

# 2017 Report and Certification of Internal Supervisory Controls

## Introduction

Section 961 of Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”) requires that not later than 90 days after the end of each fiscal year, the Securities and Exchange Commission (“SEC” or “Commission”) shall report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services on the supervisory controls over the conduct by the Commission of examinations of registered entities,<sup>1</sup> enforcement investigations, and review of corporate financial securities filings. This report is being submitted for the Commission’s fiscal year ending September 30, 2017.

## Background

The SEC’s mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. Although the SEC’s functional responsibilities are organized among five divisions and 23 offices, the scope of the activities covered in Section 961 fall principally under the purview of: the Office of Compliance Inspections and Examinations (“OCIE”), the Office of Credit Ratings (“OCR”),<sup>2</sup> the Division of Enforcement (“Enforcement”), and the Division of Corporation Finance (“Corporation Finance”). Therefore, in the context of this report, references to “the Commission’s internal supervisory controls” or “internal supervisory controls of the Commission” relate to the relevant internal supervisory controls of OCIE, OCR, Enforcement, and Corporation Finance.

OCIE principally administers the examination program for SEC-registered entities including, among others, self-regulatory organizations, broker-dealers, transfer agents, clearing agencies, municipal advisors, investment companies, and investment advisers. OCIE conducts examinations to foster compliance with the securities laws, to detect violations of the law, to

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<sup>1</sup> References to “examinations” within this report refer to both examinations and inspections conducted by either the Office of Compliance Inspections and Examinations or the Office of Credit Ratings.

<sup>2</sup> The Act also mandated the creation of OCR, which was established in June 2012 upon the hiring of its Director and was immediately staffed with a reassigned examination team from OCIE and a reassigned monitoring team from the Division of Trading and Markets. The certification mandated by Section 961 of the Act is required for the “Director of the Division of Enforcement, the Director of the Division of Corporation Finance, and the Director of the Office of Compliance Inspections and Examinations (or the head of any successor division or office).” The SEC has determined that OCR should be considered a successor of OCIE and therefore subject to the reporting certification of Section 961.

identify risks and to inform policy. OCR is responsible for conducting examinations and monitoring the activities of Nationally Recognized Statistical Rating Organizations to assess and promote compliance with statutory and Commission requirements. Enforcement is principally responsible for assisting the Commission in executing its law enforcement function by, among other things, conducting investigations of potential securities law violations; recommending, in appropriate circumstances, that the Commission institute civil actions in federal court or before an administrative law judge; and prosecuting cases on behalf of the Commission. Finally, Corporation Finance is principally responsible for selectively reviewing the disclosure documents that relate to the offer and sale of securities in registered transactions and which publicly-held companies file with the Commission. Through Corporation Finance's review process, the Division provides comments on where it believes companies can improve or enhance their compliance with the disclosure requirements of the federal securities laws.

Staffing within OCIE and Enforcement consists of attorneys, accountants, examiners, subject matter experts, and other employees located both in the Washington, D.C. office and in 11 regional offices located throughout the country. OCR's staff is comprised of similarly diverse professionals who are divided between Washington, D.C. and the New York Regional Office. The majority of the SEC's other offices and divisions, including Corporation Finance, are located exclusively in Washington, D.C.

This report describes the scope and methodology used to evaluate the internal supervisory controls and relevant procedures applicable to the OCIE, OCR, Enforcement, and Corporation Finance staff that perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings. Furthermore, the report describes whether any significant deficiencies in these controls or procedures have been identified to exist as of the end of the fiscal year. The report also includes a description of the inherent limitations of procedures applicable to staff, internal supervisory controls, and the evaluation process. Finally, the report includes an assessment of control and procedure effectiveness, the Certification of Supervisory Controls that is required by the Act, and the status of the Comptroller General's review pursuant to Section 961(e) of the Act.

