2005). The 2004 Presidential election took place in FY 2005. The beginning of the new fiscal year (October 1) coincides with the peak pre-election period when the FEC experiences its heaviest workloads for many programs.

The flow of work for programs such as audits and enforcement actions is such that action on the referrals for audits and compliance actions from the 2004 election will not be finalized for 3 to 4 years after the election. As a result, work undertaken or completed in any fiscal year includes work that began in previous election cycles. The Strategic Plan for FY 2004-2009 outlines performance goals and workloads by election cycle, while the annual performance plan (now the performance budget) relates the specific activities of FY 2005 to work from several election cycles. The performance budget relates the performance goals for FY 2005 to the levels of

funding. Goals for the major program areas, public disclosure, compliance, and public financing, establish targets for the speed/timeliness in which an action should take place, and the volume of transactions that will be processed.

Section 1.C: Analysis of FEC's Financial Statements and Stewardship Information

Balance sheet

As a small agency, almost 98% of FEC's assets consist of Fund Balance with Treasury (cash) and Property Plant and Equipment (PPE).

Cash decreased by about \$3.3 million or 28% from FY 2004 largely due to payments to contractors working on IT contracts and GSA for construction work. PPE increased by approximately \$1.3 million or 15% from FY 2004 mainly as a result the completion of leasehold improvements of FEC's Washington headquarters in April 2005.

Statement of Net Cost

FEC's total budget in FY 2005 was \$51.7 million. Of this, about \$37.8 million or 73% is related to personnel costs. Overall, costs increased by approximately \$4.3 million or 8.4% from FY 2004. The largest part of the increase, \$4.6 million, was Gross Costs with the public which increased due to salaries, depreciation and IT related contracts in FY 2005. Staffing increased in FY 2004-5 as a result of changes in legislation affecting campaign finance laws in late 2002.

Statement of Changes in Net Position

Total Financing Sources under Cumulative Results of Operations increased by about \$4.5 million or 8.6% primarily due to an increase in Appropriations Used which is largely a function of payments made. Appropriations Used increased primarily because of the increase in budget for salaries from the prior year, the increased rent and IT contracts.

Statement of Budgetary Resources

Total Budgetary Resources increased by approximately \$2.0 million or 3.9% over FY 2004. Primarily this is due to an increase in the appropriation of \$919,000 and a decrease in transfers out of \$481,000. In FY 2004 FEC transferred funds to the newly formed Election Assistance Commission. Total Status of Budgetary Resources increased by \$2.0 million. This is primarily due to an increase in payroll, rent and related services of \$620,000 and Category B (IT contracts) obligations of about \$987,000. Obligated balances transferred, net, end of period decreased by \$3.5 million primarily as a result of the liquidation of undelivered orders for construction services and IT contracts.

Statement of Financing

Total resources used to finance activities increased by \$1.9 million which is primarily the result of an increase in obligations incurred for payroll, rent and IT contracts. Total resources used to finance net cost of operations increased by \$3.5 million or 7.1% from FY 2004 primarily due to the liquidation of obligations for construction and IT contracts. Components not requiring or generating resources increased by \$726,000 due to an increase in depreciation.

Statement of Custodial Activity

Cash collections for civil penalties decreased from the prior year in the area of civil penalties by approximately \$2.0 million. This is primarily due to the cyclical nature of federal election cycles and thus, the related enforcement cycles.

The FEC does not maintain any stewardship assets.

Section 1.D: Analysis of the Entity's Systems, Controls, and Legal Compliance

The FEC managers' self-assessments required by OMB Circulars A-123 and A-127 indicate that there are no material weaknesses. Employees in all divisions continue to review specific procedures on an ongoing basis and improve internal controls where possible.

This year the independent auditors, Clifton Gunderson (CG), identified four material weaknesses (cost accounting system and processes, custodial receipts, general property and equipment and information technology) and two reportable conditions (financial reporting and payroll). While FEC management recognizes that room for improvement exists, the FEC fundamentally disagrees with several of CG's findings (see Section III - Management's Response to Auditor's Report for a full analysis)

Debt Collection Improvement Act

The FEC manages its delinquent debt pursuant to the Debt Collection Improvement Act (DCIA) of 1996. It refers delinquent debt greater than 90 days old to the Department of the Treasury (Treasury) for cross servicing and offset. In FY 2005, the FEC's net receivables totaled \$427,151.

Prompt Payment Act

The Prompt Pay Act requires Federal agencies to make timely vendor payments and to pay interest penalties when payments are late. The FEC's on-time payment rate for FY 2005 was effectively 100%.

Improper Payments Information Act

In accordance with OMB guidance, the FEC reviewed all of its programs and activities to identify those that may be susceptible for significant erroneous payments. The FEC does not make grants, and its non-personnel expenses are approximately \$15 million. The FEC is confident that

improper payments are immaterial.

Grants Management

FEC does not administer any grant programs.

Section 1.E: Possible Future Effects of Existing Events and Conditions

There are several existing events and conditions that could have possible future effects on the FEC.

First, the Supreme Court will hear two cases this term regarding the campaign finance law. The first case, *Wisconsin Right to Life, Inc. v. Federal Election Commission*, challenges provisions of the BCRA that prevent corporations or labor unions from buying radio and television ads that reference a clearly identified federal candidate during the weeks just before an election. Second are the consolidated cases, of *Randall v. Sorrell*, *Vt. Republican State Committee v. Sorrell*, and *Sorrell v. Randall*. These cases present challenges to a 1997 Vermont law that puts a ceiling on how much a candidate for state office can spend. Under the law, candidates for governor may spend no more than \$300,000 per two-year election cycle. Candidates for lieutenant governor may spend no more than \$100,000, and smaller limits apply to other offices.

Second, proposed legislation from the House or Senate, if enacted, could have future effects. One such proposal is S. 1053, the 527 Reform Act of 2005, which would amend the FECA to clarify when organizations described in section 527 of the Internal Revenue Code of 1986 must register as political committees. The House has a similar piece of legislation pending, H.R. 1316, the 527 Fairness Act of 2005.

Third, legislative recommendations from the FEC, if enacted, could have future effects. On March 5, 2005, the FEC submitted 16 legislative recommendations to Congress and the President, five of which were considered a priority by the Commission.

- The addition of the Commission to the list of agencies that are authorized to issue immunity under Title 18;
- Increasing the record retention period from three years to five years;
- Adding a provision to make it a violation for anyone to aid and abet another party in violating the FECA;
- Making permanent the Administrative Fine program for reporting violations; and
- Requiring the electronic filing of Senate reports.

Fourth, the solvency of the Presidential Election Campaign Fund may have major consequences for the FEC. The agency's early projections concerning primary matching payments for the 2004 election cycle indicated that January 2004 payments to eligible Presidential candidates could be less than 20% of the amount certified, even if one major party candidate declined to participate in the matching payment program. However, three major party candidates—Howard Dean, John Kerry and President Bush—chose not to participate in the program, and the only shortfall that occurred in the 2004 cycle took place in February, when candidates received

approximately 46 cents per dollar certified. For the 2004 elections, a total of eight candidates were certified for matching funds. With the participation of three additional major party candidates, the program would have experienced severe shortfalls. The Presidential Election Campaign Fund is likely to continue to face major deficits in timely payments in the 2008 election and is in danger of falling short of the funds necessary to meet the objectives of the public financing program unless legislative action is taken. The Commission has consistently made legislative recommendations to Congress to address this problem. The FEC is concerned that the potential for a totally open primary in both major parties in 2008 (with the presumed participation of many candidates in both primaries) will further exacerbate the potential shortfall. At some point, without legislative remedy, the shortfall could impact payments to general election candidates as well as to primary candidates.

Section 1.F: Other Management Information, Initiatives and Issues

Management's Response to Inspector General's Management and Performance Challenges

The FEC recognizes that our agency, like all others, faces management and performance challenges. The Inspector General identified three areas – information technology security, financial reporting and human capital management – that represent critical infrastructure and operational challenges for all Federal agencies. We are cognizant of these government-wide challenges and are working both internally and partnering externally to address and overcome these challenges.

Information Technology Security

The Commission agrees with the Inspector General that the benefits of information technology (IT) also bring the risks of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services. While the FEC's is exempt from the Paperwork Reduction Act and its progeny governing IT management controls and procedures for IT security, FEC management continues its commitment to the spirit and intent of such legislation.

As the Inspector General points out, computerized systems enable the FEC to carry out its mandate to ensure that the campaign process is fully disclosed. To address the ever-present threats of data misuse, destruction, or inappropriate disclosures, as well as to ensure continuity of operations in the event of a disaster, the Commission has taken aggressive actions to secure its IT infrastructure. In FY 2005, the Commission continued a mandatory security awareness training program for its employees and contractors. We also continue to monitor and evaluate our Information System Security Policy.

The FEC will continue its vigilance in this area and welcomes further comments from the Inspector General on IT security issues.

Financial Reporting

The FEC shares the IG's goal of producing timely, accurate, and useful financial information that is essential for making day-to-day operating decisions and managing the government's operations more efficiently and effectively. The FEC is also committed to fully complying with all financial management laws and standards.

The FEC achieved considerable progress in financial reporting in FY 2005. The Commission took many steps to formalize and streamline its reporting process. We worked to make reconciliation more efficient and to have minimal items to reconcile. The steps taken by the FEC will enable us to be 100% USSGL compliant in FY 2006. Finally, the FEC is working diligently to determine whether it should upgrade or replace its accounting system to meet the demands of the new reporting requirements.

These are just some of the improvements made in financial management in FY 2005. And although significant progress has been made in this area, the FEC understands the challenges ahead. In FY 2006 we will focus on improving the accounts receivable and property processes and training of finance and other key staff.

Human Capital Management

The Commission encounters the same long-standing challenge that faces the rest of the federal government: the development and implementation of a consistent strategic approach to managing and maintaining an appropriately skilled workforce. To address this challenge, the Commission has undertaken a comprehensive human capital management initiative. This initiative includes effective planning for future needs, changes in recruitment, strategic hiring, training the current workforce, and retention of critical staff. The Commission made strides in succession planning and diversity in the hiring of several mid-career managers to fill critical top-level positions. We have implemented a new performance appraisal system and identified and addressed training gaps and mission-critical leadership positions.

The Commission is committed in moving forward on the President's Management Agenda to make Government more citizen-centered, market-based and results-oriented by assisting FEC management in restructuring its workforce to implement necessary changes in the human capital management arena. We are dedicated to maintaining and strengthening our commitment to a diverse Federal workforce that is skilled, flexible, and focused on results and service. We are aware that we still have much to do and are diligently working to improve our overall situation.

Section 1.G: Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Federal Election Commission, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the Federal Election Commission in accordance with U.S. generally accepted accounting principles (GAAP) for Federal entities and the formats prescribed by the Office of Management and Budget, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read

with the realization that they are for a component of the U.S. Government, a sovereign entity.

SUPREME COURT OF THE UNITED STATES

Syllabus

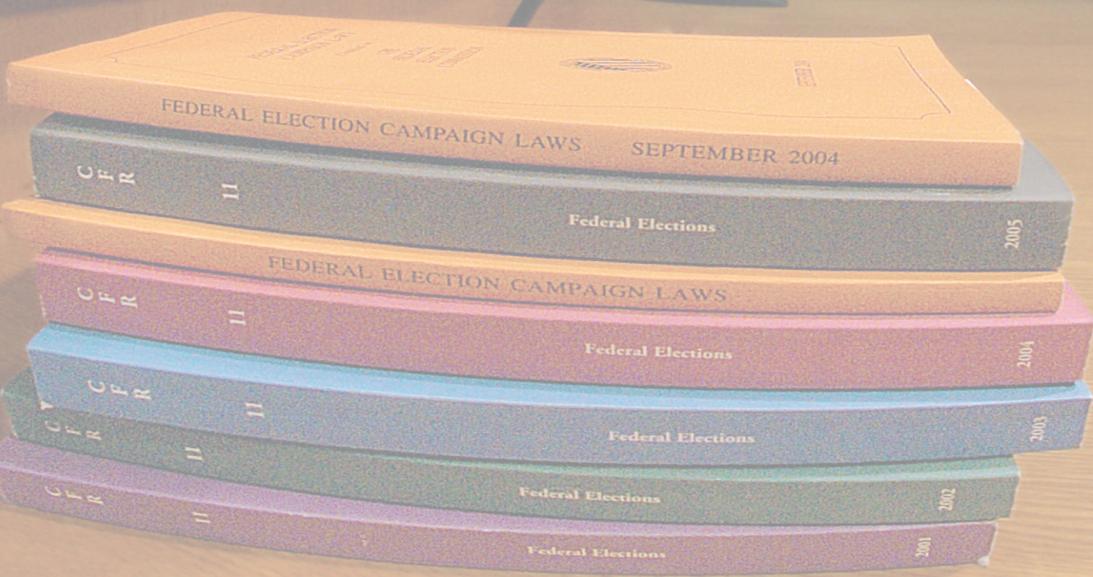
MCCONNELL, UNITED STATES SENATOR, ET AL.
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PETITION FROM THE UNITED STATES DISTRICT COURT FOR THE
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Argued September 8, 2003 — Decided December 10, 2003

The Bipartisan Campaign Reform Act of 2002 (BCRA) and the Federal Election Campaign Act of 1971 (FECA) are the primary federal enactments of what first conceived to be the national system of money-raising and contribution development in the United States.

Section II
Performance Report



SECTION II

Performance Report

Overview of Strategic Plan

The FEC's Strategic Plan for FY 2004 – 2009 was developed in accordance with the Government Performance and Results Act. This plan provides the framework for how the FEC will use its resources to implement and enforce the campaign finance laws during the 2004 (FYs 2003-2005), 2006 (FYs 2005-2007), and 2008 (FYs 2007-2009) election cycles.

FY 2005 Performance Budget and Results

The FEC's Strategic Plan identifies performance goals by election cycle or other multi-year periods. The FY 2005 Performance Budget focuses on the results sought for only the fiscal year. While it is difficult to measure how the FEC ensures public faith in the political and campaign finance systems, the FEC gauges its effectiveness through a series of indicators designed to measure performance in areas that promote confidence in the campaign finance process.

The FEC continues to refine its performance measurement metrics to demonstrate to the American people how effectively it is performing its mission. This year, the FEC operated under its first performance budget, which tied performance goals to levels of funding. The Commission submitted a list of performance measures with the FY 2005 budget that reflected information reported in previous years. As part of the evolution to a performance budget, the Commission reviewed these performance metrics for FY 2005 and determined that many of them were measures of output rather than outcome. The FEC is revising its strategic plan and will submit new performance measures with the performance budget due to the Congress in February 2006.

The Commission's eight key performance measures by major program are highlighted below, with comparative results from FYs 2002, 2003, and 2004. Results for the performance indicators submitted with the FY 2005 budget are provided in Appendix B.

Goals and Objectives for FY 2005

To achieve its mission, the FEC has identified three major program areas - public disclosure, compliance, and public financing. FEC's goals, objectives, performance measures, and desired outcomes described in this report are tied to these three core FEC programs:

1. Public Disclosure

Goal: Allow the public to make informed choices in the electoral process through the full disclosure of the sources of candidate campaign funding.

Objective: To ensure full, accurate, and timely disclosure of campaign finance activity in Federal elections by publicizing campaign finance reports required to be filed for public view under the FECA, and to provide information and policy guidance on the FECA to the public, press, and those persons and entities required to comply with the FECA.

Performance Measures:

- Make reports filed with the FEC available to the public within 48 hours.
- Review all reports and statements received.
- Respond to data requests from press, public, and committees within 72 hours.

Analysis:

When a committee files its FEC report on paper, the Commission’s Public Records Office ensures that a copy is available for public inspection within 48 hours at FEC’s headquarters, located at 999 E Street, N.W., Washington, DC. Simultaneously, the FEC’s IT staff begins to enter the information disclosed in the report into the FEC computer database. Reports filed electronically are made available to the public within 24 hours, if not almost immediately. The amount of information disclosed has grown dramatically over the years. By December 2004, more than 28 million pages of information dating back to 1972 were available for public review.

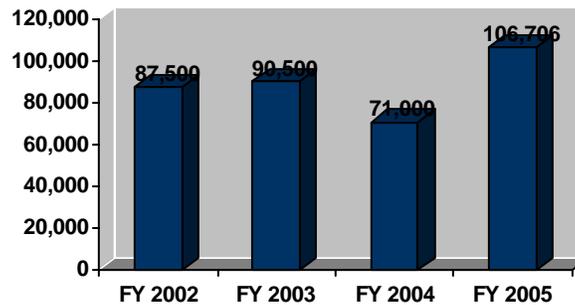


Figure 2 – Total Reports and Statements Filed

On the FEC website, the public can access all reports filed with the agency regardless of whether they were filed electronically or on paper. Scanned copies of paper reports can be searched and viewed through the FECs digital imaging system on-line. The imaging system permits a user to view a committee’s report on a high resolution computer screen (or a paper copy), just as the document appeared in its original form. Campaign finance data can also be searched in a host of different ways: one can search the database by individual contributor, committee, candidate, occupation, date, dollar amount, or other search criteria. In FY 2005, the website recorded more than 100 million “hits” from the public, more than double the “hits” in FY 2002.

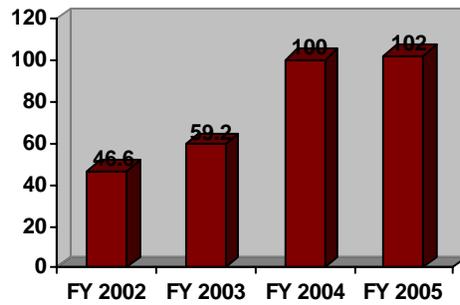


Figure 3 - Total Website Hits, Fiscal Year (in millions)

The Commission's Reports Analysis Division reviews all reports to track compliance with the law and to ensure that the public record provides a full and accurate portrayal of campaign finance activity. Significant backlogs of reports awaiting review developed, reaching more than 30,000 reports at one point in the 2000 cycle. However, the division made significant improvement in the timeliness of the review of reports in FY 2004 for the 2004 cycle, resulting in the lowest backlog ever. In 2004, the Reports Analysis Division collaborated with other divisions to provide greater accessibility and more efficient service to the public and the regulated community.

The Public Disclosure Division, Press Office, and Information Division staff assists thousands of callers and visitors every year.

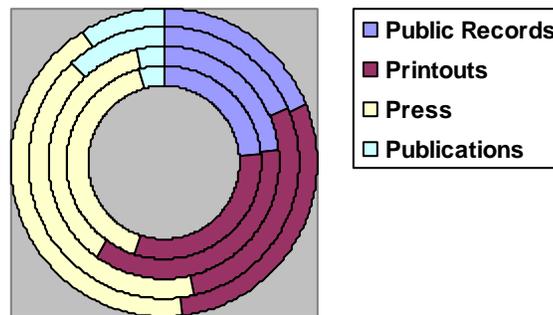


Figure 4 – Data Requests Responded to Within 72 Hours - 2002 (inner circle) to 2005

2. Compliance

Goal: The goal of the FEC's Compliance program is to foster an attitude of voluntary compliance with the limits, prohibitions, and reporting requirements of the FECA through enforcement of the FECA in a timely, consistent, and comprehensive manner.

Objective: Demonstrate to the public and the election community that the FECA is enforced

fairly and swiftly, thus resulting in (1) a high level of voluntary compliance with the FECA, and (2) the most efficient use of FEC enforcement resources by focusing on the most salient and significant FECA compliance concerns.

