



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

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**Office of the  
Inspector General**

**MEMORANDUM**

**TO:** Chairman Timothy Massad,  
Commissioners: Scott O'Malia, Mark Wetjen, Sharon Bowen, and J. Christopher  
Giancarlo

**FROM:** A. Roy Lavik *ARL*  
Inspector General

**DATE:** July 17, 2014

**SUBJECT:** Performance Audit Report # 14-P-05-DSIO

Attached is the Commodity Futures Trading Commission (CFTC) Office of the Inspector General (OIG) audit report on:

*"CFTC's Management Controls and Procedures for Evaluating Futures Commission Merchants' (FCM) and Retail Foreign Exchange Dealers' (RFED) Compliance with CFTC Financial Reporting Requirements Mandated by the Commodity Exchange Act and the Dodd Frank Act"*

The CFTC-OIG contracted with an independent public accounting firm, CliftonLarsonAllen to conduct this audit. The OIG monitored this audit and concurs with CliftonLarsonAllen's findings in the attached audit report. The findings were discussed with management in the Division of Swap Dealer and Intermediary Oversight; their comments are attached to the final report.

Should you have any questions regarding this report, please do not hesitate to contact me.

Attachments



**CliftonLarsonAllen**

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

**Report on  
Management's Procedures for Evaluating  
Futures Commission Merchants and Retail Foreign Exchange Dealers  
Compliance with Financial Reporting Requirements**

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### **ABBREVIATIONS**

CFTC	U.S. Commodity Futures Trading Commission
CLA	CliftonLarsonAllen LLP
CEA	Commodity Exchange Act
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
FCM	Futures Commission Merchants
FY	Fiscal Year
OIG	Office of the Inspector General
RFED	Retail Foreign Exchange Dealers
RSR	Regulatory Statement Review

## **INTRODUCTION**

The U.S. Commodity Futures Trading Commission (CFTC) was created by the Congress in 1974 as an independent agency with a mandate to regulate commodity futures and option markets in the United States. Its mission is to protect market participants and the public from fraud, manipulation, abusive practices, and systemic risk related to derivatives—both futures and swaps—and to foster transparent, open, competitive, and financially sound markets. In carrying out its mission and to promote market integrity, CFTC polices the derivatives markets for various abuses and works to ensure the protection of customer funds. The agency also seeks to lower the risk of the futures and swaps markets to the economy and the public. CFTC's fiscal years (FYs) 2012 and 2013 budgets were about \$205 million and \$308 million, respectively.

CliftonLarsonAllen LLP (CLA) was engaged by CFTC's Office of the Inspector General (OIG) to conduct an audit of CFTC's management controls and procedures for evaluating Futures Commission Merchants' (FCMs') and Retail Foreign Exchange Dealers' (RFEDs') compliance with CFTC financial reporting requirements mandated by the Commodity Exchange Act (CEA) and Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The objective of this audit was to assist OIG in evaluating CFTC's management controls relating to its regulatory oversight of FCMs' and RFEDs' compliance with financial reporting requirements during FYs 2012 and 2013. Our audit was limited to CFTC's oversight of FCMs and RFEDs holding customer funds.

## **BACKGROUND**

CFTC's Division of Swap Dealer and Intermediary Oversight (DSIO) has responsibility for overseeing the registration and compliance of intermediaries and futures industry self-regulatory organizations, including U.S. derivatives exchanges and the National Futures Associations. Under Dodd-Frank Act, DSIO is responsible for developing and monitoring compliance with regulations addressing registration, business conduct standards, capital adequacy, and margin requirements for swap dealers and major swap participants. DSIO's New York Regional Office has primary responsibility for ensuring and conducting reviews of FCMs' and RFEDs' compliance with CFTC financial reporting requirements.

As required under CEA, FCMs and RFEDs are required to periodically file a variety of audited and unaudited financial reports and other information with CFTC each year. Such reports and information include statements of financial condition, computation of minimum capital requirements, income, changes in ownership equity, changes in subordinated liabilities, and cash flows.