### **Internal Supervisory Controls and Procedures Applicable to Staff**

Section 961(b)(1) of the Act requires the assessment of both the Commission's internal supervisory controls and procedures applicable to the Commission staff who perform examinations of registered entities (i.e., OCIE and OCR), enforcement investigations (i.e., Enforcement), and reviews of corporate financial securities filings (i.e., Corporation Finance). The terms "internal supervisory controls" and "procedures applicable to staff" are not defined in the Act. For purposes of this report and the attached certification, "procedures applicable to staff" refer to the established "day-to-day" procedures to be followed by the employees within

the applicable programs. “Internal supervisory controls” refer to the processes established by management to monitor that the procedures applicable to staff are consistently being performed according to policy and procedures, and also remain reasonable, adequate, and current.

## **Scope and Methodology**

### *1. Overview*

The Directors of OCIE, OCR, Enforcement, and Corporation Finance, each with the assistance of his or her supervisory staff and other office or division personnel, evaluated the effectiveness of internal supervisory controls and relevant procedures applicable to staff. The internal supervisory control review encompassed controls in place during the entire fiscal year and the assurance of those controls encompassed the 90-day period ending on the final day of the fiscal year ending on September 30, 2017. Upon completion of the evaluation, each Director signed a certification concerning the adequacy of the Commission’s internal supervisory controls with respect to his or her office or division.

To facilitate an effective, efficient, and consistent approach to the evaluations, the agency established a working group consisting of Senior Officers and staff from OCIE, OCR, Enforcement, Corporation Finance, and the Office of the Chief Operating Officer. Additionally, the working group, as needed, obtained input from other divisions or offices within the agency. The working group met and communicated regularly to discuss the execution of each division’s or office’s assessment and to ensure a consistent methodology for conducting the Section 961 assessment corresponding with relevant government-wide internal controls standards and guidance.

OCIE, OCR, Enforcement, and Corporation Finance engaged in a “top-down, risk-based” consideration of their functional responsibilities, focusing on assessing whether their respective objective of conducting examinations, investigations, or reviews of corporate financial securities filings in accordance with adopted policies and procedures had been consistently met during the 90-day period subject to evaluation. This approach involved identifying risks to achieving such objectives, determining whether controls exist to address those risks, and evaluating the operating effectiveness of the controls included in the evaluation. The procedures for collecting information to evaluate the effectiveness of internal supervisory controls consisted principally of interviews, observation, process walkthroughs, inspection of documents, self-assessments (including the use of sub-certifications), and through the application of judgment, as appropriate.

In addition, relevant members of the working group reviewed and considered background material that included the review of the internal supervisory controls pursuant to the requirements of Section 961 of the Act, the Federal Managers’ Financial Integrity Act (FMFIA)

assurance statements for fiscal year 2017, results of an agency-wide review of entity-level controls, and recent Office of Inspector General (“OIG”) and GAO findings.

Finally, the divisions and offices reviewed any deficiencies identified by assessing their impact on the evaluation of the design and operating effectiveness of internal supervisory controls, including making the determination of whether any such deficiencies were considered significant, either individually or in the aggregate. OCIE, OCR, Enforcement, and Corporation Finance provided summary information for such determination and for the evaluation as a whole to the respective office or division director in order to support the relevant assertions within the certification.

## *2. Examinations and Investigations*

To assess the effectiveness of internal supervisory controls over examinations and investigations and the procedures applicable to the staff performing such functions, OCIE, OCR, and Enforcement utilized assessment staff that included members of the working group, senior managers, and other staff with experience in conducting examinations or investigations, as applicable. The assessment staff, along with senior staff and officers, for each function identified and evaluated the risks and related controls that are important to the function’s ability to consistently conduct examinations or investigations according to policies and procedures, which included the identification of any deficiencies in control design or operating effectiveness.

In the case of OCIE and Enforcement, the evaluation also included an identification of the information technology (“IT”) systems used to track examinations and investigations and an assessment of how the IT systems are used to support supervisory controls and the procedures applicable to staff. In the case of OCR, the assessment staff reviews and tests supervisory controls within its examination system.

The assessment staff for examinations and investigations conducted structured interviews with Home and Regional Office Senior Officers<sup>3</sup> and other staff with the goal of obtaining their assistance and support in the identification and description of controls. In order to assess the effectiveness of supervisory controls, the teams designed tests around the internal supervisory controls that were determined to be designed appropriately. The staff used a combination of statistical, random, and judgmental sampling techniques to select samples for validating operational effectiveness, as applicable. The staff obtained and documented evidence to support the effective operation of supervisory controls.