Performance Measures:

- Committees found to have questionable activity are referred for audit or enforcement action.
- Meet deadlines for issuance of advisory opinions and filing litigation pleadings
- Maintain an average active enforcement caseload in excess of 50% of total caseload and close more than 50% of enforcement cases with substantive Commission action

Analysis:

The desired outcomes are the perception by the regulated community that disclosure reports must be filed accurately and timely and that the FECA is enforced impartially and timely. Compliance goals focus primarily on the number of actions accomplished. Enforcement cases are generated through complaints filed by the public, referrals from other Federal and state agencies, and the FEC’s own monitoring procedures. The Reports Analysis Division reviews each committee report filed to ensure the accuracy of the information on the public record and to monitor the committee’s compliance with the law. If the information disclosed in a report appears to be incomplete or inaccurate, the reviewing analyst sends the committee a “request for additional information.” The committee may avoid a potential enforcement action and/or audit by responding promptly to such a request. Most responses take the form of an amended report. Although the Commission does not have authority to conduct random audits of committees, it can audit a committee “for cause” when the committee’s reports indicate probable violations of the law. In FY 2005, the Audit Division completed a major effort to increase the number of non-Presidential committees audited in each election cycle.

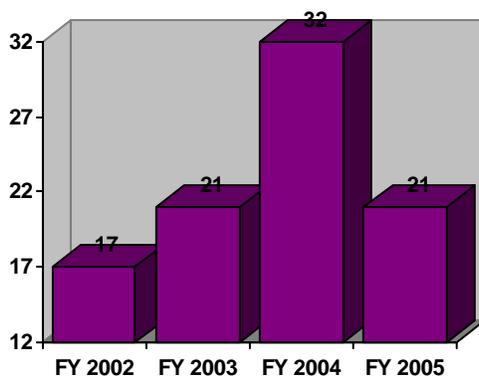


Figure 5 – Number of Non-Presidential Audits Completed

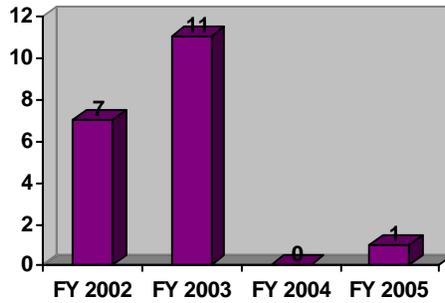


Figure 6 – Number of Presidential Audits Completed

Whether initiated by outside complaint or internal referral, the most complex and legally significant enforcement matters are handled by the Enforcement Division of the Office of General Counsel (OGC), which:

- Recommends to the Commission whether to find “reason to believe” the FECA has been violated, a finding that formally initiates an investigation;
- Investigates potential violations of the FECA by requesting, subpoenaing, and reviewing documents and interviewing and deposing witnesses; and
- Conducts settlement negotiations on behalf of the Commission, culminating in “conciliation agreements” with respondents.

Based on the results of its investigations, the Office of General Counsel recommends to the Commission whether to find “probable cause to believe” the FECA has been violated. The agency must attempt to resolve enforcement matters through conciliation. If conciliation fails, however, the FEC may sue a respondent in Federal district court.

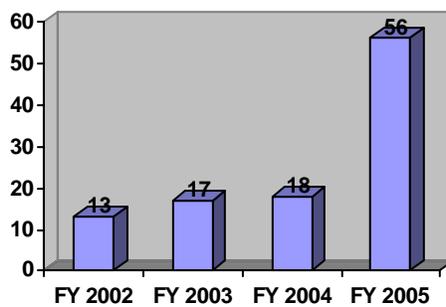


Figure 7 – Number of Cases Referred for Enforcement Action

In addition, two programs under the Office of the Staff Director (Administrative Fines and Alternative Dispute Resolution) have allowed the Office of General Counsel to focus its enforcement resources on more substantive cases and improve the timeliness of cases closed. The total cases closed decreased partially because some of the less substantive cases were transferred to the new Administrative Fine and Alternative Dispute Resolution programs,

allowing the Office of General Counsel to concentrate its resources on more salient cases. The efforts by the Office of General Counsel, Administrative Fine Program, and Alternative Dispute Resolution have led to increased fines and penalties being levied against committees.

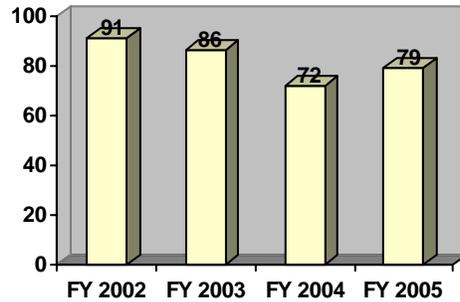


Figure 8 – Number of Cases Closed: OGC

Administrative Fine and Alternative Dispute Resolution cases are closed in significantly less time than OGC cases. Administrative Fine cases for late and non-filers take less time to complete, especially when measured from the date a “reason to believe” determination is made to the final resolution date. The difficulties associated with the mail processing and delivery post-9/11 had a somewhat adverse impact on processing these cases. There is evidence, however, that the program is improving filing timeliness and compliance, and that the cases are most likely to derive from non-electronically filed reports (also from smaller committees in terms of dollar activity). Alternative Dispute Resolution cases have shown improvement in timeliness for those cases not dismissed and generally take less time to complete than traditional enforcement cases.

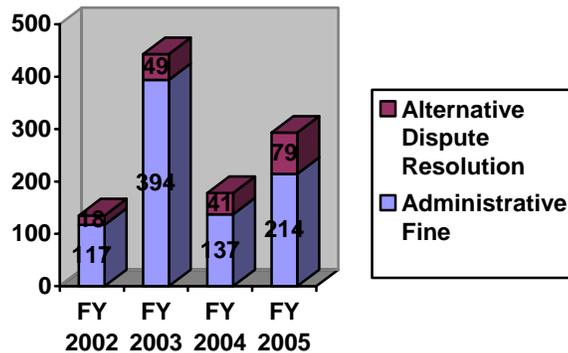


Figure 9 – Number of Cases Closed: ADR and AF

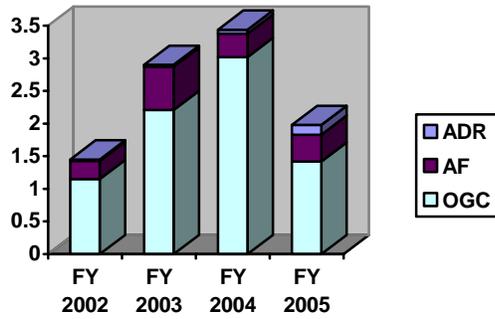


Figure 10 - Amount of fines or penalties (in millions)

3. Public Financing

Goal: Limit the influence of personal wealth and special interest groups on the outcome of Presidential elections by offering public funding of campaigns.

Objective: Implement the Presidential election public funding provisions of the campaign finance law and successfully administer the public funding provisions for qualified candidates in Presidential elections.

Performance Measures:

- Establish the eligibility of candidates for matching funds in a timely manner.
- Ensure that all Federal funds disbursed in Presidential elections are properly certified and accounted for by eligible candidates.

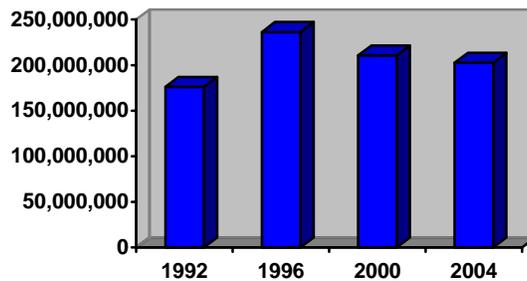


Figure 11 - Matching Fund Payouts

Based on statutory criteria, the Commission determines which candidates and committees are eligible for public funds, and in what amounts. The U.S. Treasury then makes the necessary payments. Later, the Commission audits all of the committees that received public funds to ensure that they used the funds properly. Based on the Commission's findings, committees may

be required to make repayments to the U.S. Treasury. (For information about the public financing process, visit the FEC's website at www.fec.gov.)

Other FY 2005 Performance Results

IT developments and enhancements assist the FEC in meeting its objectives and goals. The two major on-going initiatives are the IT Enhancements and the Electronic Filing projects. During FY 2005, the Commission continued to provide point of entry for the filing of House disclosure documents; scan all documents and transmit images to the House Office in usable format for that office; work with the Senate Office in making Senate documents available for disclosure; and enhance and upgrade the FEC imaging system and all web-based disclosure applications. The FEC also continued its multi-year enhancement and upgrade of IT systems for all Commission Offices and Divisions; migration to client/server environment; implementation of document management system; and maintenance of its new finance and accounting system. The Commission started a data mining program to take advantage of the enhanced disclosure system and to enhance the automated review process in RAD.

The Commissioners and management staff continued to comply with government-wide laws and regulations for budget, planning, personnel, Equal Employment Opportunity, and other issues affecting Federal agencies and to provide guidance and support to the staff in meeting the FEC mission and achieving agency objectives and goals.

The Department of Agriculture, which performs the payroll function for the FEC, underwent a Statement of Auditing Standards (SAS) 70 system review, which noted several reportable conditions that did not affect the FEC. These audits, completed under the guidelines of the American Institute of Certified Public Accountants' SAS Number 70, Service Organizations, provide an opinion on the internal controls placed in operation and include tests of operating effectiveness.

Data Sources and Quality

The FEC has a planning and budgeting system based on a detailed Management Information System (MIS), and is driven by program-based workloads and activity data, outputs, and productivity measures. The FEC has also married the A-123 and A-127 processes, under the Federal Managers' Financial Integrity Act, to ongoing program management activities, and relates the annual A-123 reports to the FEC budget requests.

The evaluation of program resources--mainly staff resources--and the resulting program outputs and productivity measures are used in the internal planning and budget formulation processes. Commission management plans and budget requests are workload-driven and related to resource levels and expected program activity levels.

As a personnel-intensive agency, approximately 70% of the Commission's resources are staff costs, and the remaining 30% represents mainly rent and other direct support for that staff. Using the MIS and summary MIS reports, all workloads, program outputs, productivity, and effectiveness and efficiency are being monitored in monthly management reports. Several other

tracking systems monitor the status of reports processing (filing, filming, data coding and entry, and reports review), enforcement and litigation activities, Advisory Opinions and regulatory rule making, and audit progress. The Enforcement Priority System continually adjusts active enforcement case loads to match available resources.

A major, multiyear effort to institute a case management system for OGC to track enforcement cases resulted in the system becoming fully operational in FY 2003. This system monitors case status and tracks staff time by case for all OGC programs, not just enforcement. The implementation of the case management system provides a significant tool for the FEC to monitor resource usage and case progress.

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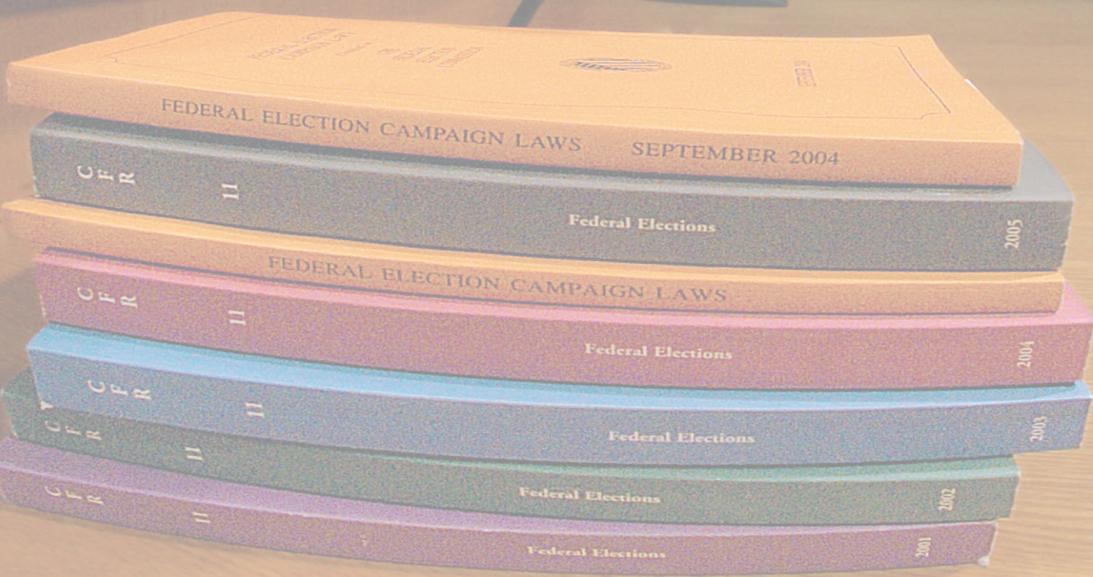
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No. 02-5176. Argued September 8, 2003. Decided December 10, 2003.

The Bipartisan Campaign Reform Act of 2002 (BCRA) and the Federal Election Campaign Act of 1971 (FECA), and other portions of the United States Code, prohibit the national parties of what first conceived to be the

Section III
Auditor's Report And Financial Statements



SECTION III

Auditor's Report and
Financial Statements

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

November 15, 2005

I am pleased to present the Federal Election Commission's (FEC's) financial statements for fiscal year (FY) 2005. This section contains the independent auditor's report, management's response to the auditor's report and the principal financial statements and notes.

The financial statements have been prepared from the books and records of the FEC in accordance with U. S. generally accepted accounting principles (GAAP) for the Federal Government and Office of Management and Budget Circular A-136, Financial Reporting.

We continue to strive for excellence in the financial management of the FEC. Every dollar is important and the way we manage those dollars makes a difference in how successfully we accomplish our mission. The FEC received an unqualified opinion on the Balance Sheet, State of Changes in Net Position, Statement of Budgetary Resources, Statement of Financing and Statement of Custodial Activity. The FEC received a qualified opinion from Clifton Gunderson (CG) on our cost allocation methodology for the Statement of Net Cost, despite the fact that the process was the same as last year and the FEC addressed all the recommendations from FY 2004 audit in this area. The auditor opined that the FEC has four material weakness (cost accounting system and processes, custodial receipts, general property and equipment and information technology) and two reportable conditions (financial reporting and payroll). The FEC fundamentally disagrees with CG's conclusions.

During the past year, the FEC achieved progress on many fronts. We reduced considerably the time spent preparing interim and final financial statements and implemented a formal process for the Chief Financial Officer to review these reports. We developed and formally documented budget and property policies and procedures. We also updated the accounting policy and procedure manual. Finally, we engaged contractors to resolve software problems in our accounting system.

Looking ahead, we will be taking actions that will have both short- and long-term benefits. We will continue to strengthen our fiscal management and accountability by enhancing internal controls, complying with financial management laws and regulations, and taking timely corrective actions on the auditor's recommendations concerning material weaknesses and reportable conditions. Specifically, we are working to make the accounting system 100 percent compliant with the U.S. Standard Government Ledger by FY 2006. We will undertake a study to determine whether our accounting system should be upgraded or replaced so that we can comply with Department of the Treasury and Office of Management and Budget's new reporting requirements.

I am fully committed to the continuing improvement of the Commission's financial management. My goal is to attain an unqualified audit opinion each year, maintain strong internal controls and provide timely, accurate and reliable financial information to ensure we make informed decisions.

Sincerely,

A handwritten signature in blue ink that reads "Anthony P. Scardino". The signature is written in a cursive style with a large initial "A".

Anthony P. Scardino
Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

Office of Inspector General

MEMORANDUM

TO: The Commission

FROM: Inspector General

SUBJECT: Audit of the Federal Election Commission's Fiscal Year 2005 Financial Statements

DATE: November 10, 2005

This letter transmits the final audit report of the Federal Election Commission's (FEC) fiscal year (FY) 2005 financial statements. In accordance with the Accountability of Tax Dollars Act of 2002, the FEC prepared financial statements in accordance with Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, as amended, and subjected them to audit.

The Chief Financial Officers Act of 1990 (Public Law 101-576, commonly referred to as the "CFO Act"), as amended, requires the FEC Office of Inspector General (OIG), or an independent external auditor as determined by the Inspector General, to audit the agency financial statements. Under a contract monitored by the OIG, Clifton Gunderson LLP (CG-LLP), an independent certified public accounting firm, performed the audit of the FEC's FY 2005 financial statements.

The OIG commends the FEC for the accomplishment of completing the fiscal year 2005 on time this year. The Inspector General acknowledges the significant challenge of meeting the accelerated due date of the annual financial statement audit required by OMB.

Audit Process

CG-LLP conducted the audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended. The results of

the financial statement audit are detailed in three reports: report on compliance with laws and regulations; report on internal control; and the opinion on the financial statements.

Report on Compliance with Laws and Regulations

FEC management is responsible for complying with laws and regulations applicable to the agency. To obtain reasonable assurance about whether FEC's financial statements are free of material misstatements, CG-LLP performed tests of compliance with certain provisions of laws and regulations, non-compliance with which could have a direct and material effect on the determination of financial statement amounts, and certain laws and regulations specified in OMB Bulletin No. 01-02, such as the Anti-Deficiency Act and the Prompt Payment Act.

The results of CG-LLP's tests of compliance with laws and regulations described in the audit report disclosed no instances of noncompliance with the laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Report on Internal Control

CG-LLP's planning and performance of the audit included consideration of the FEC's internal control over financial reporting. The CG-LLP auditors obtained an understanding of the FEC's internal control; determined whether internal controls had been placed in operation; assessed control risk; and performed tests of controls in order to determine auditing procedures for the purpose of expressing an opinion on the financial statements. The auditors limited their internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and consequently CG-LLP did not provide an opinion on internal control.

Internal control as it relates to the financial statements, is a process, affected by agency's management and other personnel, designed to provide reasonable assurance of the following: (1) transactions are properly recorded, processed, and summarized to permit preparation of the financial statements and assets are safeguarded against loss from unauthorized acquisition, use or disposition; (2) transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations identified by OMB; and (3) transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

In performing the testing of internal control necessary to achieve the objectives in OMB Bulletin No. 01-02, the auditors identified matters relating to significant deficiencies in the design or operation of FEC's internal control. The testing of internal control identified both reportable conditions and material weaknesses. The American Institute of Certified Public Accountants (AICPA) categorizes reportable conditions as matters relating to significant deficiencies in the

design or operation of the internal control, which in the judgment of the auditor, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

CG-LLP identified material weaknesses in the areas of:

- Cost Accounting System and Processes
- Administrative Fines, Civil Penalties and Miscellaneous Receipts
- General Property and Equipment
- Information Technology

CG-LLP identified reportable conditions, not considered to be material weaknesses, which include the following:

- Financial Reporting
- Payroll

Opinion on the Financial Statements

CG-LLP audited the balance sheets of the FEC as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended. In the report dated November 7, 2005, CG-LLP issued a qualified opinion on the FEC's financial statements.

In fiscal year 2005, the FEC was late in providing cost information to support the allocation of program costs reported on the statement of net cost. As a result, adequate time did not remain to obtain sufficient competent evidential matter and apply auditing procedures necessary to conduct the audit in accordance with the standards and OMB audit guidance mentioned above.

In the independent auditor's opinion, except for the effects of such adjustments to the fiscal year 2005 statement of net cost, if any, as might have been necessary had the auditors been able to perform adequate audit procedures on the program costs referred to in the preceding paragraph, the financial statements and related notes referred to above were presented fairly, in all material respects, the financial position of the FEC as of September 30, 2005 and 2004, and its net cost, changes in net position, budgetary resources, reconciliation of net cost to budgetary obligations,

and custodial activity for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The audit included an examination, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audit also included assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall principal statements' presentation.

Audit Follow-up

The report on internal control contains numerous recommendations to address weaknesses found by the auditors. Management was provided a draft copy of the audit report for comment and CG-LLP reviewed management's comments. Although CG-LLP stands by the report and the weaknesses detailed, the OIG and CG-LLP intend to work with management through the follow-up and audit process to ensure the weaknesses are addressed satisfactorily. In accordance with OMB Circular No. A-50, *Audit Followup*, revised, and based on an agreement with the Offices of the Staff Director and General Counsel, the Staff Director or designee shall develop an action plan for corrective action of the recommendations. The action plan is to set forth specific action planned to implement the recommendations and the schedule for implementation.