## **SUMMARY OF RESULTS**

Our audit found that CFTC had management controls to help achieve its regulatory oversight of FCMs' and RFEDs' compliance with CFTC financial reporting requirements during FYs 2012 and 2013. Our analysis of a sample of FCMs and RFEDs reviewed by DSIO indicated that CFTC's prescribed procedures for conducting its reviews were generally followed. We identified, and communicated separately to management, certain matters about CFTC's control deficiencies for which CFTC could take measures to strengthen its controls.

## SCOPE AND METHODOLOGY

Our audit scope was limited to evaluating CFTC's management controls toward achieving its regulatory oversight of FCMs' and RFEDs' compliance with financial reporting requirements during FYs 2012 and 2013. Our audit was limited to CFTC's reviews of FCMs and RFEDs holding customer funds.

We reviewed CEA and Dodd-Frank Act provisions; CFTC financial rules, regulations, and procedures, and specifically CFTC management controls and reviews of FCMs' and RFEDs' compliance with financial reporting requirements. In addition, we interviewed CFTC headquarters and DSIO's New York regional office officials about the management controls, policies, and procedures used in reviewing FCMs' and RFEDs' compliance with financial reporting requirements. We also analyzed the reports and workpapers of a sample of FCMs and RFEDs reviewed by DSIO in FYs 2012 and 2013, and determined their compliance with financial reporting requirements. Regulatory Statement Review (RSR) express is an internally developed system used by CFTC to process and verify financial reports submitted by the FCMs and RFEDs. This system utilizes comprehensive edit and logic checks to analyze the financial reports for specific financial ratios and/or reportable events. CLA did not perform an Information Technology system and security assessment or conduct an evaluation of the RSR express's functionality and capability.

We conducted this performance audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusion based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our conclusion.

This report is intended solely for the information and use of CFTC's management and OIG, and is not intended to be, and should not be, used by anyone other than these specified parties.

The signature is written in a cursive, handwritten style. It reads "Clifton Larson Allen LLP".

Calverton, Maryland  
April 25, 2014



CliftonLarsonAllen

CliftonLarsonAllen LLP  
www.cliftonlarsonallen.com

Inspector General  
U.S. Commodity Futures Trading Commission

In planning and performing our performance audit of the U.S. Commodity Futures Trading Commission's (CFTC's) management controls and procedures for evaluating Futures Commission Merchants' (FCMs') and Retail Foreign Exchange Dealers' (RFEDs') compliance with CFTC financial reporting requirements mandated by the Commodity Exchange Act (CEA) and Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for fiscal years 2012 and 2013 in accordance with Government Auditing Standards, issued by the Comptroller General of the United States, we considered the entity's internal control as a basis for designing procedures that are appropriate for this engagement.

During our audit, we became aware of deficiencies in internal control other than significant deficiencies and material weaknesses and other matters that are opportunities to strengthen management's internal control and improve the efficiency of CFTC's operations related to its oversight of the FCMs' and RFEDs' compliance with the mandated financial reporting requirements referred to above.

While the nature and magnitude of these other deficiencies in internal control were not considered important enough to merit the attention of those charged with governance, they are considered of sufficient importance to merit management's attention.

We did not audit CFTC's responses and, accordingly, we express no opinion on them.

