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CFTC's Auditor Finds "Material Error" in FY2015 Financial Statements

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The Commodities Futures Trading Commission's (CFTC's) independent auditor, KPMG LLP, contends that CFTC understated its liabilities by $194 million in FY2015 and $212 million in FY2014. At issue is how CFTC has accounted for costs related to office space leases that span several years. The point of contention between KPMG and CFTC's management is whether only the current year lease expenses should be recognized on the financial statements or should the expenses related to the full term of the lease contracts be recognized. KPMG also found *material weaknesses* in internal control over financial reporting. The House Appropriations Subcommittee on Agriculture is scheduled to hold a hearing on CFTC's budget on February 10, 2016.

CFTC's FY2015 Audit Opinion and Management Response

Based on the issues surrounding lease expenses, KPMG issued a *qualified* opinion on CFTC's financial statements for 2015 and 2014 instead of an unqualified opinion as it has in the previous years. The qualified opinion is based on how lease obligations are reported on CFTC's statements of budgetary resources and in the related notes (Note 10).

An unqualified audit opinion communicates that the financial statements are presented fairly, in all material respects (meaning there are no significant issues). A qualified opinion communicates that the financial statements are materially misstated. Material misstatements of financial statements may arise for a number of reasons, including

- the appropriateness of the selected accounting policies;
- the application of the selected accounting policies; and
- the appropriateness of the financial statement presentation or the appropriateness of adequacy of disclosures in the financial statements.

KPMG determined that all prior period financial statements audited by KPMG (2004-2008, 2010-2014) contained material errors and withdrew its prior audit opinions. CFTC's independent auditor for 2009 was Clifton Gunderson LLP. CFTC's management is responsible for preparing the financial statements; the auditor only expresses an opinion on the financial statements.

In its 2015 Independent Auditors' Report, KPMG noted that except for the issues surrounding lease obligations, the financial statements are presented fairly in all material respects. CFTC's practice of entering into lease contracts and how they are reported, however, might be a potential violation of the Anti-Deficiency Act (ADA, (31 U.S.C. §1341(a)

(1)(A)). The ADA prohibits federal employees from authorizing an expenditure or obligation in excess of the amount available in the appropriations fund unless authorized by law.

CFTC's management did not concur with KPMG's audit opinion for the FY2015 financial statements. CFTC stated that there has not been an official determination that the commission has violated any regulations and that CFTC does not have a formal accounting policy specifically related to the recognition of lease obligations. Based on CFTC's review of its lease accounting policies, it concluded that its historical lease accounting treatment might be inconsistent with Office of Management and Budget (OMB) Circular A-11, *Preparation, Submission and Execution of the Budget*. CFTC's review of its lease accounting practice was undertaken as a result of the Government Accountability Office's (GAO's) request for CFTC's views on various legal issues involving CFTC's leases. According to CFTC, GAO is currently reviewing issues surrounding its accounting policy for lease obligations and expects GAO's opinion in FY2016.

Background on CFTC's Leases

CFTC does not own real estate. It leases its buildings in Washington, DC, Chicago, New York, and Kansas City. CFTC only reports the annual portion of the lease obligations due each year in its financial statements, not the total obligation for the term of the lease contracts. KPMG contends that the U.S. generally accepted accounting principles (GAAP) requires CFTC to recognize the lease obligation for the term of the contracts at lease inception. By not recognizing lease obligations over the term of the lease agreements, KPMG believes the obligated balances on the statement of budgetary resources are understated by $194 million and $212 million, respectively, for FY2015 and FY2014. For comparison, the agency's FY2015 appropriated budgetary resources are $250 million. Should CFTC and GAO concur with KPMG's interpretation of U.S. GAAP, the lease obligations for the term of the lease agreements would be reported on the financial statements instead of as a note to the financial statement (Note 10).

Recognition of lease obligations for the term of the lease contracts on the financial statements does not imply that CFTC would need to pay the remainder of the lease payments in the current year. Recognition of these obligations on the statement of budgetary resources for the terms of the lease contract communicates to Congress the potential future lease payments that CFTC might be obliged to pay. During the FY2016 appropriations hearings, Congress raised concerns about CFTC's use of unoccupied lease space.

Material Weakness in Internal Control

Significant portions of the Sarbanes-Oxley Act (P.L. 107-204) were written to address management responsibility over internal controls and financial statements in the private sector. Subsequently, these internal control practices have been widely accepted both in private and public sectors. According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), internal controls help "entities achieve important objectives and sustain and improve performance."

In general, by testing the internal controls, an auditor is able to design audit procedures that are appropriate to gain reasonable assurance the financial statements are presented fairly, in all material respects. If there is a weakness in internal control, then the auditor might need to take additional steps when they express an opinion on the financial statements. According to KPMG's audit report, KPMG considered CFTC'S internal controls over financial reporting, but KPMG did not express an opinion on the overall effectiveness of the internal controls across CFTC. The internal controls were considered only in the context of how effective they are at potentially preventing errors in financial reporting. KPMG stated there was a material weakness in the internal controls over financial reporting. This deficiency would not allow management or employees, in the normal course of business to prevent or detect and correct misstatements on a timely basis. CFTC's management concurred with these findings.