OIG Evaluation of Clifton Gunderson LLP's Audit Performance

In connection with the OIG's contract with CG-LLP, the OIG reviewed CG-LLP's reports and related documentation and inquired of its representatives. Specifically, we performed the following: (1) reviewed CG-LLP's approach and planning of the audit; (2) evaluated the qualifications and independence of the auditors; (3) monitored the work of the auditors throughout the audit; (4) examined audit documents and audit reports to ensure compliance with *Government Auditing Standards* and OMB Bulletin No. 01-02; and (5) performed other procedures we deemed necessary.

The OIG's review of CG-LLP's work, as differentiated from an audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States, was not intended to enable us to express an opinion on the FEC's financial statements; provide conclusions about the effectiveness of internal control; or reach conclusions on whether FEC's management substantially complied with laws and regulations related to the audit. CG-LLP is responsible for the opinion and conclusions reached in the attached reports dated November 7, 2005. The OIG review disclosed no instances where CG-LLP did not comply, in all material respects, with *Government Auditing Standards*.

If you should have any questions, please contact my office on (202) 694-1015. We appreciate the courtesies and cooperation extended to Clifton Gunderson LLP and the OIG staff during the conduct of the audit.



Lynne A. McFarland
Inspector General

Attachments

Cc: Acting Staff Director
Chief Financial Officer and Deputy Staff Director for Management
Accounting Officer
Information Technology Director



Independent Auditor's Report

To the Inspector General of the
Federal Election Commission

We have audited the balance sheets of the Federal Election Commission (FEC) as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended. These financial statements are the responsibility of FEC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements' presentation. We believe our audits provide a reasonable basis for our opinion.

In fiscal year 2005, the FEC was late in providing cost information to support the allocation of program costs reported on the statement of net cost. As a result, adequate time did not remain to obtain sufficient competent evidential matter and apply auditing procedures necessary to conduct the audit in accordance with the standards and OMB audit guidance mentioned above.

In our opinion, except for the effects of such adjustments to the fiscal year 2005 statement of net cost, if any, as might have been necessary had we been able to perform adequate audit procedures on the program costs referred to in the preceding paragraph, the financial statements and related notes referred to above present fairly, in all material respects, the financial position of the FEC as of September 30, 2005 and 2004, and its net cost, changes in net position, budgetary resources, reconciliation of net cost to budgetary obligations, and custodial activity for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106
tel: 301-931-2050
fax: 301-931-1710

www.cliftoncpa.com

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In accordance with *Government Auditing Standards*, we have also issued our reports dated November 7, 2005 on our consideration of FEC's internal control over financial reporting, and on our tests of FEC's compliance with certain provisions of laws and regulations. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of our audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management Discussion and Analysis, required supplementary information, and other accompanying information contain a wide range of data, some of which is not directly related to the financial statements. We do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with the FEC officials. Based on this limited work, we found no material inconsistencies with the financial statements or nonconformance with OMB guidance.

Clifton Henderson LLP

Calverton, Maryland
November 7, 2005



Independent Auditor's Report on Internal Control

To the Inspector General of the
Federal Election Commission

We have audited the financial statements of the Federal Election Commission (FEC) as of and for the year ended September 30, 2005, and have issued our report dated November 7, 2005. In our report, our opinion was qualified for the effects of adjustments, if any, as might have been necessary had we been able to perform adequate audit procedures on the cost information supporting the allocation of program costs reported on the statement of net cost. Except as described above, we conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended.

In planning and performing our audit, we considered FEC's internal control over financial reporting by obtaining an understanding of FEC's internal control; determined whether internal controls had been placed in operation; assessed control risk; and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act (FMFIA) (31 U.S.C. 3512), such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur

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and not be detected. However, we noted certain matters discussed in the following paragraphs involving the internal control and its operation that we consider to be reportable conditions and material weaknesses.

Finally, with respect to internal control related to performance measures reported in FEC's Performance and Accountability Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02, as amended. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

FEC attained a major achievement by having its financial statements audited for the first time in fiscal year 2004. FEC continues to design and implement internal controls to strengthen its financial reporting processes. Also, early in the second half of fiscal year 2005, FEC hired a Deputy Staff Director for Management/Chief Financial Officer, a position which was not filled for over a year. In fiscal year 2005, however, certain controls were still being designed, not yet implemented, not fully implemented or not consistently implemented throughout the year.

MATERIAL WEAKNESSES

I. Cost Accounting System and Processes

The weaknesses identified below collectively resulted in a material weakness in FEC's cost accounting system and processes.

A. Cost Allocation Methodology (Repeat Finding)

FEC does not have a cost accounting system that is integrated with the general ledger (GL) system. The current cost accounting system is not adequate to produce the cost data for the Statement of Net Cost (SNC) in an efficient manner. Moreover, the lack of documented procedures and the heavy reliance on a single person to carry out this process impaired FEC's ability to generate timely information especially after the person became unavailable. Consequently, FEC was not able to provide the documentation for cost allocation timely and we were not able to apply auditing procedures to satisfy ourselves with the program costs reported on the SNC.

The cost data presented on the SNC is compiled from three systems' raw data, which is then gathered and analyzed using an elaborate, complex, and manually intensive process. Raw data used in the allocation of costs, such as FTE hours, is sometimes based on estimates due to the timing of the availability of the data.

FEC summarizes employee hours in a spreadsheet based on an office's program numbers, which is generated by a system. The program numbers represent the type of work performed by an employee and the hours are assigned directly or allocated to FEC's three major programs. FEC could not provide crosswalk documentation or definitions supporting the basis of assignment or allocation. The data accumulation and analysis is performed by one person and not subjected to a second review.

The manually intensive and elaborate cost allocation process dictates the need for a formal comprehensive policy and procedures.

A control activity in the GAO *Standards for Internal Control in the Federal Government* is appropriate documentation of transactions and internal control. Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals. All documentation and records should be properly managed and maintained.

Recommendations:

1. Establish formal and comprehensive cost allocation methodology and related policy and procedures.
2. Cross-train employees to minimize the risks of major interruptions in normal business operations.
3. Establish a review process wherein a person, other than the preparer, reviews the work performed to ensure accuracy and propriety.
4. Maintain audit trails to support the allocation methodology and amounts.

B. Managerial Cost Accounting (Repeat Finding)

Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, requires reporting components to perform a minimum-level of cost accounting and provide basic information necessary to accomplish the many objectives associated with planning, decision-making, and reporting. This minimum-level of cost accounting includes, among others: providing information for performance measurement; integrating both cost accounting and general financial accounting by using the United States Standard General Ledger (USSGL); providing useful information; and accommodating management's special cost information needs or any other needs that may arise due to

unusual or special situations or circumstances. The present FEC cost accounting system does not provide the minimum-level identified above.

FEC is currently testing a new cost accounting system with a target implementation date of January 2006. The FEC believes the conditions noted above will be corrected by the new cost accounting system.

Recommendation:

5. Evaluate the functional requirements for the new cost accounting system to ensure that at least, the minimum level of cost accounting required in SFFAS No. 4 is attained.

II. Administrative Fines, Civil Penalties and Miscellaneous Receipts (Custodial Receipts) (New Condition)

The weaknesses identified below collectively resulted in a material weakness in FEC's custodial receipts.

FEC does not have adequate systems and controls in place to ensure that custodial receipts are properly accounted for and recorded timely. There were no formal accounting policy and procedures to ensure that various offices periodically forward to, or notify, the finance office of all identifiable, legally enforceable claims (receivable and revenue) for recording of activities in accordance with the accounting standards. The lack of a policy, standard mechanism and consistent approach resulted in transactions not being recorded and reported timely and required the FEC to expend significant effort towards the end of the fiscal year to identify all transactions that should be recorded.

Moreover, for receivables already recorded in the books, FEC lacked adequate documentation of analysis applied in determining the allowance for doubtful accounts. In addition, transactions related to the custodial receipts, which are non-appropriated funds, were recorded in Standard General Ledger (SGL) account no. 1011, an account used for appropriated funds. The use of the incorrect SGL account was corrected in September 2005 when the auditors brought this issue to FEC's attention.

SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, states that non-exchange revenue (e.g. penalties and fines) should be recognized when a specifically identifiable, legally enforceable claim to resources arises, to the extent that collection is probable (more likely than not) and the amount is reasonably estimable. An allowance for uncollectible accounts receivable should be recognized as a revenue adjustment.

The United States Standard General Ledger (USSGL) provides a uniform Chart of Accounts and technical guidance to be used in standardizing federal agency accounting.

Recommendations:

6. Establish and implement policy and procedures ensuring communication and coordination between program offices and finance office on activities with financial impact. The policy should also clearly establish the FEC's revenue recognition policy. The finance office should design a standard report outlining all the necessary information to record the financial activities. The report should be prepared and submitted timely at least monthly by the program offices to the finance office.
7. Document the policy and basis for the allowance for uncollectible accounts.

III. General Property and Equipment (Property) (Modified Repeat Finding)

FEC's accounting for property involves a time-consuming effort that increases the risk of errors due to its process of expensing its property at the time of acquisition and preparing a journal voucher to reclassify the expense to an asset for reporting purposes. In mid-September 2005, FEC changed to a new property management system. However, the accounting for property did not change.

Our audit disclosed deficiencies, errors or omissions that questioned the effectiveness of FEC's internal control on property. The weaknesses identified below collectively resulted in a material weakness in FEC's general property and equipment. Some examples are noted below:

- The internal control to ensure completeness and proper valuation of property recorded in the books was not properly designed, and consequently, was not effective. The periodic property reconciliation process did not identify software that should have been capitalized until during the audit process. In addition, the monthly management analysis of financial activities did not show an analysis of property.
- Although the number of items in FEC's capitalized asset is not many, most of these assets are bulk purchases comprised of many individual properties which are individually entered into the property system for accountability purposes. The information contained in the property system is not always complete. We found that some items in the property system did not have the bar code identification, serial number and location of the asset.
- Although we were informed that a property physical inventory was conducted, FEC could not provide the instructions, complete results and reconciliation of the physical inventory to the property system and the general ledger balance.

- FEC did not always capitalize assets in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*. Moreover, FEC's processes of identifying software in progress and completed were not adequate to ensure that all software was identified and recorded.
- For 12 of the 18 property additions tested, the receiving reports were not complete or included incorrect information.
- The obligating memo for one of the 15 sample items was not approved by the accounting officer, an authorized approving officer.
- There was no standard process, mechanism or a policy to ensure that program offices notify the finance office of the acquisition or disposition of property such as software in development, completed software, construction in progress, and completed construction to ensure the accounting impact of the transaction is recorded timely and properly.

One of the five standards for internal control in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* is control activities. Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records, which provide evidence of execution of these activities as well as appropriate documentation.

Recommendations:

8. Reconcile the total of the individual property items in the property system to the bulk purchase total recorded in the books to ensure completeness of the property system records.
9. Document physical inventory procedures, results, and reconciliation and maintain the documentation for audit trail purposes.
10. Revise the software capitalization policy to comply with SFFAS No. 10.
11. Enforce compliance and consistent implementation of policies and procedures related to completing receiving reports and the review and approval of obligating memos or documents.
12. Establish a standard process and policy where program offices are required to notify the finance office of any property acquisition or disposition with accounting impact to ensure proper and timely recording of the transaction.

IV. Information Technology (IT)

The reportable conditions below, when evaluated together, make the IT area a material weakness.

A. Entity-Wide Security Program

GAO reported in July 2005 that the underlying cause for information security weaknesses is that agencies have not yet fully implemented entity-wide information security programs. An entity-wide security program provides a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of the entity's computer-related controls. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, and improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources. (U.S. Government Accountability Office, *Weaknesses Persist at Federal Agencies Despite Progress Made in Implementing Related Statutory Requirements*, GAO-05-552 [Washington, D.C.: July 2005]).

FEC has taken important steps to establish an effective information security program, but has not completed the documentation, approval and implementation of an entity-wide security program plan. In October 2004, FEC issued a memo informing employees that the "Information System Security Program Policy" (Policy Number 58A) was approved and should be followed by all employees. Policy Number 58A was created to "manage the risk to information rather than just systems" and serve as the backbone of FEC's entity-wide security program. Policy 58A and its subsets supplement Directive 58, "Electronic Records, Software and Computer Usage," which was issued in November 1997.

In fiscal year 2005, FEC has completed the identification of its major applications and mission critical general support systems (MCGSS) as part of its risk mitigation strategy. FEC management also created a Security Review Policy that calls on management to perform annual external penetration testing, disaster recovery tests, a review of incident response procedures, a network vulnerability study, a code review of one major application and a review of access control procedures. Additionally, FEC management is currently in the process of soliciting bids for risk assessments. Management has completed the statement of work, received proposals and is currently reviewing the proposals. The risk assessment and business impact analysis are key components in the development of security plans and disaster recovery plans. These components are essential in the establishment of the framework for the development and implementation of the FEC's security plans and disaster recovery plans.

Current weaknesses that exist in FEC's information security program include the following:

- **(Repeat Finding)** FEC has not fully implemented its documented framework of policies and standards to mitigate risks associated with the management of information resources.
- **(Repeat Finding)** FEC has not completed the documentation, approval and implementation of its entity-wide security program plan.
- **(Modified Repeat Finding)** FEC has not completed the documentation, approval and implementation of security plans for six of the 13 identified major applications and MCGSS.
- Resource Classifications in FEC's security plans are not based on Risk Assessments.
- **(Modified Repeat Finding)** FEC has not fully implemented a program for the continuous monitoring and evaluation of the computer security policy and control effectiveness. Although the FEC has created a Security Review Policy, the FEC did not provide evidence of several components of the security reviews to be conducted during the fiscal year that would document the continuous monitoring and evaluation of the security policy. For example, the auditors were not provided with evidence of the following reviews required by the policy: MCGSS reviews; test of the incident response procedures; and a code review of one major application. The FEC has created a Security Review Policy that calls on management to perform annual external penetration testing, disaster recovery testing, a review of incident response procedures, a network vulnerability study, and a review of access control procedures. Additionally, FEC management issued a memo on May 21, 2004 outlining a schedule of review of its major applications and MCGSS with reviews of the MCGSS beginning in the third quarter of fiscal year 2005.
- **(Repeat Finding)** Risk assessments have not been conducted for more than three years. FEC management is currently in the process of soliciting bids for risk assessments.
- **(Repeat Finding)** Major applications and MCGSS have not been certified and accredited to ensure that they are operating according to FEC's security requirements.
- There are weaknesses in FEC's program to document corrective actions and verify that the weaknesses identified have been addressed.

Recommendations:

13. Implement a framework of policies and standards to mitigate risks associated with the information resources management.
14. Complete the documentation, approval and implementation of an entity-wide security program plan.
15. Develop and implement security plans for all major applications and MCGSS as part of a risk mitigation strategy.
16. Ensure that Resource Classifications in FEC's security plans accurately reflect the risk and vulnerabilities of FEC systems.
17. Complete the implementation of the program for the continuous monitoring and evaluation of the computer security policy and control effectiveness.
18. Conduct risk assessments at least every three years as part of an overall strategy to mitigate risks associated with its information technology environment.
19. Certify that the major applications and MCGSS are operating according to FEC's security requirements.
20. Strengthen FEC's program to document corrective actions and verify that weaknesses identified have been addressed. Ensure and document that recommendations from the most recent network security review have been implemented.

B. Controls to Protect Information

For a computerized organization like FEC, achieving an adequate level of information protection is highly dependent upon maintaining consistently effective access controls and system software controls. Access controls limit and monitor access to computer resources (i.e., data files, application programs, and computer-related facilities and equipment) to the extent necessary to provide reasonable assurance that these resources are protected against waste, loss, unauthorized modification, disclosure, or misappropriation. Access controls include logical/technical controls such as designing security software programs to prevent or detect unauthorized access to sensitive data. Similarly, system software controls limit and monitor access to powerful programs and sensitive files that control computer processing and secure the application and data supported by the system.

Our limited testing of internal controls identified weaknesses related to the information protection in the FEC's information systems environment. Impacted areas included the local area and wide area networks as well as its midrange computer systems (e.g. servers). These vulnerabilities expose FEC and its computer systems to risks of external and internal intrusion, and subject sensitive information related to its major applications to potential unauthorized access, modification, and/or disclosure.

Current weaknesses in access controls include the following:

- **(Modified Repeat Finding)** The principle of "least privilege" is not enforced. A high-level finance officer has system administrator access to the GL system.
- **(Repeat Finding)** FEC does not maintain visitor logs for data center access and has not implemented adequate compensating controls to monitor and record visitor access to the data center.
- **(Modified Repeat Finding)** FEC does not use access request forms to document user access rights or periodically review all access rights for appropriateness. Specifically, we noted that data center access request e-mails were only available for three out of 40 users and there was no evidence of data center access revalidation. Additionally, we noted that access rights for the new property system were not documented; access requests were verbally approved, according to management.
- **(Modified Repeat Finding)** The GL system application does not have the built in functionality to enforce password controls. Specifically,
 - It does not enforce password changes,
 - It does not have an account lockout policy,
 - It does not prevent users from using previous passwords, and
 - It does not have the ability to enforce strong password requirements.
- **(Repeat Finding)** FEC does not comply with its auditing policy because it does not automatically log the network activity described in its *Audit Event Standards*, even though it has the capability to do so.
- FEC is not actively monitoring the use of budgetary overrides in the GL application.
- FEC does not periodically review its firewall rule set for appropriateness.
- Local area network (LAN) user accounts are not appropriately reviewed:
 - One account has not been used since 1998;
 - One account has not been used since 2002; and
 - Two accounts have not logged on since 2004.

Recommendations:

21. Create a new GL system application role to give employees with necessary and appropriate access rights to fulfill their job responsibility.
22. Monitor and record visitor access to the data center.
23. Use access request forms to document user access rights and periodically review the access for appropriateness.
24. Develop mitigating controls to ensure that GL system passwords are in agreement with FEC policy.
25. Automatically log network activity as required by the *Audit Events Standards*.
26. Institute a process to manually review logs of users using budgetary overrides where the reviewer is an individual who does not have access to utilize the overrides.
27. Periodically review the firewall rule set for appropriateness.
28. Periodically review LAN user accounts and disable unnecessary user accounts.

C. Contingency Plan

Losing the capability to process and protect information maintained on FEC's computer systems can significantly impact FEC's ability to accomplish its mission to serve the public. The purpose of service continuity controls is to ensure that, when unexpected events occur, critical operations continue without interruption or critical operations are promptly resumed.

To achieve this objective, FEC should have procedures in place to protect information resources and minimize the risk of unplanned interruptions and a plan to recover critical operations should interruptions occur. These plans should consider activities performed at FEC's general support facilities (e.g. FEC's LAN, wide area network, and telecommunications facilities), as well as the activities performed by users of specific applications. To determine whether the disaster recovery plans will work as intended, FEC should establish and periodically test the capability to perform its functions in disaster simulation exercises.

Our review of the service continuity controls identified deficiencies that could affect FEC's ability to respond to a disruption in business operations as a result of a disaster or other long-term emergency. The deficiencies were as follows:

- **(Modified Repeat Finding)** FEC has not performed a Business Impact Analysis (BIA) to formally identify and prioritize all critical data and operations on its networks and the resources needed to recover them if there is a major interruption or disaster. In addition, we could not determine whether FEC had established emergency processing priorities that will help manage disaster situations more effectively for the network. FEC also has not included business owners in the discussion to determine how much backup data is needed on-hand to minimize the impact of a disaster. FEC is currently in the process of creating a request for proposal for completing a BIA.
- **(Modified Repeat Finding)** FEC has not established an alternate processing site for its operations in the event of a disaster, including its general ledger system. Additionally, the FEC disclosure database is replicated at an off-site location as a web-enabled, read-only database the public can access. In the event that data cannot be updated at FEC and then replicated to the off-site location, there is no operational mechanism to update the disclosure database at the off-site location. FEC has developed a cost analysis of establishing an alternate site and is currently pursuing interagency agreements to address this issue.
- FEC has not developed a Continuity of Operations Plan (COOP) to support the continuation of its core mission in the event of a disaster that renders the FEC's facilities unusable.
- **(Modified Repeat Finding)** FEC has not developed and documented a comprehensive contingency plan of its data centers, networks and telecommunication facilities. FEC has created a contingency plan that includes procedures for restoring its network and the GL system application in the event of a disaster. Although FEC has identified the system resources and relevant points of contact associated with the two systems, the following elements were missing from the contingency plan:
 - The plan does not cover all major applications and mission critical systems, and
 - The plan does not prioritize resources or set a timeframe for recovery.