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

*CliftonLarsonAllen LLP*

Calverton, Maryland  
April 25, 2014

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September 30, 2013

**FISCAL YEAR 2013 FINDINGS**

**1. DIVISION OF SWAP DEALER AND INTERMEDIARY OVERSIGHT (DSIO) POLICIES AND PROCEDURES FOR EVALUATING FCMs AND RFEDs COMPLIANCE WITH FINANCIAL REPORTING REQUIREMENTS**

**Conditions** – During our review of the CFTC’s assessment process used to monitor the FCMs’ and RFEDs’ compliance with financial reporting requirements mandated by the CEA, we noted that DSIO management did not have a formal policy in place to establish the staff hierarchy for DSIO reviews of FCMs and RFEDs until June 2013. The policy required that a CT Level 14 or above perform the second review and approval of the FCMs’ and RFEDs’ compliance with the financial reporting requirements. We examined the reviews conducted by DSIO staff and noted the following

- In 2 of the 32 FCMs/RFEDs financial statements examined, the second/supervisory review was performed by an auditor at a CT grade level 13 or lower subsequent to the date of the new policy.
- In 13 of the 32 FCMs/RFEDs financial statements examined, the second/supervisory review was performed by an auditor at a CT grade level 13 or below before the policy was established.

In addition, we noted instances that the DSIO policies and procedures did not contain clear and concise instructions to ensure the objectives of the review procedures were met. For example, management’s policy contained a procedure for its staff to investigate and document the cause of material changes to specific line items during the examination of the FCMs and RFEDs financial statements. However, the manual did not include a provision and/or parameter on what constitutes a material change.

**Recommendations** – We recommend that CFTC:

1. Develop a documented monitoring process of control activities related to the supervisory review of FCMs’ and RFEDs’ financial reporting compliance to ensure that the process is operating as management intended to accomplish its control objective. The results of the monitoring activities should be evaluated and any deficiency identified should be corrected by management in a timely manner.

**Management Response:**

CFTC management concurred with Recommendation 1. However, management indicated a monitoring process and controls have been in place since December 2013. Only the appropriate, assigned staff can perform an initial and supervisory review of the financial statements. This is controlled in two ways. First, the names of the staff and supervisors assigned to a particular firm are coded directly into RSRexpress by the System Administrator (upon the request from an Associate Director) thereby ensuring that only assigned individuals can sign off a supervisor review. Second, a monthly report is generated for each Associate Director detailing the status of the monthly financial review process and resolution of any issues noted. This report is summarized and presented to the Deputy Director in a monthly status report highlighting any issues and reviews outstanding more

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than 30 days. If a financial review is outstanding for an extended period of time, appropriate actions are taken by management.

**Auditor's Comments:**

Management stated that a monitoring process and controls were placed in operations as of December 31, 2013, approximately two months subsequent to the audit periods. As a result, we could not determine the adequacy of control design or operating effectiveness of management's corrective actions.

2. Refine current policies and/or procedures manual to incorporate the review and/or research criteria for material variances in all places mentioned in the manual. In addition, management should review and determine whether any other vague criteria exist and update accordingly. All documented policies and procedures should be clear, concise, and descriptive.

**Management Response:**

CFTC management did not concur with Recommendation 2. Management indicated that the definition for materiality is set forth in CFTC interpretation 4-1 dated July 29, 1985, which clearly and concisely states the definition in terms of a percentage. This definition has been readily accepted and applied in practice by the Commission Staff, the Division of Enforcement and by the DSROs. This definition was reviewed as recently as June 2013 in discussions with the DSROs and was reaffirmed as appropriate at that time. Additionally, management performed a review of its procedures and identified no "vague criteria" in its procedures.

**Auditor's Comments:**

Management stated that a definition for materiality was set forth in CFTC interpretation 4-1. However, the aforementioned interpretation addresses material error. The specific research criterion for material variance was not defined in DSIO's policies and procedures. Such vague criteria allows for inconsistent application of the procedure performed by staff.

## 2. REGULATORY STATEMENT REVIEW (RSR) EXPRESS

**Condition** – CFTC uses RSRExpress as an essential application to process and verify financial reports submitted by the FCMs and RFEDs. RSRExpress is an internally modified information technology system that utilizes comprehensive edit and logic checks to analyze the financial reports for specific financial ratios and/or reportable events. The Office of Data and Technology management stated that the RSRExpress system operates under the overall structure of the General Support System (GSS) and has inherited all the information technology controls associated with GSS. However, management was not able to provide documentation that supports the above assertion or documentation that a security assessment was performed on RSRExpress.

