

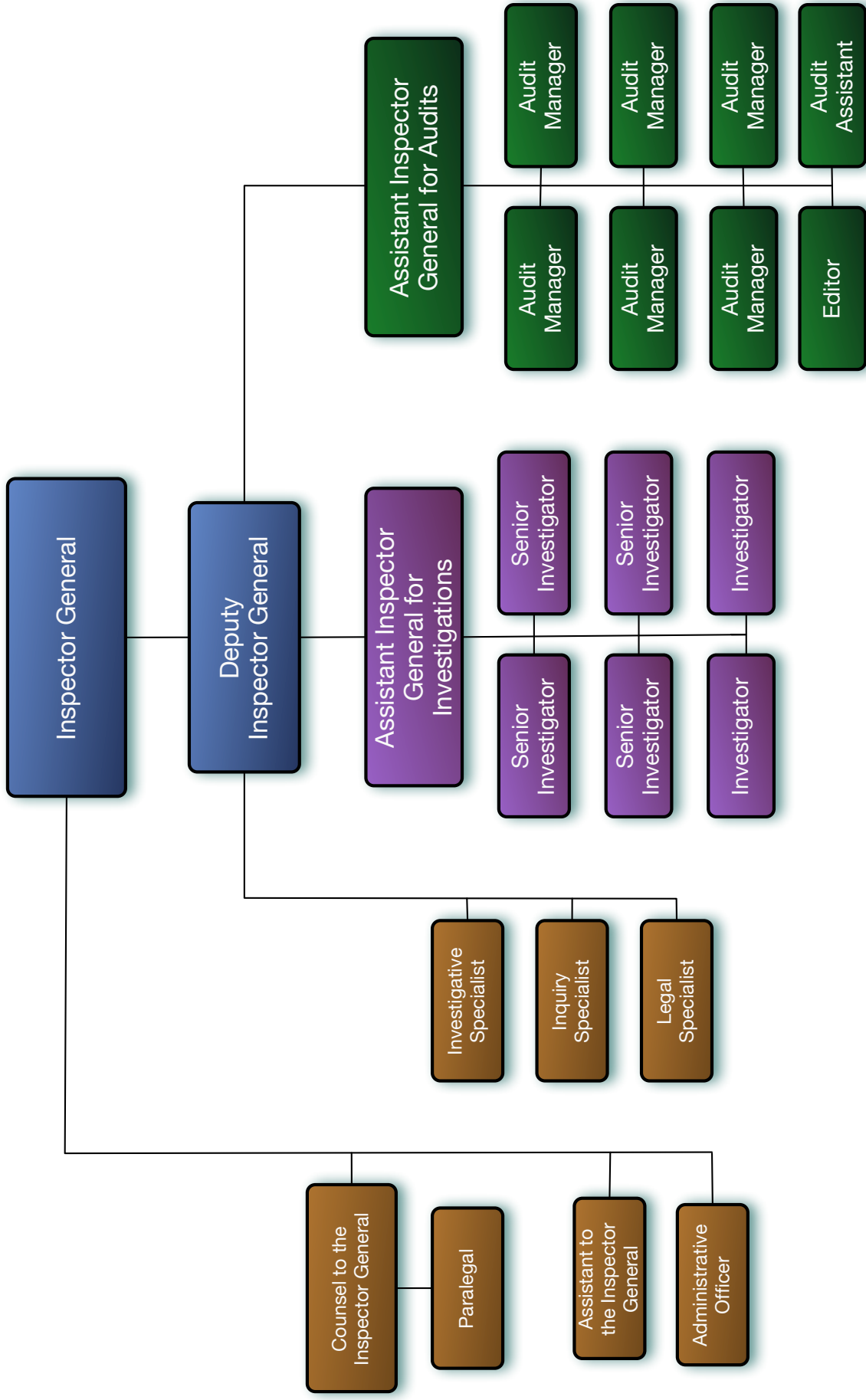


U.S. SECURITIES AND EXCHANGE COMMISSION  
OFFICE OF INSPECTOR GENERAL

SEMIANNUAL REPORT TO CONGRESS  
October 1, 2010 - March 31, 2011

# Organizational Chart

## Office of Inspector General



October 1, 2010 - March 31, 2011



**U.S. Securities  
and Exchange  
Commission**

# OFFICE OF INSPECTOR GENERAL SEMIANNUAL REPORT TO CONGRESS

## MISSION

The mission of the Office of Inspector General (OIG) is to promote the integrity, efficiency, and effectiveness of the critical programs and operations of the United States Securities and Exchange Commission (SEC or Commission). This mission is best achieved by having an effective, vigorous, and independent office of seasoned and talented professionals who perform the following functions:

- Conducting independent and objective audits, evaluations, investigations, and other reviews of SEC programs and operations;
- Preventing and detecting fraud, waste, abuse, and mismanagement in SEC programs and operations;
- Identifying vulnerabilities in SEC systems and operations and recommending constructive solutions;
- Offering expert assistance to improve SEC programs and operations;
- Communicating timely and useful information that facilitates management decision making and the achievement of measurable gains; and
- Keeping the Commission and the Congress fully and currently informed of significant issues and developments.