Recommendations:

29. Perform a Business Impact Analysis to formally identify and prioritize all critical data and operations on FEC's networks and the resources needed to recover them if there is a major interruption or disaster. Ensure that emergency processing priorities are established to assist in managing disaster situations more effectively for the network and include business owners in the discussion to determine how much backup data is needed on-hand to minimize the impact of a disaster.

30. Establish alternative processing site for FEC's operations in the event of a disaster and ensure that an operational mechanism exists to update the disclosure database in the event that the FEC database is unavailable to replicate the disclosure database resident at the off-site location.
31. Develop a Continuity of Operations Plan (COOP) to support the continuation of the FEC's core mission in the event of a disaster that renders the FEC's facilities unusable.
32. Develop and document a comprehensive contingency of operations plan of FEC's data centers, networks and telecommunication facilities.

D. Software Development and Change Controls

Establishing controls over the modification of application software programs helps to ensure that only authorized programs and authorized modifications are implemented. This is accomplished by instituting policies, procedures, and techniques that help make sure all programs and program modifications are properly authorized, tested, and approved and that access to and distribution of programs is carefully controlled. Without proper controls, there is a risk that security features could be inadvertently or deliberately omitted or "turned off" or that processing irregularities or malicious code could be introduced.

(Modified Repeat Finding) FEC has not fully implemented its System Development Life Cycle (SDLC) Methodology, specifically:

- The FEC is not using Change Implementation/Notices to document change requests,
- One change did not show evidence of user acceptance testing,
- Two changes did not show evidence of implementation approval,
- Test results and approvals are not documented on Test Problem Reports and Test Approval Determinations, as indicated in the SDLC, and
- The FEC did not perform a feasibility study or cost-benefit analysis for the acquisition of Probar, a new property management system.

Recommendation:

33. Fully implement the System Development Life Cycle Methodology.

REPORTABLE CONDITIONS

V. Financial Reporting (Modified Repeat Finding)

A. General Ledger (GL) System Setup and Posting Model Definitions (Modified Repeat Finding)

The GL system setup and posting model definitions do not fully comply with the transactions posting models consistent with the USSGL guidance and policies when recording and classifying certain transactions. The resources expended to periodically review and research incorrect posting logic errors, reconciliation, and adjustments to the general ledger accounts could be devoted to the routine daily business operations of FEC. FEC is aware of the inherent limitations of the GL system and has requested assistance from the vendor to correct posting logic. FEC anticipates corrections will be finalized in fiscal year 2006.

Recommendation:

34. Ensure that corrections made to the posting logic comply with the USSGL and that the USSGL accounts and posting logic are updated as changes to USSGL are issued.

B. Continuing Resolution Accounting (New Finding)

FEC did not record apportionments granted during the continuing resolution period in accordance with the instructions from the OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, and OMB Bulletin No. 04-05, *Apportionment of Continuing Resolution(s) for Fiscal Year 2005*. Specifically, FEC recorded the entire requested appropriation of \$52 million as budget authority in October 2004 even though the entire budget authority did not become available until January 2005. Under the continuing resolution accounting scenario provided by the U.S. Treasury, amounts recorded as appropriation/ apportionment should only be in amounts determined in accordance with OMB Bulletin No. 04-05. Although the incorrect entries automatically became correct entries upon the receipt of the full appropriation, which was apportioned in January 2005, the system's funds control during the continuing resolution period was not effective and the risk that unavailable funds could be expended during this period was high.

In addition, proper reconciliation should be performed by reflecting what was actually recorded in the books versus what was reported by the U.S. Treasury FMS 6653, *Undisbursed Appropriation Account Ledger*.

Recommendation:

35. Comply with the continuing resolution accounting scenario prescribed by U.S. Treasury in accordance with memorandum issued by OMB.

C. Integrated Financial Management System (Repeat Finding)

A single, integrated financial management system is a unified set of financial systems linked together electronically in an efficient and effective manner to provide agency-wide financial system support. Integration means that the user is able to have one view into systems such that, at whatever level the individual is using the system, he or she can obtain needed information efficiently and effectively through electronic means. It does not necessarily mean having only one software application covering all financial management system needs within an agency. Interfaces are acceptable as long as the supporting details are maintained and accessible to managers. Interface linkages must be electronic unless the number of transactions is so small that it is not cost beneficial to automate the interface. Easy reconciliation between systems, where interface linkages are appropriate, must be maintained to ensure data accuracy.

FEC does not have an integrated financial management system. Significant financial management systems such as the cost system, receivable systems and the property and equipment system do not interface with the GL system.

Recommendation:

36. Continue to assess the degree of integration necessary to have a single, unified financial system by evaluating the functional requirements and the costs and benefits of integrating the financial reporting, property and equipment, receivable, and the cost systems with the GL system.

VI. Payroll (Modified Repeat Finding)

The results of our internal control tests disclosed weaknesses in payroll processing similar to the prior year, as follows:

- Transmitting certain payroll transactions, such as leave balance adjustments, to FEC's payroll service provider is a two-step process initiated by the FEC. We noted that in two instances, FEC made the first step in adjusting an employee's leave balance but failed to perform the second step. As a result, the leave adjustment was not transmitted or reflected in the service provider's system.
- Documentation such as election forms for payroll deduction authorization (FEGLI, federal tax withholding, savings bond, FEHB, and TSP-FERS) and SF-50 form were

not consistently maintained in the payroll files, and therefore some were not available for our review.

- FEC's policy requires timekeepers to perform bi-weekly reconciliations between the leave balances in FEC's records and the payroll service provider. The timekeepers are to forward leave balance certifications to the finance office indicating whether balances agree or disagree. Thirteen of the 45 leave balance certification forms were not submitted and five of the 45 submitted were incomplete. Furthermore, there was no indication that the finance office followed-up on the certifications that were not received or incomplete.
- For two of the 45 employees tested, the T&A (time and attendance) report did not agree with the service provider's leave balance report. However, the timekeeper certified that the leave balance report agreed with individual leave records. In addition, there were also two instances where the timekeeper submitted a leave balance certification but there was no leave balance on the employee's T&A report.
- For two of the 45 employees tested, we noted four instances where the approved T&A reports were not properly completed.

OMB Circular A-123, *Management Accountability and Control* (Revised June 21, 1995), requires that "the documentation for transactions, management controls and other significant events must be clear and readily available for examination." GAO *Standards for Internal Control in the Federal Government* states that transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use or commit resources and other events are initiated or entered into."

FEC Accounting Manual Vol. I, Section 1.3.2.2.10, Reconciliation, states that "transactions recorded in the FEC accounting system [should be] periodically reconciled with source documents." Section 1.3.2.2.15, Compensation, also states "timely, accurate, and complete subsidiary records [should be] maintained of vacation [and] sick leave and other balances."

Recommendations:

37. Implement procedures to ensure that leave adjustments are completely processed and transmitted to the service provider.
38. Maintain in the personnel files all payroll deduction authorization forms initiated through FEC, i.e., not done directly by the employee with a service provider.
39. Ensure that timekeepers: perform the bi-weekly reconciliation between leave balances reported in its records and the service provider's records; and submit the bi-weekly leave balance certification to the finance office timely.

40. Implement procedures for ensuring all payroll and personnel documents are properly completed and authorized before payroll data is transmitted to the payroll service provider for processing.

41. Consider automating payroll processing to decrease the risk of errors.

VII. Status of Prior Year Comments

As required by *Government Auditing Standards* and OMB Bulletin No. 01-02, as amended, we have reviewed the status of FEC's corrective actions with respect to the findings and recommendations from the previous year's report on internal controls. For those items not addressed in various sections of our Independent Auditor's Report on Internal Control, summarized above, the following discusses the current status of resolutions for matters raised:

Financial Reporting

- **Condition:** FEC did not have a written policy and procedures to formalize plans, methods, and procedures to guide the financial statement preparation and reporting process.

In fiscal year 2005, FEC established an accounting department annual calendar and audit schedule and developed written procedures for the compilation of the quarterly reports. Therefore, we have removed this as a material weakness.

- **Condition:** FEC did not prepare and analyze monthly reconciliations of subsidiary and summary account balances.

In fiscal year 2005, FEC continued with the monthly reconciliations and analysis that it started at the end of fiscal year 2004 for Fund Balance with Treasury, budgetary accounts, and general property and equipment accounts. However, we continue to identify deficiencies in the reconciliation of software in development and physical inventory. This condition, therefore, continues to exist for certain accounts as explained above.

Entity-Wide Security Program

- **Condition:** There is no periodic security awareness training. Training is only provided to new employees and contractors. FEC did conduct a baseline awareness training program, but does not have a process in place to provide security awareness training on an annual basis.

In fiscal year 2005, FEC provided periodic computer security awareness training to all employees and contractors (i.e. contractors granted access to the FEC's network). Therefore, we have removed this as a reportable condition.

Controls to Protect Information

- **Condition:** No documentation or verification that the vulnerabilities identified in the February 2004 network penetration scan had been addressed.

In fiscal year 2005, FEC rescanned its systems and verified that the vulnerabilities identified in the February 2004 network penetration scan had been addressed. Therefore, we have removed this as a reportable condition.

- **Condition:** There are no records of access requests granted to remote users. FEC was unable to provide access request approval documentation to support the access of all dial-up and virtual private network (VPN) users that we sampled for our review. In addition, there was no evidence of periodic re-validations of these users.

In fiscal year 2005, FEC documented and revalidated VPN and dial-up access rights and privileges. Therefore, we have removed this as a reportable condition.

- **Condition:** GL system access requests are not properly documented or reviewed. FEC was only able to provide us original access matrices for eight of the 33 current GL system users. Additionally, FEC does not periodically perform revalidations of GL system access.

In fiscal year 2005, FEC documented access requests for new users and performed revalidations of access rights granted to existing users of the GL system. Therefore, we have removed this as a reportable condition.

- **Condition:** Data center access is not adequately documented or reviewed:
 - Four employees have their names misspelled on the cardholder report;
 - One of the individuals with access to the data center was terminated recently, but his access key is still active and the physical location of the key could not be determined; and
 - FEC could not identify one user who has access to the data center or justify why the individual has access to the data center

In fiscal year 2005, FEC disabled the active access keys of users not requiring access to the data center and identified all users with access to the data center, but FEC needs to ensure names are correctly spelled on the cardholder report. Therefore, we have removed this as a reportable condition.

Contingency Plan

- **Condition:** FEC does not have adequate capacity for most of its back-up tapes in its fireproof safe; hence, back-up tapes are not kept in a fireproof safe.

In fiscal year 2005, FEC has procured an additional fireproof safe(s) for back-up tapes. Therefore, we have removed this as a reportable condition.

- **Condition:** FEC's data center is fully exposed to a wet pipe sprinkler system, with no compensating controls to avoid inadvertent water damage to critical hardware and magnetic media in the case of a malfunction or false alarm.

FEC has compensating controls to avoid inadvertent water damage to critical hardware and magnetic media in the case of a malfunction or false alarm from the wet pipe sprinkler system. Therefore, we have removed this as a reportable condition.

Software Development and Change Controls

- **Condition:** No written policy has been created to manage software libraries.

In fiscal year 2005, FEC has established a written policy to manage software libraries. Therefore, we have removed this as a reportable condition.

- **Condition:** Written procedures to modify, test, approve or release software for any of its applications, including the GL system, have not been documented.

In fiscal year 2005, FEC documented written procedures to modify, test, approve and release software for its applications. Therefore, we have removed this as a reportable condition.

- **Condition:** Emergency change procedures and procedures for installing patches are not documented.

In fiscal year 2005, FEC documented written emergency change procedures for installing patches. Therefore, we have removed this as a reportable condition.

- **Condition:** Certain software code changes for the GL system were not reviewed before being implemented.

In fiscal year 2005, FEC has established policies and procedures to ensure that the software code is reviewed prior to moving the modified code into production.

Additionally, there were no software changes to the GL system for fiscal year 2005. Therefore, we have removed this as a reportable condition.

OTHER MATTERS

Federal Managers' Financial Integrity Act (31 U.S.C. 3512) (FMFIA)

OMB Circular No. A-123, *Management Accountability and Control*, provides the reporting guidelines for the FMFIA. OMB Circular No. A-123 states that annually, by December 31, the head of each executive agency submit to the President and the Congress (i) a statement on whether there is reasonable assurance that the agency's controls are achieving their intended objectives, (ii) a report on material weaknesses in the agency controls, and (iii) whether the agency's financial management systems conform with government-wide requirements.

OMB Bulletin No. 01-02 requires that the auditor's report on internal control "identify those material weaknesses disclosed by the audit that were not reported in the reporting entity's FMFIA report." FEC's FMFIA report dated October 4, 2005 reports that FEC management did not identify material weaknesses, but acknowledged the FEC fiscal year 2004 Independent Auditor's Report on Internal Control included material weaknesses. FEC disagreed with the material weaknesses identified in the internal control report, and therefore, did not prepare a report on material weaknesses, including agency plans to correct the material weaknesses and progress against those plans in the FMFIA report submitted.

In addition to the material weaknesses and reportable conditions described above, we noted certain matters involving internal control and its operation that we reported to the management of FEC in a separate letter dated November 7, 2005.

This report is intended solely for the information and use of the management of FEC, FEC Office of Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Henderson LLP

Calverton, Maryland
November 7, 2005



Independent Auditor's Report on Compliance with Laws and Regulations

To the Inspector General of the
Federal Election Commission

We have audited the financial statements of the Federal Election Commission (FEC) as of and for the year ended September 30, 2005, and have issued our report dated November 7, 2005. In our report, our opinion was qualified for the effects of adjustments, if any, as might have been necessary had we been able to perform adequate audit procedures on the allocation of program costs in the statement of net cost. Except as described above, we conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended.

The management of FEC is responsible for complying with laws and regulations applicable to FEC. As part of obtaining reasonable assurance about whether FEC's financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to FEC.

The results of our tests of compliance with laws and regulations described in the preceding paragraph disclosed no instances of noncompliance with the laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

We noted certain immaterial instances of noncompliance that we have reported to management of FEC in a separate letter dated November 7, 2005.

This report is intended solely for the information and use of the management of FEC, FEC Office of Inspector General, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
November 7, 2005

*Centerpark I
4041 Powder Mill Road, Suite 410
Calverton, Maryland 20705-3106*

tel: 301-931-2050
fax: 301-931-1710

www.cliftoncpa.com

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Offices in 14 states and Washington, DC



MANAGEMENT COMMENTS AND RESPONSE TO THE INDEPENDENT AUDITOR'S REPORT

EXECUTIVE SUMMARY

This year the independent auditors, Clifton Gunderson (CG), identified four material weaknesses (cost accounting system and processes, custodial receipts, general property and equipment and information technology) and two reportable conditions (financial reporting and payroll). While area for improvement exists, the FEC fundamentally disagrees with several of CG's findings. The FEC has made significant progress in addressing the material weaknesses and reportable conditions identified last year. We demonstrated the improvements made throughout the financial and information technology (IT) areas, and yet very little improvement was recognized.

We firmly believe that the FEC improved its financial reporting and IT policies and procedures, both in response to audit findings and in compliance with all laws and regulations. Following are specific highlights:

- *Cost allocation methodology* - although the process is manual, it meets the flexible standards allowed for in this area. There were no changes in the cost allocation methodology from last year to this year. Yet, last year it was not a material weakness and this year it not only was a material weakness, it was enough to qualify a statement. A new system will be implemented in early FY 2006. Management found it was neither cost effective nor practical to implement the system so close to the end of the fiscal year. The new system will ensure accurate and more efficient processing.
- *Managerial cost accounting* – should not be classified as a material weakness because the critical elements of SFFAS No. 4 have been met.
- *Custodial receipts* - the process we had in place was sufficient given the nature of the activity. For FY 2006 we require monthly, standardized reports from the relevant divisions.
- *General property and equipment* - we believe that none of the weaknesses cited by CG, either alone or collectively, are substantial enough to warrant classification as a material weakness.
- *Information Technology* - none of the reportable conditions in the area of IT, either individually or collectively, rise to the level of material weakness. The FEC meets the standards set forth in all applicable IT standards and regulations.

Most important, any issue noted by CG was detected within a timely period by employees in the normal course of performing their assigned functions and, therefore, by definition does not constitute a material weakness.

COMMENTS AND RESPONSE

Following are the FEC's responses to and comments on the auditor's report on internal control. Clifton Gunderson (CG) also provided a report on compliance with laws and regulations. They found that the FEC was in compliance with laws and regulations.

The FEC is proud of the significant progress made over the past fiscal year in terms of strengthening our internal controls. Such strides have been noted both by the Inspector General and the independent auditors. Fully mindful of the IG's and auditor's comments from the previous year, we took a critical look at the issues and prioritized them. Most findings in the finance area were resolved in FY 2005. For example, in prior years it had taken us up to three weeks to prepare quarterly financial reports. Now we are able to complete this process in a matter of days. We were also able to improve our timeliness with respect to reconciliations. Not only have we become more efficient at producing financial reports, we have become more effective. This year we only had to make six "on top" adjustments; down from thirteen last year.

We implemented several process changes. We standardized and formalized reconciliation processes. We added purchase order reconciliation, relationship testing and property modules to automate our system processes and reduce error. All of these improvements have been formally documented. The Accounting Policy and Procedure manual was changed and formally reviewed and approved by the Chief Financial Officer. The manuals have allowed for better cross training of staff to ensure that no process is fully dependent on one employee.

The overriding issue for the FEC's comments is what constitutes a material weakness. GAO defines material weakness as ". . . reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions." Reportable conditions "are matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation. . . ." (OMB Bulletin 01-02).

MATERIAL WEAKNESSES

I. Cost Accounting System and Processes

A. Cost Allocation Methodology (Repeat Finding) (NFR #37, #38, #40)

Recommendations

1. Establish formal and comprehensive cost allocation methodology and related policy and procedures.

FEC RESPONSE:

The FEC established and provided the auditors with a simple, straightforward crosswalk, supporting the basis of allocations. The FEC also established and provided the auditors with cost allocation methodology and related policy and procedures.

2. Cross-train employees to minimize the risks of major interruptions in normal business operations.

FEC RESPONSE:

The FEC cross-trained three employees on the cost allocation process. The FEC provided evidence to the auditors that personnel were crossed trained and able to perform the cost-allocation process.

3. Establish a review process wherein a person, other than the preparer, reviews the work performed to ensure accuracy and propriety.

FEC RESPONSE:

The FEC established a review process for the cost allocation process. The FEC provided evidence to the auditors that a review process was in place and was followed in the cost-allocation process.

4. Maintain audit trails to support the allocation methodology and amounts.

FEC RESPONSE:

The FEC maintained an audit trail that supports the allocation methodology and provided the audit trail to the auditors.

B. Managerial Cost Accounting (Repeat Finding)

Recommendation:

5. Evaluate the functional requirements for the new cost accounting system to ensure that at least, the minimum level of cost accounting required in SFFAS No. 4 is attained.