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<sup>3</sup> The Regional Office Directors and Home Office Senior Officers within OCIE and Enforcement have supervisory responsibility for staff in their respective offices; accordingly, evaluations of internal supervisory controls over examinations and investigations required the coordinated participation of the Home and Regional Offices.

This process was closely coordinated with the annual Management Assurance statement process performed for FMFIA purposes and used the sub-certification prepared for the FMFIA assurance statement, due to the concurrent nature of the identified risks, controls and gaps. The sub-certifications were provided to the Director of OCIE and Co-Directors of Enforcement, along with background materials, to support the assertions in the certification required by Section 961(c)(2) of the Act.

### *3. Reviews of Corporate Financial Securities Filings*

To assess the effectiveness of internal supervisory controls over reviews of corporate financial securities filings and the procedures applicable to the staff conducting those reviews, Corporation Finance established an assessment team that included senior management and other staff members. The assessment team identified and evaluated risks and related controls that are important to Corporation Finance's ability to consistently conduct reviews according to policies and procedures, which included the identification of any deficiencies in control design or operating effectiveness.

The evaluation included the assistance of the Disclosure Standards Office, which is staffed with permanent managers and rotators with significant experience performing reviews of corporate financial securities filings. In order to assess the effectiveness of internal supervisory controls, the team designed and executed tests of supervisory controls during an interim period and the year-end that included a combination of random and judgmental sampling techniques to select samples for validating operational effectiveness. The team obtained and documented evidence to support the effective operation of supervisory controls.

This process built upon the annual Management Assurance statement process performed for FMFIA purposes.

#### **Inherent Limitations**

All control systems, including internal supervisory controls, are subject to inherent limitations. No matter how well-conceived and operated, an internal control system cannot provide absolute assurance regarding the achievement of objectives, nor can an evaluation of an internal control system provide absolute assurance that significant deficiencies will be identified. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that internal supervisory controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Because of the nature, including breadth, of the Commission's examination, investigation, and review of corporate financial securities filings functions, as well as limitations on resources, management and staff within the relevant offices and divisions must exercise judgment in conducting examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings. As such, controls are inherently designed to allow for the application of judgment in decision-making. There may be instances where judgments made in good faith are in hindsight deemed inappropriate.

The evaluations of internal supervisory controls and procedures applicable to staff covered by this report for the Commission's fiscal year ending September 30, 2017 represent the seventh time such evaluations have been conducted pursuant to the requirements of Section 961 of the Act. The SEC will continue to enhance the approach taken in 2017 to improve the effectiveness and efficiency of the efforts going forward. The results of GAO's review under Section 961(e) of the Act may also result in adjustments to the process in future years.

Despite the limitations described above, it is our belief that the evaluations of the Commission's internal supervisory controls and procedures applicable to staff provide a reasonable and justifiable basis for the conclusions expressed in this report.

### **Significant Deficiencies**

Section 961(c)(2)(D) requires each respective Director of OCIE, Enforcement, and Corporation Finance and any successor offices, such as OCR, to certify that he or she has disclosed to the Commission any significant deficiencies in the design or operation of internal supervisory controls that could adversely affect the ability of the applicable Division or Office to consistently conduct inspections, or investigations, or reviews of corporate financial securities filings with professional competence and integrity. Under the terms of Reorganization Plan No. 10 of 1950, the executive and administrative functions of the Commission are transferred to the Chairman of the Commission, including, among other functions, the appointment and supervision of personnel employed under the Commission.<sup>4</sup> Accordingly, the Director of each respective Division or Office should make any required disclosures to the Chairman of the Commission. To make this clear, the attached certification states that the respective Directors have "disclosed to the Chairman of the Commission any significant deficiencies in the design or operation of internal supervisory controls...." A copy of this report is also being provided to each Commissioner.