**Recommendation** – We recommend that that CFTC management:

Review the current classification of RSRExpress as a minor application<sup>1</sup> and reevaluate the Federal Information Processing System 199 categorization of RSRExpress. A further review of the data types

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<sup>1</sup> See OMB Circular A-130 Appendix III for a discussion on major vs. minor system.



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housed in RSReXpress by the Office of Data and Technology will assist management in evaluating security risks associated with the system. Once the assessment is performed, management should implement the necessary controls to mitigate security risks identified with this system.

***Management Response:***

Management concurred with our recommendation. However, management stated that RSReXpress inherits controls from the CFTC General Support System (GSS or CFTC Network) for NIST 800-53 Revision 3. The GSS is rated as a moderate impact system, as are all the other major CFTC systems. Changes to RSReXpress have been and will continue to be evaluated by the CFTC Security Impact Analysis (SIA) component of the change management process, which considers controls for all of the NIST 800-53 Revision 3 control families. Eight such SIA reviews of RSReXpress changes have been conducted in FY 2013. However, management will reconsider, during its transition to compliance with NIST 800-53 Revision 4, current Certification and Accreditation (C&A) boundaries and may adjust them in order to identify and manage risk as efficiently as possible.

***Auditor's Comments:***

Management comments appear to be responsive to our recommendation. The CFTC Office of the Inspector General should follow-up with management to ensure that the corrective action implemented by management is effective



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Kevin C. Piccoli  
Deputy Director

**To: Tony Baptiste - OIG**  
**From: Kevin Piccoli - DSIO Examinations**  
**Cc: Gary Barnett**  
**Date: May 28, 2014**  
**Subject: Audit Report Management Comments**

Tony – as requested, please find below our response to the Management Letter Comments we received from your recent review of DSIO – Examinations group. Please let me know if you have any comments or questions.

### Recommendation # 1.1

#### Management Response:

A monitoring process and controls have been in place since December 2013. Only the appropriate, assigned staff can perform an initial and supervisory review of the financial statements. This is controlled in two ways. First, the names of the staff and supervisors assigned to a particular firm are coded directly into RSRexpress by the System Administrator (upon the request from an Associate Director) thereby ensuring that only assigned individuals can sign off a supervisor review. Second, a monthly report is generated for each Associate Director detailing the status of the monthly financial review process and resolution of any issues noted. This report is summarized and presented to the Deputy Director in a monthly status report highlighting any issues and reviews outstanding more than 30 days. If a financial review is outstanding for an extended period of time, appropriate actions are taken by management.

Concur: Yes  No

### Recommendation #1.2

#### Management Response:

The definition for materiality is set forth in CFTC interpretation 4-1 dated July 29, 1985 which clearly and concisely states the definition in terms of a percentage. This definition has been readily accepted and applied in practice by the Commission Staff, the Division of Enforcement and by the DSROs. This definition was reviewed as recently as June 2013 in discussions with the DSROs and was reaffirmed as appropriate at that time. Additionally, we have performed a review of our procedures and identified no "vague criteria" in our procedures.

Concur: Yes  No

**Recommendation #2.1**

**Management Response:**

RSRexpress inherits controls from the CFTC General Support System (GSS or CFTC Network) for NIST 800-53 Revision 3. The GSS is rated as a moderate impact system, as are all the other major CFTC systems. Changes to RSRexpress have been and will continue to be evaluated by the CFTC Security Impact Analysis (SIA) component of the change management process, which considers controls for all of the NIST 800-53 Revision 3 control families. Eight such SIA reviews of RSRexpress changes have been conducted in FY 2013. However, the CFTC will reconsider, during its transition to compliance with NIST 800-53 Revision 4, current Certification and Accreditation (C&A) boundaries and may adjust them in order to identify and manage risk as efficiently as possible.

Concur: Yes  No