FEC RESPONSE:

The FEC disagrees with this finding and its classification as a material weakness. SFFAS No. 4 gives agencies the flexibility to devise methods for allocating costs that are appropriate for the agency's size, mission and nature of costs incurred, so long as the method is reliable and timely. The FEC's system provides sufficient information

to both high level management and program managers on the full cost of federal programs, our activities, and outputs. The FEC system meets the fundamental elements of managerial cost accounting as set forth in SFFAS No. 4. It: (1) accumulates and reports FTE usage rates on a regular basis for management information purposes; (2) establishes responsibility segments to match costs with outputs; (3) determines full costs of government goods and services; and (4) uses appropriate costing methodologies to accumulate and assign costs to outputs. The new system will meet the same requirements.

II. Administrative Fines, Civil Penalties and Miscellaneous Receipts (Custodial Receipts) (New Condition) (NFR #19, #36, #38)

FEC RESPONSE:

While we are cognizant of the issues presented in this finding, we do not believe it warrants classification as a material weakness. Although the FEC recognizes this as an area that needs to be strengthened with more formal processes, the FEC does have adequate systems and controls in place to ensure custodial receipts are properly accounted for and timely recorded.

During FY 2005, the relevant divisions reported internally on a quarterly basis. Take for example the Administrative Fine program. After an initial attempt to collect debts, delinquent civil penalties are referred to Treasury. This requires significant reporting and documentation. The FEC and Treasury amounts must balance each month, and this reconciliation serves as an external check.

Of the total in-house serviced debt outstanding at September 30, 2005, over 70% of it accrued in September 2005. Thus, most of the accounts receivable (AR) balance could not have been entered into the general ledger (GL) before year end. The increase in in-house serviced debt was due in part to the fact that Treasury put a hold on submission of collections. CG did not propose any adjustments to any balances recorded in GL. Therefore, FEC believes it is unlikely material misstatements could have occurred in this area and not have been detected in a timely manner by the staff in the routine performance of their jobs.

While we believe that quarterly reporting was sufficient given the nature of the activities, we have implemented monthly reporting for FY 2006. We are in the process of developing a standard format for each division to use. Each month all internally generated reports will be reconciled to the GL and each division will be provided a status report. FEC will continue reconciling cash and receivables with Treasury and adding aging categories to facilitate review by management and preparation of the quarterly report on receivables to Treasury. All of these changes, including a description of how the Allowance for Uncollectible Accounts is calculated, will be put into the Accounting Manual once they are finalized.

Recommendations:

6. Establish and implement policy and procedures ensuring communication and coordination between program offices and finance office on activities with financial impact. The policy should also clearly establish the FEC's revenue recognition policy. The finance office should design a standard report outlining all the necessary information to record the financial activities. The report should be prepared and submitted timely at least monthly by the program offices to the finance office.

FEC RESPONSE:

A policy will be developed and distributed to program offices for monthly reporting. Expected completion: November 30, 2005.

7. Document the policy and basis for the allowance for uncollectible accounts.

FEC RESPONSE:

Procedures will be developed and included in the Accounting Policy and Procedures Manual. Expected completion: November 30, 2005.

III. General Property and Equipment (Property) (Modified Repeat Finding) (NFR #38, #39, #32)

FEC RESPONSE:

The FEC agrees with this comment in general, but not its classification as a Material Weakness. The FEC made significant strides in the property accounting area in FY 2005. Furthermore, the FEC did not have to make any material adjustments to the GL or schedules provided to CG as a result of the audit.

Significant improvements from last year's report on internal controls include:

- A new property system was implemented in September 2005 which eliminated difficulty in calculating depreciation which stemmed from programming issues with the prior contractor;
- Software-in-development was tracked and reported quarterly;
- All assets were recorded at invoice values (vs. estimates for some last year); and
- Exceptions to internal control sample items decreased significantly

As noted to CG, the new property system facilitates preparation of audit schedules and related notes. Moreover, the new system, along with improved policies and procedures to be implemented in FY 2006, will: 1) help link individual assets to bulk purchases by PO number; 2) help identify new assets that meet the capitalization

criteria; and 3) capture additional data regarding custody and location of assets. For example, all new computers made as part of a bulk purchase were entered in the system with the associated purchase order and reports were developed to list individual items. These improvements should result in a more seamless integration between the inventory system and the identifying, reporting and tracking of capitalized assets to the balances in the general ledger. FEC is also continuing to review all inventory items to complete the information coded in the system.

The process of conducting a physical inventory of assets for FY 2005 was contracted out to a vendor. The contractor used a bar code scanner for all assets and uploaded the information to the property system. The general ledger balance was reconciled to the balances in the property system and the reconciliation was provided to CG. The physical inventory did not disclose any capitalized assets that needed to be adjusted. In FY 2006 specific procedures will be written for the contractor and FEC staff to use and assist with the reconciliation.

FEC software capitalization policy is in compliance with SSFAS No. 10. The FEC believes the process to identify software in progress and completed software in progress was adequate and that all such software was identified and recorded correctly. CG has not provided specifics as to why it believes FEC is not in compliance with SFFAS No. 10, which was taken almost verbatim from the standard. FEC is continuing to develop more formalized methods of notifications for various property events to trigger entries in the general ledger. This will include coding training in FY 2006 for affected offices. The timeliness of completed construction was more a function of a delay in obtaining adequate information from General Services Administration (GSA) than a lack of internal notifications. FEC notes these types of transactions were all recorded accurately well before the year end statements were prepared.

The FEC is only aware of problems with nine receiving reports, not twelve as indicated in the report. Most of these were for the lack of descriptions on the receiving report, which is *not* required by FEC. We agree with one noted problem where the approving official cited the work authorization number instead of the invoice number on the receiving report; however, the invoice was paid correctly.

Recommendations:

8. Reconcile the total of the individual property items in the property system to the bulk purchase total recorded in the books to ensure completeness of the property system records.

FEC RESPONSE:

The FEC implemented a new property system to accomplish this. For example, all new computers made as part of a bulk purchase were entered in the system with the associated purchase order and reports were developed to list individual items. The

FEC maintains that for each individual asset of a bulk purchase, the reconciliation of cost between the general ledger and the inventory system is not necessary and will not be accurate due to freight and/or installation costs which are not recorded at the individual asset level. The damage/loss of an individual asset of a bulk purchase would not materially impact the balances in the general ledger. Bulk buys are recorded in the general ledger at the actual total invoice cost. The individual items are tracked in the physical inventory system and are inventoried annually.

9. Document physical inventory procedures, results, and reconciliation and maintain the documentation for audit trail purposes.

FEC RESPONSE:

Procedures will be developed for the next inventory which is planned for FY 2006. The reconciliation will be maintained for audit.

10. Revise the software capitalization policy to comply with SSFAS No. 10.

FEC RESPONSE:

The software capitalization policy is in compliance with SSFAS No. 10. No specific area of non compliance was identified by CG.

11. Enforce compliance and consistent implementation of policies and procedures related to completing receiving reports and the review and approval of obligating memos or documents.

FEC RESPONSE:

As noted in last year's response and throughout this year's fieldwork, the description on the receiving report is an optional, not a required, field. In FY 2006 the form and procedures will be rewritten to make this clearer.

12. Establish a standard process and policy where program offices are required to notify the finance office of any property acquisition or disposition with accounting impact to ensure proper and timely recording of the transaction.

FEC RESPONSE:

FEC agrees with this recommendation and has already started to write the policy and develop necessary procedures and forms. Expected completion: December 31, 2005.

IV. Information Technology (IT)

FEC RESPONSE:

The FEC does not agree that the reportable conditions in the IT area reach the level of a material weakness. In conjunction with the Financial Statements Audit of the FEC, four areas of Information Technology were examined for material weaknesses. The outcome of the audit in IT revealed a number of reportable conditions, none of which, individually, rise to the level of material weakness. FEC Management is also of the opinion that the collective “weight” of these reportable conditions does not together result in a material weakness. The reason for this position is that reportable conditions have been recognized and corrective actions have been and are being taken. The cost benefits test may be used for portions of these conditions, but for the majority the FEC has initiated corrective actions, some of which pre-date the audit.

FEC Management has also indicated our position on the FEC exemption from the Paperwork Reduction Act, which also exempts the FEC from many of the related and underlying statutes and regulations. We agree that best practices and sound management controls justify the use of some of the recommendations made during the audit in the area of IT control (many of which the FEC as implemented already). However, the FEC strongly believes that these recommendations, either singularly or collectively, do not rise to the level of material weaknesses. In addition, the FEC maintains that the agency cannot be held to guidance and criteria identified in studies and analyses as if these were standards that are required to be adhered to.

Finally, the FEC continues to maintain that it is not appropriate to find the existence of financial management material weaknesses for systems and applications that do not directly impact on the accuracy and security of information used in the FEC financial statements.

A. Entity-Wide Security Program

Recommendations:

13. Implement a framework of policies and standards to mitigate risks associated with the information resources management.

FEC RESPONSE:

As a vital component of the Information Systems Security Program Policy (ISSPP) 58A, the FEC developed and approved sub-policy 58-2.1: Risk Management Policy. This policy establishes a framework of procedures and standards to mitigate risks associated with the management of information resources. The Risk Management Policy states that external risk assessments should be performed within the recommended 3 year period; however, current budgetary restraints have prevented this.

FEC management completed the Statement of Work (SOW), received proposals from three vendors and is currently reviewing the proposals. In addition the FEC has allocated \$250,000 in FY 2006 (pending no further budgetary constraints) to partially accomplish this goal. Until greater resources are allocated, the FEC shall continue to conduct its own internal reviews such as those specified in its Security Review Policy.

14. Complete the documentation, approval and implementation of an entity-wide security program plan.

FEC RESPONSE:

In November 1997, the FEC established Directive 58, outlining the Commission policy on the control of Commission software and the use of agency computers. This Directive formed the basis of the Agency's computer security program. This Directive has been enhanced and expanded incorporating the latest guidance and best practices provided by NIST. In December 2001 Directive 58 was updated by establishing an Information Systems Security Officer. In April 2004 Information System Security Program Policy 58A was developed and the final policy was approved by the Chief Information Officer in September 2004. The implementation of the FEC entity wide security program plan occurred on October 2004, when FEC issued a memo informing all employees/contractors that "Information System Security Program Policy" Policy Number: 58A was approved and should be adhered to by all employees/contractors.

15. Develop and implement security plans for all major applications and MCGSS as part of a risk mitigation strategy.

FEC RESPONSE:

The FEC has provided the financial auditors with system security plans for all of its financial systems and four non-financial systems for a total of seven. The financial auditors have been provided with planned target dates for the remaining four non-financial systems.

16. Ensure that Resource Classifications in FEC's security plans accurately reflect the risk and vulnerabilities of FEC systems.

FEC RESPONSE:

The FEC has implemented an entity-wide security program plan that specifies that external risk assessments should be performed within the recommended 3 year period. FEC management has completed the Statement of Work (SOW) has received proposals from three vendors and is currently reviewing the proposals. In addition the FEC has allocated \$250,000.00 in fiscal 2006 (pending no further budgetary constraints) to partially accomplish this goal. Until greater resources are allocated, the FEC shall continue to utilize the considerable knowledge, skills and experience of the

Information Technology Division to provide input for resource classifications.

17. Complete the implementation of the program for the continuous monitoring and evaluation of the computer security policy and control effectiveness.

FEC RESPONSE:

The FEC has implemented an entity-wide security program plan that specifies the establishment of a program for the continuous monitoring and evaluation of the computer security policy and control effectiveness. To this end the FEC has developed and implemented 58-2.11 Security Review Policy that specifies a minimum set of review activities such as: annual external penetration testing; disaster recovery testing; a review of incident response procedures; a network vulnerability study; a code review of one Major Application and a review of access control procedures. FEC has provided the auditors with documentation and evidence that the specified activities did occur.

18. Conduct risk assessments at least every three years as part of an overall strategy to mitigate risks associated with its information technology environment.

FEC RESPONSE:

The FEC has implemented an entity-wide security program plan that specifies that external risk assessments should be performed within the recommended 3 year period. FEC management completed the Statement of Work (SOW), received proposals from three vendors and is currently reviewing the proposals. In addition the FEC has allocated \$250,000 in FY 2006 (pending no further budgetary constraints) to partially accomplish this goal. Until greater resources are allocated, the FEC shall continue to conduct its own internal reviews such as those specified in its Security Review Policy.

19. Certify that the major applications and MCGSS are operating according to FEC's security requirements.

FEC RESPONSE:

The FEC has implemented an entity-wide security program plan that specifies that the certification of its major applications and mission critical general support systems are operating according to FEC's security requirements. These certifications will occur upon the completion of external risk assessments. In lieu of such assessments, FEC has leveraged the considerable knowledge, skills and experience of the Information Technology Division senior management.

20. Strengthen FEC's program to document corrective actions and verify that weaknesses identified have been addressed. Ensure and document that

recommendations from the most recent network security review have been implemented.

FEC RESPONSE:

The FEC has completed the majority of recommendations from the prior year's audit. In accordance with its risk management strategy, the FEC has assessed the risk associated with these deficiencies and has documented, developed and implemented compensating controls or has documented and developed multi-fiscal-year mitigation strategies to counteract the specified deficiency. These compensating controls and/or multi-fiscal-year mitigation strategies take into account that all associated risk may not be completely eliminated during the current audit year, resulting in some residual risk. Any residual risk has been accepted by the appropriate system owner.

B. Controls to Protect Information

Recommendations:

21. Create a new GL system application role to give employees with necessary and appropriate access rights to fulfill their job responsibility.

FEC RESPONSE:

The FEC has recognized the need to further refine the granularity of GL's access control matrix and has developed a system application role with appropriate access rights for employees to fulfill their job responsibility. The FEC is currently testing the system application role to reduce the possibility of disrupting critical business functions. The financial auditors have been provided planned target dates for the implementation of the system application role.

22. Monitor and record visitor access to the data center.

FEC RESPONSE:

Individuals requiring an escort within the FEC building are always escorted by an authorized employee when they enter the FEC computer facilities. The FEC has historically used the Kastle Key system to electronically log when someone enters the computer facility and will continue to do so. However, ITD has implemented the use of a written log for all escorted persons who enter the facility, even though we believe it is a manual redundant system.

23. Use access request forms to document user access rights and periodically review the access for appropriateness.

FEC RESPONSE:

The FEC has instituted a process that utilizes electronic mail to request, approve and document user access rights. Access rights are periodically reviewed in accordance with 58-2.11 Security Review Policy.

24. Develop mitigating controls to ensure that GL system passwords are in agreement with FEC policy.

FEC RESPONSE:

The current version of PeopleSoft does not contain a facility for the automated enforcement of passwords. The FEC is aware of this vulnerability and the risk associated with this version of PeopleSoft's lack of automated authentication enforcement. The FEC has implemented a series of compensating controls consisting of additional user awareness training, policy issuance and manual enforcement to mitigate associated risk. The FEC understands and accepts the residual risk until an automated solution can be found.

25. Automatically log network activity as required by the *Audit Events Standards*.

FEC RESPONSE:

The Audit Event Standards have been modified, and the FEC is now in compliance with these standards.

26. Institute a process to manually review logs of users using budgetary overrides where the reviewer is an individual who does not have access to utilize the overrides.

FEC RESPONSE:

Please refer to the Accounting Officer response in NFR-10.

27. Periodically review the firewall rule set for appropriateness.

FEC RESPONSE:

The FEC does periodically review the firewall rules. The rules were reviewed in May 2005.

28. Periodically review LAN user accounts and disable unnecessary user accounts.

FEC RESPONSE:

The System Administrators review computer accounts periodically and delete the accounts that have not been accessed within 90 days. The user accounts are also reviewed and deleted using the "Hiring Report" that is produced by HR. In addition, all user accounts that have not been accessed within 90 days will be disabled.

C. Contingency Plan

Recommendations:

29. Perform a Business Impact Analysis to formally identify and prioritize all critical data and operations on FEC's networks and the resources needed to recover them if there is a major interruption or disaster. Ensure that emergency processing priorities are established to assist in managing disaster situations more effectively for the network and include business owners in the discussion to determine how much backup data is needed on-hand to minimize the impact of a disaster.

FEC RESPONSE:

The BIA is a new requirement, and we do not have funds in the 06 Budget. Funds will be requested in the 2007 Budget.

The plan covers all major Financial Applications and does provide a detailed restoration time for the PeopleSoft restoration process. The other major application, Comprizon Buy, is a less complicated restoration and has a much shorter relative time frame for installation, making a detailed time breakdown unnecessary.

30. Establish alternative processing site(s) for FEC's operations in the event of a disaster and ensure that an operational mechanism exists to update the disclosure database in the event that the FEC database is unavailable to replicate the disclosure database resident at the offsite location.

FEC RESPONSE:

Currently an alternate processing site for operations is not in the budget, and we could not afford an alternate site.

31. Develop a Continuity of Operations Plan (COOP) to support the continuation of the FEC's core mission in the event of a disaster that renders the FEC's facilities unusable.

FEC RESPONSE:

The COOP plan is a new requirement that was raised by the audit this year, and funds

will be requested in the 2007 budget.

32. Develop and document a comprehensive contingency of operations plan of FEC's data centers, networks and telecommunication facilities.

FEC RESPONSE:

This has been done. Please see the disaster recovery plan

D. Software Development and Change Controls

Recommendation:

33. Fully implement the System Development Life Cycle Methodology.

FEC RESPONSE:

Establishing controls over the modification of application software programs is an industry Best Practice and one the FEC agrees with. The FEC has instituted policies, procedures and techniques that help make sure all programs and program modifications are properly authorized, tested and approved. This has been accomplished through the implementation of the SDLC and the associated policies and procedures (for example: the Change Management Policy, Requirements Procedure, Release Procedure, Change Management Procedure, etc.) The SDLC has been fully implemented; however, we have found that there are a couple instances where the SDLC does not match the actual practice. For example, changes are documented using ClearQuest (an industry standard for managing changes). However, the SDLC mentions documenting changes using a Change Implementation Notice. As a result of this difference the FEC is in the process of making sure the SDLC reflects the actual practice. To reiterate, the FEC does have procedures and controls in place to ensure programs and program modifications are properly authorized, tested and approved, and the FEC is in the process of making sure those procedures and controls are identified properly in the SDLC.

REPORTABLE CONDITIONS

V. Financial Reporting (Modified Repeat Finding)

A. General Ledger (GL) System Setup and Posting Model Definitions (Modified Repeat Finding) (NFR #41)

Recommendation:

34. Ensure that corrections made to the posting logic comply with the USSGL and that the USSGL accounts and posting logic are updated as changes to USSGL are issued.

FEC RESPONSE:

We agree with this finding. As noted by CG, FEC's consultant recommended fixing this problem at the beginning of the next fiscal year. FEC expects to be in full compliance with USSGL in FY 2006.

B. Continuing Resolution Accounting (New Finding) (NFR #13, #35)

FEC RESPONSE:

We disagree with this finding and its classification as a Reportable Condition. As discussed with CG on several occasions, FEC believes the reconciliations with Treasury were proper. Management was well aware the Agency was operating under a CR and the FEC had in place compensating controls to track spending against the CR. This information (i.e., internal correspondence, tracking reports, etc.) was made available to CG. In fact, FEC operated under 3 CRs in FY 2005 until the appropriation passed in December 2004. The duration of the CRs was 50 days, 12 days and 5 days, respectively. The FEC believes there was no danger of overspending the CR amount, as the Budget Officer had to manually approve all non-personnel related expenditures personally. Before approving any expenditure, the Budget Officer compared available balances to the request and only approved the most critical expenditures.

It is not always feasible for a small agency to record appropriations, detailed budgets and purchase orders in increments this small. In fact, Treasury does not record appropriation information at all until the warrant is issued. In FY 2005 Treasury did not record the warrant until January 2005, more than 3 months after the fiscal year started. Even if the FEC recorded the CR amount, it would still not agree to Treasury's fund balance of zero. FEC would still have reconciling items with Treasury's balance. FEC believes this is no more accurate than recording the full appropriation from a control perspective. If FEC did not record the appropriation in its general ledger, a budget could not be input to control spending at all.