As part of the evaluations described above, the respective OCIE, OCR, Enforcement, and Corporation Finance assessment teams evaluated their findings to determine whether any deficiencies existed as of September 30, 2017. The severity of all deficiencies identified was

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<sup>4</sup> 15 F.R. 3175, 64 Stat. 1265, Section 1(a).

evaluated to determine whether any, either individually or in the aggregate, constituted a significant deficiency. Upon completion of this process, **no significant deficiencies in internal supervisory controls were identified.**

For purposes of making the determinations described above, a “significant deficiency” meriting the attention by the Chairman of the Commission, is any deficiency, or combination of deficiencies, in internal supervisory controls that inhibits the respective Office or Division from achieving the overall goals established by senior management for consistently conducting examinations, investigations, or reviews of corporate financial securities filings with professional competence and integrity.

### **Summary of Assessment Results**

Based on the results of the evaluations described above, as of September 30, 2017, the internal supervisory controls of the Commission with respect to OCIE and OCR examinations, Enforcement investigations, and Corporation Finance reviews of corporate financial securities filings are effective, and the procedures of the Commission applicable to the OCIE, OCR, Enforcement, and Corporation Finance staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings, respectively, are effective.

### **Certification of Internal Supervisory Controls**

See Exhibit A - Section 961(c)(2) Certification

### **Summary of Review by the GAO**

Section 961(e) of the Act requires a review by the Comptroller General of the United States of the adequacy and effectiveness of the Commission’s internal supervisory control structure and procedures not less frequently than once every three years. Section 961(b)(3) of the Act requires this report to contain a summary of the GAO’s review.

The GAO initiated its triennial review under Section 961(e) and released its report in October 2016, “*Management Has Enhanced Supervisory Controls and Could Further Improve Efficiency*” (GAO-17-16). The report concluded that the agency’s overall internal supervisory control framework reflected key components of internal controls, and that appropriate steps had been taken by the agency to enhance the framework since GAO’s initial review in 2013. The report also stated that the agency had implemented GAO’s 2013 recommendation that it should make certain that existing and future supervisory controls have clearly defined activities and readily available documentation demonstrating execution of the activities, and recommended

that additional measures could be taken to formalize the Commission's 961 Working Group or otherwise establish a formal body to leverage the divisions' and offices' experiences, expand their collaboration to share best practices, and streamline procedures and documentation. The SEC has taken steps to implement all of GAO's recommendations, and looks forward to GAO's review in 2019.



**Exhibit A**

**SECTION 961(c)(2) CERTIFICATION**


Pursuant to the requirements of Section 961(c)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, I hereby certify that:

1. I am directly responsible for establishing and maintaining the internal supervisory controls of the Division or Office of which I am the head.
2. I am knowledgeable about the internal supervisory controls of the Division or Office of which I am the head.
3. I have evaluated the effectiveness during the 90-day period ending on the final day of the fiscal year ended September 30, 2017 of the internal supervisory controls of the Division or Office of which I am the head.
4. I have disclosed to the Chairman of the Commission any significant deficiencies in the design or operation of internal supervisory controls identified as a result of the evaluation described above that could adversely affect the ability to consistently conduct with professional competence and integrity, respectively:
  - (a) inspections and examinations by the Office of Compliance Inspections and Examinations and its successor office, the Office of Credit Ratings,
  - (b) investigations by the Division of Enforcement, or
  - (c) reviews of corporate financial securities filings by the Division of Corporation Finance.


This certification concerning the adequacy of the Commission's internal supervisory controls is based on the review described in the accompanying report of the internal supervisory controls and procedures applicable to the staff that performs the duties described above within the Division or Office of which I am the head and is accurate to the best of my knowledge and belief. This review was performed with the assistance of my supervisory staff and other personnel within my Division or Office.

**With Respect to Inspections and Examinations:**

Name: Peter B. Driscoll  
Date:   
Title: Director 12/8/17  
Office of Compliance Inspections and Examinations

Name: Jessica S. Kane  
Date:   
Title: Acting Director 12/8/17  
Office of Credit Ratings

**With Respect to Reviews of Corporate Financial Securities Filings:**

  
Name: William H. Hinman  
Date: 12/11/2017  
Title: Director  
Division of Corporation Finance

**With Respect to Investigations:**

  
Name: Stephanie Avakian  
Date: 12/11/2017  
Title: Co-Director  
Division of Enforcement

  
Name: Steven Peikin  
Date: 12/7/17  
Title: Co-Director  
Division of Enforcement