The most important issue is that the reconciliations have been current and correct all year. CG audited the reconciliations of all cash accounts extensively, proposed no adjustments and had no other findings.

CG should also be aware that FEC recorded only the CR amount for FY 2006. It was considerably easier this year because the CR was for 48 days (about 13% of the total) and FEC expects only the one CR for FY 2006 instead of piecemeal CRs like last year.

Recommendation:

35. Comply with the continuing resolution accounting scenario prescribed by U.S. Treasury in accordance with memorandum issued by OMB.

FEC RESPONSE:

As noted, FEC disagrees with this as a Reportable Condition. However, FEC is in full compliance with this in FY 2006.

C. Integrated Financial Management System (Repeat Finding) (NFR #40)

FEC RESPONSE:

While the FEC is pleased that CG has downgraded this from a material weakness to a reportable condition, we still disagree with this classification. To be fully integrated, a system must use the same information in preparing performance and cost allocation reports and in this regard, FEC's systems are fully integrated. Even if one were to adopt a more broad definition of integration, the FEC is compliant with OMB and GAO standards. CG is fully aware that a budget preparation and MIS system will be fully operational and integrated with the financial system as of January 1, 2006. The FEC implemented these new systems even though OMB guidance and GAO standards do not require agencies to have totally integrated systems.

Recommendation:

36. Continue to assess the degree of integration necessary to have a single, unified financial system by evaluating the functional requirements and the costs and benefits of integrating the financial reporting, property and equipment, receivable, and the cost systems with the GL system;

FEC RESPONSE:

The FEC continues to perform a cost-benefit analysis to determine whether total integration of all budget, procurement, property and financial systems is worth the cost for a small federal agency. Based upon the accuracy and reliability of our current financial systems, the FEC is comfortable with the risks of the current interfaces we have developed between the systems.

Additionally, the FEC has requested funding in the FY 2006 and FY 2007 budgets to fully examine our finance system requirements, with the objectives ranging from a system upgrade to a complete system replacement that would be fully integrated with the FEC's budget, procurement, inventory, and HR system. The FEC has been meeting with US Government agencies that have been selected as Centers of Excellence (COE), as well representatives of the Office of Management and Budget to refine our quest for a integrated financial management system.

VI. Payroll (Modified Repeat Finding)

FEC RESPONSE:

The FEC believes it has strong controls in the payroll area, but as in all areas we believe controls can be improved. The FEC improved several important control processes in the payroll area in FY 2005. Compliance with requirements to submit leave verification reports requested from timekeepers saw improvement in the latter part of the year.

Recommendations:

37. Implement procedures to ensure that leave adjustments are completely processed and transmitted to the service provider.

FEC RESPONSE:

Instructions will be issued in early FY 2006 to ensure staff is clear on this issue. Another technician will initial the changes have been made correctly.

38. Maintain in the personnel files all payroll deduction authorization forms initiated through FEC, i.e., not done directly by the employee with a service provider.

FEC RESPONSE:

Finance and HR met in May 2005 to coordinate the roles of the respective offices. Most of the documents cited as missing by CG were subsequently located. More attention will be paid to this in FY 2006, including spot checks by management.

39. Ensure that timekeepers: perform the monthly reconciliation between leave balances reported in its records and the service provider's records; and submit the bi-weekly leave balance certification to the finance office timely.

FEC RESPONSE:

As noted to CG during the audit, compliance with this requirement increased significantly during the latter part of the fiscal year and is continuing in FY 2006. Finance management will also have a technician audit one timesheet for completeness per timekeeper for each pay period. Results will be documented.

40. Implement procedures for ensuring all payroll and personnel documents are properly completed and authorized before payroll data is transmitted to the payroll service provider for processing.

FEC RESPONSE:

FEC will place more emphasis on this in FY 2006 including sampling of timesheets for completeness and accuracy.

41. Consider automating payroll processing to decrease the risk of errors.

FEC RESPONSE:

FEC is studying the merging of time and attendance with the management information system. Part of that study will include whether it is feasible to further automate the payroll process.

OTHER MATTERS

Federal Managers' Financial Integrity Act (31 U.S.C. 3512) (FMFIA)

OMB Circular No. A-123, *Management Accountability and Control*, provides the reporting guidelines for the FMFIA. OMB Circular No. A-123 states that annually, by December 31, the head of each executive agency submit to the President and the Congress (i) a statement on whether there is reasonable assurance that the agency's controls are achieving their intended objectives, (ii) a report on material weaknesses in the agency controls, and (iii) whether the agency's financial management systems conform with government-wide requirements.

OMB Bulletin No. 01-02 requires that the auditor's report on internal control "identify those material weaknesses disclosed by the audit that were not reported in the reporting entity's FMFIA report." FEC's FMFIA report dated October 4, 2005 reports that FEC management did not identify material weaknesses, but acknowledged the FEC fiscal year 2004 Independent Auditor's Report on Internal Control included material weaknesses. FEC disagreed with the material weaknesses identified in the internal control report, and therefore, did not prepare a report on material weaknesses, including agency plans to correct the material weaknesses and progress against those plans in the FMFIA report submitted.

FEC RESPONSE:

We believe that our annual assurance letter satisfies the requirements of A-123 for FY 2005. OMB Circular A-123 Management's Accountability and Control states "[t]he statement on reasonable assurance represents the agency head's informed judgment as to the overall adequacy and effectiveness of management controls within the agency." When monitoring and evaluating internal controls, A-123 clearly states that management should independently make the determination as to whether any material weaknesses exist. The "auditor's reports" is only one of ten possible sources.

We further believe that our documentation is sufficient under A-123. A-123 states "[a]gency management should determine the appropriate level of documentation needed to support this assessment." We are comfortable with our current level of documentation.

PRINCIPAL STATEMENTS

Federal Election Commission BALANCE SHEET As of September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Assets		
Intragovernmental:		
Fund Balance with Treasury (Note 2)	\$ 8,567,325	\$ 11,817,284
Total Intragovernmental Assets	<u>8,567,325</u>	<u>11,817,284</u>
Accounts Receivable, net (Note 3)	427,150	95,358
General Property and equipment, net (Note 4)	10,064,293	8,753,961
Advances to others	<u>11,614</u>	<u>4,014</u>
Total Assets	<u>\$ 19,070,382</u>	<u>\$ 20,670,617</u>
Liabilities		
Intragovernmental:		
Accounts Payable (Note 5)	\$ 137,000	\$ 237,080
Custodial Liability	<u>677,317</u>	<u>461,025</u>
Total Intragovernmental	814,317	698,105
Accounts Payable	884,084	742,256
Accrued payroll and benefits	1,484,178	1,190,514
Unfunded leave	1,963,941	1,785,307
Actuarial Federal Employees Compensation (FECA) liability (Note 6)	36,076	43,425
Other	<u>1,954</u>	<u>5,187</u>
Total Liabilities	<u>5,184,550</u>	<u>4,464,794</u>
Commitments and Contingencies (Note 7)	-	-
Net Position		
Unexpended appropriations	5,821,557	9,280,593
Cumulative results of operations	<u>8,064,275</u>	<u>6,925,230</u>
Total Net Position	<u>13,885,832</u>	<u>16,205,823</u>
Total Liabilities and Net Position	<u>\$ 19,070,382</u>	<u>\$ 20,670,617</u>

The accompanying notes are an integral part of these statements.

Federal Election Commission
STATEMENT OF NET COST
For the Years Ending September 30, 2005 and 2004

<u>Program Costs:</u>	<u>2005</u>	<u>2004</u>
<u>Obtain Compliance:</u>		
Gross costs (Note 9)	\$ 21,932,137	\$ 31,058,811
Less: earned revenue	-	-
Net program costs	<u>21,932,137</u>	<u>31,058,811</u>
<u>Promote Disclosure:</u>		
Gross costs	25,868,674	15,942,147
Less: earned revenue	(185,860)	(149,818)
Net program costs	<u>25,682,814</u>	<u>15,792,329</u>
<u>Public Financing:</u>		
Gross costs	8,435,437	4,591,751
Less: earned revenue	-	-
Net program costs	<u>8,435,437</u>	<u>4,591,751</u>
<u>Election Administration:</u>		
Gross costs	-	309,386
Less: earned revenue	-	-
Net program costs	<u>-</u>	<u>309,386</u>
Net Cost of Operations	<u>\$ 56,050,388</u>	<u>\$ 51,752,277</u>

The accompanying notes are an integral part of these statements.

Federal Election Commission
STATEMENT OF CHANGES IN NET POSITION
For the Years Ending September 30, 2005 and 2004

	2005		2004	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	\$ 6,925,230	\$ 9,280,593	\$ 6,014,404	\$ 10,411,548
Budgetary Financing Sources				
Appropriations received		52,159,000	-	51,240,000
Appropriations transferred in/out (+/-)		-	-	(481,092)
Other adjustments (rescissions, etc.) (+/-)		(747,105)	-	(1,463,081)
Appropriations used	54,870,931	(54,870,931)	50,426,782	(50,426,782)
	54,870,931	(3,459,036)	50,426,782	(1,130,955)
Other Financing Sources:				
Imputed financing from costs absorbed by others	2,318,502		2,236,321	
	2,318,502	-	2,236,321	-
Total Financing Sources	57,189,433	(3,459,036)	52,663,103	(1,130,955)
Net Cost of Operations (+/-)	(56,050,388)		(51,752,277)	
Ending Balances	\$ 8,064,275	\$ 5,821,557	\$ 6,925,230	\$ 9,280,593

The accompanying notes are an integral part of these statements.

Federal Election Commission
STATEMENT OF BUDGETARY RESOURCES
For the Years Ending September 30, 2005 and 2004

	2005	2004
Budgetary Resources		
Budget authority:		
Appropriations received	\$ 52,159,000	\$ 51,240,000
Net transfers	-	(481,092)
	52,159,000	50,758,908
 Unobligated balance:		
Beginning of period	1,401,279	1,323,078
	1,401,279	1,323,078
 Subtotal	\$ 53,560,279	\$ 52,081,986
Recoveries of prior year obligations	693,562	887,780
Enacted rescissions	(417,272)	(302,316)
Permanently not available:		
Cancellations of expired/no-year accounts	(329,833)	(1,160,764)
Total Budgetary Resources	\$ 53,506,736	\$ 51,506,686
 Status of Budgetary Resources		
Obligations incurred		
Direct		
Category A	43,207,209	42,587,222
Category B	8,505,031	7,518,185
	51,712,240	50,105,407
 Unobligated balance		
Balance currently available:		
Category A	32,731	86,214
Category B	1,398	-
	34,129	86,214
Unobligated balance not available	1,760,367	1,315,065
Total Status of Budgetary Resources	\$ 53,506,736	\$ 51,506,686
 Relationship of Obligations to Outlays:		
Obligated balance, net beginning of period	\$ 10,050,338	\$ 10,564,690
 Obligated balance transferred, net, end of period		
Undelivered orders	4,015,446	7,875,301
Accounts payable	2,505,262	2,169,850
Other liabilities	1,954	5,187
	6,522,662	10,050,338
 Outlays		
Disbursements	54,543,120	49,737,166
 Net Outlays	\$ 54,543,120	\$ 49,737,166

The accompanying notes are an integral part of these statements.

**Federal Election Commission
STATEMENT OF FINANCING
For the Years Ending September 30, 2005 and 2004**

	2005	2004
<i>Resources Used to Finance Activities</i>		
Budgetary Resources Obligated		
Obligations Incurred	\$ 51,712,240	\$ 50,105,407
Less: Recoveries of prior year obligations	(693,562)	(887,780)
Net obligations	51,018,678	49,217,627
Other Resources		
Imputed financing from costs absorbed by others	2,318,502	2,236,321
Net other resources used to finance activities	2,318,502	2,236,321
Total resources used to finance activities	53,337,180	51,453,948
<i>Resources Used to Finance Items not Part of the Net cost of Operations</i>		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	(3,852,253)	(1,209,155)
Resources that finance the acquisition of assets	4,443,890	3,421,957
Total resources used to finance items not part of the net cost of operations	591,637	2,212,802
Total resources used to finance the net cost of operations	52,745,543	49,241,146
<i>Components of the Net Cost of Operations that will not require or Generate Resources in the Current Period</i>		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	178,635	86,430
Increase (decrease) in FECA liability	(7,349)	17,158
Total components of Net Cost of Operations that will require or generate resources in future periods	171,286	103,588
Components not Requiring or Generating Resources:		
Depreciation and amortization	3,133,559	2,407,543
Total components of Net Cost of Operations that will not require or generate resources	3,133,559	2,407,543
Total components of net cost of operations that will not require or generate resources in the current periods	3,304,845	2,511,131
Net Cost of Operations	\$ 56,050,388	\$ 51,752,277

The accompanying notes are an integral part of these statements.

Federal Election Commission
STATEMENT OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2005 and 2004

	2005	2004
Collections on Behalf of the Federal Government		
Cash Collections		
Miscellaneous Receipts	\$ 217,035	\$ 476,507
Civil Penalties	2,024,301	3,737,570
Administrative Fees	411,687	830,330
Allowance for Uncollectible Receivables	(60,579)	(381,431)
Total Custodial Revenue	\$ 2,592,444	\$ 4,662,976
 Disposition of Collections		
Transferred to Treasury	\$ 2,260,652	\$ 4,567,618
Amount to be Transferred	331,792	95,358
Total Disposition of Collections	\$ 2,592,444	\$ 4,662,976

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies

Reporting Entity

The accompanying financial statements present the financial position, net cost of operations, changes in net position, custodial activity, budgetary resources, and financing of the Federal Election Commission (FEC). Created in 1975 by an act of Congress, the FEC is an independent agency charged with administering and enforcing the Federal Election Campaign Act (FECA). The financial activity presented relates primarily to the execution of the FEC congressionally approved budget. Until March 31, 2004 FEC retained responsibility for Election Administration. Under P.L. 107-252, effective April 1, 2004, that responsibility and remaining funds were transferred to the newly formed Election Assistance Commission.

The Presidential Election Campaign Fund ("the fund") is not a reporting entity of the FEC. Federal Accounting Standards Advisory Boards' (FASAB) Statement of Federal Financial Accounting Concept No. 2, "Entity and Display," states that two criteria determine whether a program qualifies as an agency's reporting entity: conclusive criteria and indicative criteria. Conclusive criteria include which agency budgets the funds. Indicative criteria include which agency exercises "continuing administrative control including the ability to select or remove the governing authority and the authority to review and/or modify budget requests." Since the funds are budgeted, apportioned, recorded, reported and paid by Treasury, the accounts of the Presidential Election Campaign Fund are not included in the FEC's financial statements.

The FEC maintains eligibility requirements for the fund. Under the Internal Revenue Code, qualified Presidential candidates receive money from this fund. The FEC helps Treasury determine which candidates are eligible to receive the funds and the amount of funds to be received. The Secretary of the Treasury makes the payments to eligible candidates and major party and qualified minor party nominees as well as National Party Conventions also receive money from this fund. The Fund is financed exclusively by a voluntary tax check off. Individual taxpayers may direct \$3 of their tax to the Fund (up to \$6 for joint filers) by checking a box on their tax return.

Basis of Accounting and Presentation

These financial statements reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting is designed to recognize the obligation of funds according to legal requirements. Budgetary accounting is essential for compliance with legal constraints and controls over the use of Federal funds.

These financial statements have been prepared from the books and reports of FEC in accordance with U.S. generally accepted accounting principles (GAAP) for the Federal government and the Office of Management and Budget (OMB) Circular A-136, Form and Content of Agency Financial Statements.

Assets

Intra-governmental assets are those assets that arise from transactions with other Federal entities. Entity assets are available for use by the entity in its operations while nonentity assets are assets held by the entity but not available for use by the entity in its operations.

Fund Balance with Treasury

FEC does not maintain cash in commercial bank accounts. The U.S. Treasury processes cash receipts and disbursements. Funds with the U.S. Treasury consist of appropriated and deposited funds that are available to pay current liabilities and finance authorized purchase commitments as well as custodial collections which are not available to finance FEC activities. Custodial collections are classified as non-entity assets.

Accounts Receivable

FEC's accounts receivable represent amounts due from the public or U.S. Treasury for fines and penalties assessed by FEC and referred to Treasury for collection. An allowance for uncollectible accounts has been established and included in Accounts Receivable, net on the balance sheet. The allowance is a percentage of the overall receivable balance and the collection rate of past balances.

General Property and Equipment

General P&E is reported at acquisition cost. The capitalization threshold is established at \$25,000 and a useful life of 2 or more years. General P&E consists of items that are used by FEC to support its mission. Depreciation on these assets is calculated using the straight-line method with no salvage value. Depreciation begins the month after the asset is placed in service. Maintenance, repairs and minor renovations are expensed as incurred. Except for software, expenditures that materially increase values, change capacities or extend useful lives are capitalized.

Internal use software development and acquisition costs of \$25,000 are capitalized as software development in progress until the development stage is completed and the software successfully tested. At acceptance, software development-in-progress costs are reclassified as internal use software costs and amortized using the straight-line method over an estimated useful life of 5 years. Purchased commercial software that does not meet the capitalization criteria is expensed. Enhancements which do not add significant new capability or functionality are expensed. Construction costs of \$25,000 or more are accumulated as Construction in Progress until occupancy and then are capitalized as a Leasehold Improvement over 7 years or the remainder of the lease whichever is less.

The land and building in which the FEC operates is leased from a commercial entity. The General Services Administration (GSA) provides the facility occupied by the FEC. GSA charges the FEC a Standard Level Users Charge that approximates the commercial rental rates for similar properties.

Liabilities

Liabilities represent amounts that are likely to be paid by the FEC as the result of transactions or events that have already occurred; however, no liabilities are paid by the FEC without an appropriation. Intragovernmental liabilities arise from transactions with other Federal entities. Liabilities classified as not covered by budgetary resources are liabilities for which appropriations have not been enacted and liabilities resulting from the agency's custodial activities. FEC also has an intragovernmental liability to the U.S. Treasury for funds collected from the public but not yet transferred. These funds may not be used to fund FEC operations.

Accounts Payable

Accounts payable consist of amounts owed for goods, services, and other expenses received but not yet paid.

Accrued Payroll and Benefits

Accrued Payroll and Benefits represents salaries, wages and benefits earned by employees, but not disbursed as of September 30, 2005. Accrued payroll and benefits are payable to employees and are therefore not classified as intragovernmental.

Annual, Sick and Other Leave

Annual leave is recorded as a liability when it is earned; the liability is reduced as leave is taken. Each year, the balance in the accrued, restored, and compensatory leave account is adjusted to reflect current leave balances and pay rates. Accrued annual leave is paid from future funding sources and accordingly is reflected as a liability not covered by budgetary resources. Sick leave and other types of non-vested leave are expensed as taken.

Employee Retirement Plans***Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS)***

FEC employees participate in one of two retirement programs, either the CSRS or the FERS, which became effective on January 1, 1987. Most FEC employees hired after December 31, 1983, are automatically covered by FERS and Social Security.

For CSRS covered employees, the FEC withheld 7.0% of gross earnings. The FEC matches the withholding, and the sum of the withholding and the matching funds is transferred to the Civil Service Retirement System.

For each fiscal year the Office of Personnel Management (OPM) calculates the U.S. Government service cost for covered employees, which is an estimate of the amount of funds that, if accumulated annually and invested over an employee's career, would be enough to pay that employee's future benefits. Since the U.S. Government's estimated service cost exceeds contributions made by employer agencies and covered employees this plan is not fully funded by the FEC and its employees. For 2005 and 2004, FEC recognized \$2.318M and \$2.236M, respectively, as of September 30, as an imputed cost and as an imputed financing source for the difference between the estimated service cost and the contributions made by FEC and its employees.

FERS contributions made by employer agencies and covered employees exceed the U.S. Government's estimated service costs. For FERS covered employees the FEC made contributions of 10.7% of basic pay. Employees contributed .80% of gross earnings. Employees participating in FERS are covered under the Federal Insurance Contribution Act (FICA) for which the FEC contributes a matching amount to the Social Security Administration.

Thrift Savings Plan (TSP)

Employees covered by CSRS and FERS are eligible to contribute to the U.S. Government's TSP, administered by the Federal Retirement Thrift Investment Board. The FEC makes a contribution of 1% of basic pay for FERS-covered employees. FERS employees are eligible to contribute up to 15% of basic pay to their TSP account for 2005. In addition, FEC makes matching contributions, of up to 5% of basic pay, for employees who contribute to the Thrift Saving Plan. Contributions are matched dollar for dollar for the first 3 percent of pay contributed each pay period and 50 cents on the dollar for the next 2 percent of pay. CSRS participants may contribute up to 10% of their gross pay, but there is no governmental matching contribution. The maximum amounts that either FERS or CSRS employees may contribute to the plan in calendar year 2005 is \$14,000 for those under age fifty and \$18,000 for those fifty and older.

The FEC financial statements do not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, which may be applicable to FEC employees and funded by FEC. Such reporting is the responsibility of OPM.

Contingencies

A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. A contingency liability is recognized when a past event or exchange transaction has occurred, and future outflow or other sacrifice of resources is measurable and probable. A contingency is not disclosed when any of the conditions for liability recognition are met but the chance of the future event or events' occurring is remote. A contingency is disclosed when any of the conditions for liability recognition are not met and the chance of the future confirming event or events occurring is more than remote but less than probable.

Revenues and Other Financing Sources

Annual Salaries and Expenses Appropriation

Annual one year appropriations are provided by Congress and are available for obligation in the fiscal year for which it was provided to fund the overall operation of the FEC.

Imputed Financing Sources

In accordance with OMB Circular A-136, all expenses should be reported by agencies whether or not these expenses would be paid by the agency that incurs the expense. The amounts for certain expenses of the FEC, which will be paid by other Federal agencies, are recorded in the "Statement of Net Cost." A corresponding amount is recognized in the "Statement of Changes in Net Position" as an "Imputed Financing Source." These imputed financing sources primarily represent unfunded pension costs of FEC employees.

Statement of Net cost

Sub-Organization Program Costs

The FEC Statement of Net Cost is presented by Responsibility Segment. The Responsibility Segments are based on the FEC's mission and funding sources. The major programs that comprise the Responsibility Segments are: Obtain Compliance, Promote Disclosure and Public Financing. Costs for a fourth segment, Election Administration, is reported for the six months ended March 31, 2004, when the function transferred to the Election Assistance Commission.

Earned Revenue

Earned revenues collected by FEC included fees for seminars and conferences held during the year in various parts of the country. Earned revenues collected by FEC also included amounts collected from the public for information provided under the Freedom of Information Act (FOIA), primarily photocopying.

Net Position

Net position is the residual difference between asset and liabilities and comprises Unexpended Appropriations and Cumulative Results of Operations.

Unexpended appropriations include appropriations not yet obligated or expended, represented by the unobligated balances and undelivered orders of FEC's appropriated funds. Unobligated balances associated with appropriations that expire at the end of the fiscal year remain available for obligation adjustments, but not for new obligations, until that account is closed, five years after the appropriations expire. Cumulative Results of Operation is the Net Result of FEC's operation since inception.

Statement of Custodial Activity

The Statement of Custodial Activity summarizes collections transferred or transferable to the U.S. Treasury or other parties for miscellaneous receipts, fines and penalties. These amounts are not reported as revenue to FEC.

Use of Estimates

The preparation of financial statements in accordance with the accounting principles described above require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying footnotes. Actual results could differ from those estimates.

Note 2 - Fund Balance with Treasury

Fund balances with Treasury consisted of the following at and September 30, 2005 and 2004:

	2005	2004
Appropriated Fund	\$ 8,317,158	\$ 11,451,617
Custodial Funds	250,167	365,667
Total Fund Balance with Treasury	\$ 8,567,325	\$ 11,817,284

Status of Fund Balance with Treasury

	2005	2004
Unobligated Balance		
- Available	\$ 34,129	\$ 86,214
- Unavailable	1,760,367	1,315,065
Obligated Balance, Not Yet Disbursed	6,522,662	10,050,338
Custodial Funds	250,167	365,667
Total Status of Fund Balance with Treasury	\$ 8,567,325	\$ 11,817,284

Fund Balance with Treasury is an asset maintained with Treasury. The appropriated funds are available to pay current liabilities. FEC has the authority to disburse funds to agencies and institutions participating in its programs through the Treasury, which processes cash receipts and disbursements on its behalf. Custodial Funds consist of monies collected by FEC but not yet transferred to the U.S. Treasury. Custodial Funds are not available to finance FEC activities and are therefore classified as non-entity assets.

Available unobligated balances represent amounts that are apportioned for obligation in the current fiscal year. Unavailable unobligated balances represent amounts that are not apportioned for obligation during the current fiscal year and expired appropriations no longer available to incur new obligations. Obligated balances not yet disbursed include reimbursements and other income earned, undelivered orders and expended authority-unpaid.

Non-entity Assets

Non – entity assets consist of the following at September 30:

	<u>2005</u>	<u>2004</u>
Intragovernmental:		
Fund balance with Treasury (Custodial)	\$ 250,167	\$ 365,667
With the Public:		
Accounts Receivable	427,150	95,358
Total non-entity Assets	\$ 677,317	\$ 461,025
Total entity Assets	18,393,065	20,209,592
Total Assets	\$ 19,070,382	\$ 20,670,617

Non-entity assets are not available to finance FEC activities.

Note 3 - Accounts Receivable, Net

Accounts Receivable consist of the following at September 30:

	<u>2005</u>		
	<u>Gross Accounts Receivable</u>	<u>Allowance</u>	<u>Net Accounts Receivable</u>
NON-ENTITY			
Intragovernmental	\$ -	\$ -	\$ -
With the Public	869,161	442,011	427,150
Total Non-Entity	<u>869,161</u>	<u>442,011</u>	<u>427,150</u>
TOTAL	<u>\$ 869,161</u>	<u>\$ 442,011</u>	<u>\$ 427,150</u>

	<u>2004</u>		
	<u>Gross Accounts Receivable</u>	<u>Allowance</u>	<u>Net Accounts Receivable</u>
NON-ENTITY			
Intragovernmental	\$ -	\$ -	\$ -
With the Public	476,789	381,431	95,358
Total Non-Entity	<u>476,789</u>	<u>381,431</u>	<u>95,358</u>
TOTAL	<u>\$ 476,789</u>	<u>\$ 381,431</u>	<u>\$ 95,358</u>

Non-Entity Receivables consist of Civil Penalties assessed by FEC through its enforcement processes or conciliation agreements reached with parties. Three FEC offices administer the fines: the Office of General Counsel (OGC), the Office of Administrative Review (OAR) and the Office of Alternate Dispute Resolution (ADR). Each has a distinct role in the enforcement and collection process. The offices also have significantly different volumes. Therefore, each has a different rate of collection. The Allowance is based on the historical rate of collection for the office and an overall assessment of the debtor's willingness and ability to pay. OAR debts are referred to the U.S. Treasury for collection when delinquent. At September 30, 2005, OGC had receivables of \$285,750 and an allowance of \$65,187 (23%) for a net receivable of \$220,563. At September 30, 2004 OGC's receivable was \$47,250 and the allowance was \$37,800 (80%) for a net receivable of \$9,450. At September 30, 2005, OAR has a receivable of \$509,911 and an allowance of \$376,824 (74%) for a net receivable of \$133,087. For the year ended September 30, 2004, OAR was owed \$413,289 and the allowance was \$330,630 (80%) for a net receivable of \$82,659. The ADR receivable at September 30, 2005 was \$73,500 with an allowance of \$0 (0%) for a net receivable of \$73,500. At September 30, 2004 the receivable for ADR was \$16,250 while the allowance was \$13,000 (80%) for a net receivable of \$3,250.

Note 4 – General Property and Equipment, Net

Capitalized property and equipment, net of accumulated depreciation, consisted of the following as of September 30:

<u>Asset Class</u>	<u>Service Life (years)</u>	<u>2005</u>		
		<u>Acquisition Value</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Software	5	\$ 8,661,885	\$ 5,206,852	\$ 3,455,033
Desktop and laptop computers and peripherals	3	2,956,069	2,098,701	857,368
Leasehold Improvements	7 or less	4,416,381	1,961,072	2,455,309
Furniture	7	852,754	306,338	546,416
Equipment	7	284,611	235,595	49,016
Software-in-Development	n.a.	2,701,151	-	2,701,151
Totals		<u>\$ 19,872,851</u>	<u>\$ 9,808,558</u>	<u>\$ 10,064,293</u>

Asset Class	Service Life (years)	2004		
		Acquisition Value	Accumulated Depreciation	Net Book Value
Software	5	\$ 8,150,070	\$ 3,651,895	\$ 4,498,175
Desktop and laptop computers and peripherals	3	2,431,700	1,460,814	970,885
Leasehold Improvements	7 or less	1,912,848	1,153,973	758,875
Furniture	7	694,730	173,555	521,175
Equipment	7	234,763	234,763	-
Software-in-Development	n.a.	1,078,650	-	1,078,650
Construction-in-Progress	n.a.	926,200	-	926,200
Totals		<u>\$ 15,428,961</u>	<u>\$ 6,675,000</u>	<u>\$ 8,753,961</u>

Depreciation expense was \$3,133,559 and \$2,407,543 for the fiscal years ended September 30, 2005 and 2004, respectively.

Note 5 - Liabilities Covered and Not Covered By Budgetary Resources

Liabilities Covered by Budgetary Resources are those for which budgetary resources are available in the current fiscal year. Liabilities Not Covered by Budgetary Resources result from the receipt of goods and services, or the occurrence of events, for which appropriations, revenues, or other financing sources necessary to pay the liabilities have not yet been made available through Congressional appropriation. These include FECA and annual leave liability. FEC's liabilities covered and not covered by budgetary resources are as follows as of September 30:

	<u>2005</u>	<u>2004</u>
Liabilities Covered by Budgetary Resources		
Accounts Payable – Intragovernmental	\$ 137,000	\$ 237,080
Accounts Payable – With the Public	884,084	742,256
Accrued Payroll and Benefits	1,484,178	1,190,514
Other	1,954	5,187
Liabilities Not Covered by Budgetary Resources		
Intragovernmental:		
Custodial Liability	677,317	461,025
Accrued Unfunded FECA Liability	36,076	43,425
With the Public:		
Accrued Unfunded Annual Leave	\$ 1,963,941	\$ 1,785,307
Total Liabilities Covered and Not Covered by Budgetary Resources	<u>\$ 5,184,550</u>	<u>\$ 4,464,794</u>

Note 6 - FECA Liability

The Federal Employee's Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for FEC employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by the FEC.

The FEC accrues FECA liability at September 30th each year. FECA liability includes two components: (1) the accrued liability which represents money owed for claims paid by the DOL through the current fiscal year, for which billing to and payment by the FEC will occur in a subsequent fiscal year and; (2) the liability for future costs which represents the expected liability for approved compensation cases beyond the current fiscal year. Estimated future costs have been actuarially determined, using the model provided by DOL, and are regarded as a liability to the public because neither the costs nor reimbursement have been recognized by DOL. FECA liability is included in Liabilities Not Covered by Budgetary Resources, as described in Note 5.

Note 7 – Commitments and Contingencies

In the opinion of FEC management and legal counsel, FEC is not a party to any legal actions which are likely to result in a material liability. Accordingly, no provision for loss is included in the financial statements.

Note 8 – Leases

The FEC has a commitment under an operating lease for its headquarters office space. The lease is for a period of ten years and expires September 30, 2007. Under their lease agreement with GSA, the FEC is charged rent that is intended to approximate commercial rental rates. FEC has no capital leases. Future payments due under the lease:

Future Operating Lease Payments

<u>Fiscal Year</u>	<u>Lease Payment</u>
2006	\$ 4,059,984
2007	4,075,749
Total Future Lease Payments	<u>\$ 8,135,733</u>

Note 9 - Statement of Net Cost

FEC's costs are broken into three main programs as noted below:

	<u>2005</u>			
	<u>Obtain Compliance</u>	<u>Promote Disclosure</u>	<u>Public Financing</u>	<u>Totals</u>
Intragovernmental gross costs	\$ 2,898,838	\$ 3,419,141	\$ 1,114,937	\$ 7,432,916
Intragovernmental net costs	2,898,838	3,419,141	1,114,937	7,432,916
Gross costs with the public	19,033,299	22,249,533	7,320,500	48,803,332
Less: earned revenues from the public		(185,860)		(185,860)
Net costs with the public	19,033,299	22,263,673	7,320,500	48,617,472
Net Cost of Operations	\$ 21,932,137	\$ 25,682,814	\$ 8,435,437	\$ 56,050,388

	2004				
	Obtain Compliance	Promote Disclosure	Public Financing	Election Administration	Totals
Intragovernmental gross costs	\$ 4,843,146	\$ 2,485,933	\$ 716,013	\$ -	\$ 8,045,092
Intragovernmental net costs	4,843,146	2,485,933	716,013	-	8,045,092
Gross costs with the public	26,215,665	13,456,214	3,875,738	309,386	43,857,004
Less: earned revenues from the public		(149,818)			(149,818)
Net costs with the public	26,215,665	13,306,396	3,875,738	309,386	43,707,186
Net Cost of Operations	\$ 31,058,811	\$ 15,792,329	\$ 4,591,751	\$ 309,386	\$ 51,752,277

Note 10 - Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) compares budgetary resources with the status of those resources. As of September 30, 2005, budgetary resources were \$53,506,736 and net outlays were \$54,543,120. As of September 30, 2004, budgetary resources were \$51,506,686 and net outlays were \$49,737,166.

Apportionment Categories of Obligations Incurred

FEC receives apportionments of its resources from OMB. Category A apportionments are those for resources that can be obligated without restriction on the purpose of the obligation, other than to be in compliance with legislation underlying programs for which the resources were made available. Category B apportionments are to be used for Information Technology enhancements only.

The apportionment categories of obligations incurred are summarized below at September 30, 2005 and September 30, 2004:

	2005	2004
Direct:		
Category A	\$ 43,207,209	\$ 42,587,222
Category B	8,505,031	7,518,185
Total Apportionment Categories of Obligations Incurred	\$ 51,712,240	\$ 50,105,407

Comparison to the Budget of the United States Government

Statement of Federal Financial Accounting Standards No. 7 (SFFAS No. 7), *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires an explanation of material differences between budgetary resources available, the status of those resources and outlays as presented in the Statement of

Budgetary Resources to the related actual balances published in the *Budget of the United States Government (Budget)*. However, the *Budget* has not yet been published. The *Budget* is scheduled for publication in February 2006 and will be available through OMB. Accordingly, information required for such disclosure is not available at the time of publication of these financial statements.

Note 11 - Custodial Revenues and Accounts Receivable

FEC uses the accrual basis of accounting for the collections of fines, penalties and miscellaneous receipts. Collectibility by FEC of the fines and penalties is based on the responsible parties' willingness and ability to pay:

	<u>2005</u>	<u>2004</u>
Fines, Penalties and Other Misc. Revenue	\$ 2,592,444	\$ 4,662,976
Accounts Receivable for Fines, Penalties and Other Misc. Receipts		
Accounts Receivable	\$ 869,161	\$ 476,789
Less: Allowance for Doubtful Accounts	442,010	381,431
Total	<u>\$ 427,150</u>	<u>\$ 95,358</u>

Note 12 – Explanation of the Relationship Between Liabilities Not Covered by Budgetary Resources on the Balance Sheet and the Change in Components Requiring or Generating Resources in Future Periods

The increase (decrease) in FECA Liability of \$(7,349) is included as part of the Resources that fund expenses recognized in prior periods line item of the Statement of Financing. The change in the unfunded annual leave balance between FY 2004 and FY 2005 of \$178,634 is reflected as Components Requiring or Generating Resources in future Periods on the Statement of Financing. See Note 5 for the liability balance.

REQUIRED SUPPLEMENTARY INFORMATION

Federal Election Commission Required Supplementary Information As of September 30, 2005 and 2004

Intragovernmental Assets:

	2005	2004
Trading Partner Agency:	Fund Balance with Treasury	Fund Balance with Treasury
Treasury	\$ 8,567,325	\$ 11,817,284
Total	\$ 8,567,325	\$ 11,817,284

Intragovernmental Liabilities:

	2005	2004
Trading Partner Agency:	Accounts Payable	Accounts Payable
Covered by Budgetary Resources:		
Department of Health & Human Services	\$	\$ 11,574
Department of Labor		2,947
Department of Treasury		5,198
Government Printing Office		347
General Services Administration	137,000	198,444
OPM		588
U.S. Department of Agriculture		10,002
U.S. Postal Service		7,980
Total Covered by Budgetary Resources	\$ 137,000	\$ 237,080
Custodial:		
Department of Treasury	677,317	461,025
Total Intragovernmental Liabilities	\$ 814,317	\$ 698,105

Federal Election Commission
Statement of Budgetary Resources
For the Years Ending September 30, 2005 and 2004

Budgetary Resources	2005				2004
	Obtain Compliance	Promote Disclosure	Public Financing	Total	Total
Budget authority:					
Appropriations received	\$ 20,409,463	\$ 23,899,744	\$ 7,849,793	\$ 52,159,000	\$ 51,240,000
Net transfers	-	-	-	-	(481,092)
	20,409,463	23,899,744	7,849,793	52,159,000	50,758,908
Unobligated balance:					
Beginning of period	548,311	642,079	210,889	1,401,279	1,323,078
	548,311	642,079	210,889	1,401,279	1,323,078
Subtotal	20,957,774	24,541,823	8,060,682	\$ 53,560,279	\$ 52,081,986
Recoveries of prior year obligations	271,386	317,797	104,379	693,562	887,780
Enacted rescissions	(163,276)	(191,198)	(62,798)	(417,272)	(302,316)
Permanently not available:					
Cancellations of expired/no-year accounts					
Pursuant to Public Law	(129,061)	(151,133)	(49,639)	(329,833)	(1,160,764)
Total Budgetary Resources	\$ 20,936,823	\$ 24,695,034	\$ 8,052,624	\$ 53,506,736	\$ 51,506,686
Status of Budgetary Resources					
Obligations incurred					
Direct					
Category A	16,906,688	19,797,949	6,502,572	43,207,207	42,587,222
Category B	3,327,961	3,897,085	1,279,985	8,505,031	7,518,185
	20,234,649	23,695,034	7,782,557	51,712,240	50,105,407
Unobligated balance					
Balance currently available:					
Category A	12,807	14,998	4,926	32,731	86,214
Category B	547	641	210	1,398	-
	13,354	15,638	5,136	34,129	86,214
Unobligated balance not available	688,820	806,616	264,931	1,760,367	1,315,065
Total Status of Budgetary Resources	\$ 20,936,823	\$ 24,517,289	\$ 8,052,624	\$ 53,506,736	\$ 51,506,686
Relationship of Obligations to Outlays:					
Obligated balance, net beginning of period	\$ 3,932,629	\$ 4,605,159	\$ 1,512,550	\$ 10,050,338	\$ 10,564,690
Obligated balance transferred, net, end of period					
Undelivered orders	1,571,217	1,839,916	604,314	4,015,446	7,875,301
Accounts payable	980,292	1,147,935	377,035	2,505,262	2,169,850
Other liabilities	765	895	294	1,954	5,187
Total Obligated balance, net, end of period	2,551,509	2,987,850	981,350	6,522,662	10,050,338
Outlays					
Disbursements	21,342,353	24,992,170	8,208,597	54,543,120	49,737,166
Net Outlays	\$ 21,342,353	\$ 24,992,170	\$ 8,208,597	\$ 54,543,120	\$ 49,737,166

SUPREME COURT OF THE UNITED STATES

Syllabus

MCCONNELL, UNITED STATES SENATOR, ET AL.
FEDERAL ELECTION COMMISSION ET AL.

PETITION FROM THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF COLUMBIA

Argued September 8, 2003 — Decided December 10, 2003

The Bipartisan Campaign Reform Act of 2002 (BCRA) and the Federal Election Campaign Act of 1971 (FECA) are the primary federal enactments of nearly a century of federal enactments that have sought to regulate the raising and spending of money in political campaigns. In enacting the BCRA, Congress sought to address the development in the



APPENDICES

APPENDICES

Appendix A – Inspector General’s Management and Performance Challenges



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

Office of Inspector General

MEMORANDUM

TO: The Commission

FROM: Inspector General

SUBJECT: Inspector General Statement on the Federal Election Commission’s Management and Performance Challenges

DATE: October 21, 2005

On November 22, 2000 the President signed the Reports Consolidation Act of 2000 (Public Law 106-531), an amendment to the Chief Financial Officers (CFO) Act of 1990. The Reports Consolidation Act of 2000 requires Inspectors General to provide a summary and assessment of the most serious management and performance challenges facing Federal agencies and the agencies’ progress in addressing these challenges. Previously, the Federal Election Commission (FEC) Inspector General was not subject to this requirement, since the FEC was not a covered agency of the CFO Act of 1990. As a result of the enactment of the Accountability of Tax Dollars Act of 2002, the FEC is now subject to these provisions. The attached document responds to the requirements, and provides the annual statement on Commission challenges to be included in the *Federal Election Commission Performance and Accountability Report (PAR) Fiscal Year (FY) 2005*.

The Inspector General’s 2005 Statement on the Federal Election Commission’s Management and Performance Challenges summarizes three areas for inclusion in the FEC’s FY 2005 PAR: Information Technology Security; Financial Reporting; and Human Capital Management. The Inspector General identified these same three challenges in the 2004 PAR and continues to believe the issues remain challenges for the FEC. The FEC has devoted significant efforts to address the challenges and progress is being made on these important areas.

The assessment of the three FEC management and performance challenges is attached. The Inspector General’s assessments are based on information derived from

a combination of several sources; including Office of Inspector General audit and inspection work, Commission reports, and a general knowledge of the Commission's programs.

The Reports Consolidation Act of 2000 permits agency comment on the Inspector General's statements. Agency comments, if applicable, are to be included in the final version of the PAR that is due on November 15, 2005.


Lynne A. McFarland
Inspector General

Attachment

Cc: Robert J. Costa, Acting Staff Director
Anthony P. Scardino, CFO and Deputy Staff Director for Management

FEC Management and Performance Challenges

(Prepared by FEC's Office of the Inspector General)

INFORMATION TECHNOLOGY SECURITY

Accomplishment of the Federal Election Commission's (FEC) mission and goals depend heavily on computerized systems. The FEC mission is to assure that the campaign finance process is fully disclosed, and that the rules are effectively and fairly enforced, fostering the electorate's faith in the integrity of the nation's political process. The FEC is responsible for providing the electorate with the capability to make educated, informed decisions about the source of financial support for candidates of federal office, as well as provide confidence that those who disregard the laws regarding campaign financing and/or its requirements for public disclosure will be held accountable for non-compliance.

The Commission's computerized disclosure database plays a significant role in the mission of the agency. The database contains millions of transactions, and is available through the FEC's website, which allows the public to access campaign contribution information. In addition to the disclosure database, the FEC manages a number of mission-critical automated information systems that process and store business and administrative computer data. The FEC's local area network (LAN) supports approximately 375 users. The LAN provides desktop computing and other computer network services, to include Internet access, electronic mail, data storage, printing, and dial-up services.

While information technology (IT) can result in a number of benefits, such as information being processed quickly and communicated almost instantaneously, it also increases the risk of fraud, inappropriate disclosure of sensitive data, and disruption of critical operations and services. Although one of the FEC's primary responsibilities is the disclosure of campaign finance information, the FEC is also responsible for ensuring a high level of protection of confidential and proprietary information that should not be released to the public under the Privacy Act or other statutes. Employee's personal data, the Office of General Counsel's enforcement priority system data, and information on the FEC's investigations related to violations of election law are among several examples of sensitive information residing on the FEC's LAN. In addition to the protection of information, the FEC is also responsible for ensuring the integrity of campaign finance information before and after release. The unauthorized or intentional modification of computer data could lead to the erroneous and inaccurate disclosure of campaign finance information and have an adverse impact on the electoral process.

The Government Accountability Office (GAO) has reported IT security as a high-risk area throughout the government since February 1997. The GAO designated IT security as a government-wide high-risk area because of growing evidence indicating that controls over computerized operations were not effective, and risks were increasing. A primary reason for these weaknesses is that federal agencies have not yet fully implemented comprehensive security management programs, which are critical to identifying information security weaknesses and risks on an ongoing basis.

In 2004, IT security was identified in the Inspector General's first Statement on the Federal Election Commission's Management and Performance Challenges. An independent public accounting (IPA) firm hired by the Inspector General reported in the FEC's fiscal year (FY) 2004 FEC financial statement audit that information security management is a material weakness. The IPA's audit report included a total of twenty-seven recommendations to improve weaknesses related to information security management. Recommendations included establishing alternative processing sites for the FEC's operations in the event of a disaster and the development of a comprehensive contingency of operations plan of the FEC's data centers, networks, and telecommunication facilities, among others.

The Inspector General believes progress is being made to improve the IT security at the Commission. Several of the FY 2004 audit recommendations have already been implemented to improve IT security. One of the FY 2004 audit recommendations was to provide periodic computer security awareness training to all employees and contractors who are granted access to the FEC's computer network. The IT Division has implemented this recommendation and on October 28, 2004, the FEC's Information System Security Program Policy was distributed to all FEC employees and contractors. The policy requires that FEC management educate all employees on IT security rules and principals. As a result, the FEC has instituted an IT security awareness training program that provides mandatory security training for all new employees and contractors in addition to annual refresher training.

Other important steps have been taken by the FEC to improve IT security. In May of 2005, the IT Division, with the assistance of an outside consultant, performed a security audit of the FEC's computer network to determine the extent to which the FEC's IT infrastructure may be vulnerable to an external Internet-based penetration. In addition, the IT Division has procured a fire-proof safe to provide additional protection for the computer backup tapes prior to being sent off-site and also issued written procedures to manage changes in the computer software operating on Commission computers.

The commitment of the IT Division staff has been critical for the accomplishment of the numerous tasks necessary to protect the FEC's IT infrastructure, as well as to accomplish

the many aggressive IT initiatives contained in the FEC's IT strategic plan. Although progress is being made, considerable work remains to be done, to include resolving several of the audit recommendations contained in the FY 2004 financial statement audit. The continuous commitment of the Commission staff, buy in from the top down on the importance of IT security, and sound management practices are key elements to ensuring the FEC is prepared for the challenges that exist in the ever-changing IT environment.

FINANCIAL REPORTING

On November 7, 2002, the President signed the Accountability of Tax Dollars Act of 2002 (Public Law 107-289). The Act requires the FEC and other federal agencies not previously covered by the Chief Financial Officers Act, to prepare and submit to the Congress and the Director of the Office of Management and Budget (OMB) audited financial statements. Beginning in FY 2004, the FEC is required to prepare and submit annual audited financial statements.

The FEC was successful in obtaining an unqualified (clean) audit opinion on its first annual financial statement audit for fiscal year (FY) 2004. An independent public accounting (IPA) firm hired by the Inspector General conducted the FEC's FY 2004 audit. The IPA firm audited the FEC's balance sheet as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the year then ended. The IPA firm opined that the financial statements were presented fairly, in all material respects, and presented in conformity with generally accepted accounting principles.

The FEC's ability to receive an unqualified opinion on the first annual financial statement audit is an important achievement. Although the auditors issued an overall unqualified opinion on the financial statements, it is important to note the FY 2004 internal control audit report included a material weakness related to financial reporting and three reportable conditions. For example, the auditors concluded the interim financial statements contained several misstatements and/or misclassifications resulting from ineffective internal controls over the financial statement preparation and reporting process. In addition, a tremendous amount of effort, resources, and time by FEC management, staff, and consultants was necessary in order to achieve an unqualified opinion for FY 2004.

The Inspector General strongly believes in the importance of sound financial management. The federal government has a stewardship obligation to prevent fraud, waste, and abuse; to use tax dollars appropriately; and to ensure financial accountability to the President, the Congress, and the American people. Timely, accurate, and useful financial information is essential for making operating decisions day-to-day; managing the government's operations

more efficiently, effectively, and economically; meeting the goals of federal financial management reform legislation (such as the Chief Financial Officers Act); supporting results-oriented management approaches; and ensuring accountability on an ongoing basis.

The Inspector General is confident the accounting and financial management staff is making some progress to correct the weaknesses identified during the FY 2004 audit. Specifically, the FEC has developed important plans for the guidance and preparation of the quarterly and annual financial statements, to include an annual calendar and audit schedule detailing key due dates for financial reports to third parties. In addition, the FEC's recruitment and hiring of a new Chief Financial Officer in mid 2005 is another important step the FEC has taken to address the challenges of financial reporting.

The effort required to accomplish the federal financial and performance reporting requirements and meet the deadlines imposed is a significant challenge for the FEC. Many entities must work together to make this happen; including financial managers and staff, program managers with performance reporting responsibilities, consultants, and independent auditors. The FEC's first annual financial statement audit and submission of the Performance and Accountability Report, for FY 2004, coincided with OMB's accelerated reporting initiatives. OMB guidance shortened the time to prepare and submit the PAR, as well as to audit the year-end financial statements, from 120 days for FY 2003, to 45 days for FYs 2004 and 2005.

The Commission's ability to meet these accelerated time frames will depend upon having effective and timely interim and year-end procedures to accumulate and record financial transactions, close the books, and prepare the financial statements. A challenge for the FEC's financial management system is the ability to produce timely, accurate, and reliable information throughout the course of the year. By doing so, the effort will be lessened at fiscal year end to compile, analyze, and correct its financial data in order to prepare accurate financial statements within a reasonable timeframe after the close of the fiscal year. The FEC has made progress towards these goals, however existing weaknesses still exist and significant challenges remain ahead.

HUMAN CAPITAL MANAGEMENT

According to the Government Accountability Office's (GAO) high-risk update report released in January 2005, human capital management continues to be identified as a significant challenge to the federal government. Human capital management was first designated as a government-wide high-risk issue by GAO in January 2001 because of the federal government's long-standing lack of a consistent strategic approach to manage the human capital needed to maximize government performance. The area remains high risk because GAO believes that federal human capital strategies are not designed to meet the current and emerging workforce challenges or drive the transformations necessary for agencies to meet these challenges.

GAO reported the federal government is making progress in addressing human capital challenges in the last few years. However, GAO believes ample opportunities exist for agencies to improve their strategic management of human capital and effectively respond to current and emerging challenges. To initiate reform within the current human capital system, strategic workforce plans are required to identify and focus human capital investments on long-term issues that best contribute to results. According to GAO, "agencies need to reform their current systems so that performance and organizational results can be linked to pay and rewards". GAO also stated that "agencies need to continue to create effective hiring processes and use flexibilities and incentives to retain critical talent". Furthermore, GAO believes that agencies must have a sustained leadership to provide the focused attention essential to completing multiyear transformations.

Federal agencies, such as the FEC, must ensure a sufficient management capacity exists and must have adequate resources to properly design and effectively implement more performance oriented systems. The federal government depends on a dynamic, diverse workforce with the appropriate knowledge, proficiency, and skills base to achieve its mission. Factors such as the aging workforce suggest that the FEC's future expertise and institutional knowledge will likely decline without appropriate attention and action.

Recognizing these challenges, the Commission has several programs established to make maximum use of the available authorities to recruit, hire, develop, and retain key talent to ensure that the agency's mission is successfully executed. For example, the Commission has student volunteer and paid internship programs that offer opportunities to college students; these programs attract students with diverse backgrounds who have the skills needed to meet future employment needs. Special hiring tools, such as recruitment incentives, are used to effectively compete for highly qualified applicants. Furthermore, the Commission has established mentoring programs and other professional development opportunities to include detailing employees to other federal agencies to obtain skills relevant to the employee's current position with the FEC. Commission funds have also been allocated for

an executive development program; the Office of Human Resources and Labor Relations plans to use these funds to provide formal executive level training for the Commission's senior managers.

Additionally, the FEC's 2005 legislative recommendations to the President included the resubmission of the recommendation for the creation of Senior Executive Service (SES) positions. Since the Commission is not currently permitted to have SES positions, current senior managers are employed in senior level positions. According to the FEC, "the current senior level pay and benefits structure hinders the Commission's ability to recruit talented executives from other agencies and retain high performing senior managers". The Commission believes that converting senior level positions into SES positions would support the trend toward performance-based pay for senior executives that exist in the federal government and allow it to remain competitive in the marketplace for federal executives when a vacancy arises.

Other FEC programs and policies utilized to address challenges in human capital management include: retention incentives, the creation of an agency-wide flexi-place or telework policy, development of a database which will track employee semi-annual performance appraisals as well as the participation in occupational studies.

To measure job satisfaction among Commission employees, the agency also accepted an invitation to participate in the 2004 Federal Human Capital Survey. The survey is another performance tool that measures employees' perceptions of whether, and to what extent, conditions characterizing successful organizations are present in their agencies. It also provides general indicators of how well the federal government is running its human resources management systems. The results of the survey provided the FEC critical information and insight on areas that need improvement.

The FEC needs to continue to create effective hiring processes and use existing flexibilities and incentives to retain critical talent to reshape its workforce. Commission leaders and managers must effectively manage people, ensure continuity of leadership, and sustain a learning environment that drives continuous improvement in performance. The Commission must also reform the current management system so the pay and awards are linked to performance and organizational goals. An effective performance oriented system can be a vital tool for aligning federal agencies with desired results and creating a clear portrait of how individual performance can contribute to successful execution of the agency's mission. In addition, the FEC needs to integrate its approach to human capital management into budgetary and strategic planning processes to ensure the agency's ability to function over the long run. Federal agencies, such as the FEC, must transform their organizations to meet the new challenges of the 21st century and their most important asset in this transformation is their people.

Appendix B – Performance Measures, Fiscal Years 2002 - 2005

- - Met
- – On track to meet

Performance Measure	Met
Place between 85,000 to 90,000 reports and 20,000 to 25,000 statements from 7,500 to 8,000 committees filing reports on the public record each election cycle	□
Complete coding and entry of summary data from documents and statements filed each cycle and meet the 48 hour deadline for making documents public for 99% of those filed	■
Complete coding and entry of itemized data from reports filed, including 2.5 to 3.0 million itemized transactions per cycle, completing 95% within 45 days of reports being received at the FEC, and all reports processed within a median 7 days from receipt at the commission	□
Complete the review of all reports filed and refer all potential enforcement actions and audits each cycle, 60% of reviews within 90 days of receipt (quarterly filing periods)	■
Issue 20,000 Requests for Additional Information (RFAI's) per cycle to correct the public record, 60% within 90 days of receipt of report (contacting filers within 90 days minimizes repetitious errors which tend to further burden the disclosure process)	■
Respond to requests for assistance from 40,000 filers per cycle	■
Produce analytical releases after each election year quarterly report and the pre-general election report	■
Produce Summary statistical analyses after each election cycle: Reports on Financial Activity	■
Conduct a database accuracy review monthly for summary and itemized data entry	■
Provide free access to the FEC disclosure database to all state elections offices wishing to participate and grant waivers for state filings for participating states: currently 48 states	■
Provide timely on-line access to the FEC disclosure database to the public through the FEC website and the storefront Public Records Office	■
Make electronic filings available over the Internet upon receipt and processing at the FEC and make images of non-electronically filed reports also viewable on the FEC Web site: 4 million visits and over 100 million hits per cycle on the FEC Disclosure site	■
Respond to over 200,000 requests for data, information, copies of reports or indices, and other requests for assistance each cycle (not including visits and hits on the FEC website)	□
Respond to 100% of 50 to 60 Advisory Opinion requests per cycle within 60 and 20-day statutory deadlines	■
Publish an Annual Report each year, the FEC <i>Record</i> monthly, and provide prior notice of filing dates to filers	■
Make FEC disclosure forms and copies of FECA and FEC Regulations available to filers electronically and in print form	■

Produce additional informational and educational publications and videos such as campaign guides, brochures, and other pamphlets	■
Conduct five to six campaign finance workshops to educate filers, and monthly roundtables on FECA issues	■
Refer 75 committees for potential audits under 2 U.S.C. 438(b) per cycle, with 50 in the second year of cycle (e.g. FY 2005 for 2004 cycle) and all audit referrals of candidate committees within the statutory deadline of six months from the general election	□
Refer 45 to 50 committees for potential enforcement actions under 2 U.S.C. 437(g) per cycle	□
Complete audits of committees referred under 2 U.S.C. 438(b), estimated 45-50 for each cycle	□
Process 175-200 complaints plus 45-50 internal referrals during the two-year period	■
Assuming an average total caseload of 125-150 cases in any given month, maintain an average active caseload of 50% of total caseload	■
Activate 50% of incoming cases on average over the election cycle	■
Close 175-200 cases in each election cycle, at least 50% with substantive Commission action. (This 50% represents cases in which the Commission has reached a substantive finding on the merits of the matter, other than dismissal, including findings of no RTB.)	■
Conserve limited enforcement resources for more complex, substantive cases by continuing an administrative fine program for late and non-filing committees, removing non-filer enforcement from the standard complex enforcement process; close 375-400 cases in the second year of the cycle (e.g. FY 2005 for the 2004 cycle.)	□
Conserve additional enforcement resources through the continued operation of the ADR program, designed to streamline the resolution of administrative complaints and Title 2 audit referrals without resorting to the more complex, substantive enforcement procedures. Close 75-100 cases per election cycles, including any cases referred for mediation	■
Pursue resolution of cases through litigation and defend the FEC and FECA in suits brought by other parties to fully enforce the FECA: 1) Initiate litigation in an estimated 7-10 offensive suits per cycle (always meeting five-year statute of limitations) and 2) Defend the FEC and FECA in 20-30 suits initiated per cycle	■
Process monthly certification requests for federal matching funds (estimated 10-12 candidates in a presidential election with an incumbent, 15-17 candidates in an "open" presidential election)	■
Audit primary candidates receiving federal matching funds (same criteria for number of candidates)	■
Audit at least four (major) national party convention and host committees receiving federal funds for nominating conventions, and any eligible minor party convention committees	■
Audit general election candidate committees of two major parties (and any eligible minor parties)	■

Appendix C: Glossary of Terms

ADR	Alternative Dispute Resolution
BCRA	Bipartisan Campaign Reform Act of 2002
DAP	Data Access Program
EAC	Election Assistance Commission
EQS	Enforcement Query System
EPS	Enforcement Priority System
FEC	Federal Election Commission
FECA	Federal Election Campaign Act
FMFIA	Federal Managers' Financial Integrity Act
FTE	Full Time Equivalent
FY	Fiscal Year
GPRA	Government Performance and Results Act
IG	Inspector General
IT	Information Technology
MIS	Management Information System
MUR	Matters Under Review
OAR	Office of Administrative Review
OEA	Office of Election Administration
OGC	Office of General Counsel
OIG	Office of the Inspector General
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
PAC	Political Action Committee
RAD	Reports Analysis Division
RTB	Reason to Believe
RFAI	Request for Additional Information