# SEMIANNUAL REPORT TO CONGRESS

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Message from the  
**Inspector General**

I am pleased to present this Semiannual Report to Congress on the activities and accomplishments of the United States (U.S.) Securities and Exchange Commission (SEC or Commission) Office of Inspector General (OIG) for the period of October 1, 2010 through March 31, 2011. This report is required by the Inspector General Act of 1978, as amended, and covers the work performed by the OIG during the period indicated.

The audits, evaluations, and investigations described in this report illustrate the commitment of the SEC OIG to promote efficiency and effectiveness in the SEC, as well as the crucial effect and impact that the SEC OIG has had upon SEC operations.

During this reporting period, we issued several significant audit reports on matters critical to the SEC's programs and operations. We conducted a review of the SEC's oversight of the Securities Investor Protection Corporation's (SIPC) activities. While we found that the SEC's oversight of SIPC was generally in compliance with the pertinent statute, the Securities Investor Protection Act (SIPA), our audit determined that significant improvements could be made to enhance the process of the SEC's monitoring of SIPC. Specifically, the audit found that the SEC does not inspect SIPC's activities in any systematic fashion and last performed a full inspection of SIPC in 2003. We also found that the SEC lacked adequate written procedures and policies for its oversight of SIPC. We made 12 recommendations to the agency, which when fully implemented, will enhance the SEC's monitoring of SIPC and further ensure that the investing public is afforded adequate protection against losses caused by the failure of broker-dealers.

We also completed an audit of the SEC's implementation of and compliance with Homeland Security Presidential Directive (HSPD) 12. This Directive was signed by President George W. Bush in August 2004 and required federal agencies to have programs in place to ensure that identification issued to federal employees and contractors meets a common standard. Our audit found deficiencies in nearly every aspect of the SEC's HSPD-12 program, and we determined that the SEC missed virtually all of the deadlines established by Office of Management and Budget (OMB) guidance for implementation of HSPD-12. Our audit included 25 concrete and specific recommendations to improve the SEC's HSPD-12 program. SEC management concurred with all of these recommendations and has already partially implemented several of them. Additionally, we completed several other audits during the semiannual reporting period, including a review of the processes by which the Office of Compliance Inspections and Examinations (OCIE) refers potential violations of the federal securities laws to the Division of Enforcement in the SEC's regional offices, an audit of the SEC's budget execution cycle, a review of certain time-and-materials and labor-hour contracts, and a review of the SEC's compliance with the Federal Information Security Management Act (FISMA).

We also had a particularly productive semiannual reporting period for investigations. With only five investigators, we completed approximately 20 investigations on a myriad of complex and significant issues, including the failure to uncover a \$554 million Ponzi scheme, improprieties in the SEC's Office of Information Technology's (OIT) acquisition of approximately \$1 million of computer equipment, the alleged violation of post-employment restrictions, the role of political appointees in

the Freedom of Information Act (FOIA) process, abusive and intimidating conduct in the workplace, dissemination of false and misleading information regarding an active SEC enforcement investigation, unauthorized disclosures of nonpublic information, theft of funds, misuse of computer resources, and abuse of compensatory time for travel. We are also actively working on and finalizing several additional investigations, including an investigation of the facts and circumstances surrounding the SEC former General Counsel's involvement in activities relating to the Bernard L. Madoff Ponzi scheme in light of a lawsuit brought against him and his brothers by the trustee appointed in the Madoff liquidation under SIPA for the return of approximately \$1.5 million in fictitious profits received from the Ponzi scheme, and an investigation into allegations that the agency's leasing activities and related procurements at the Constitution Center and Station Place III sites in Washington, D.C., have resulted in significant waste of government funds and/or violated federal regulations.

This semiannual reporting period has also been a busy one for consultations and briefings with Congressional offices. We were very active in providing advice to and discussing issues with Members of Congress and Congressional staff regarding a wide variety of matters affecting the SEC and the broader financial system, including the implementation and impact of numerous elements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. On February 10, 2011, I testified before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. House of Representatives, concerning my Office's oversight efforts, including our identification of waste, fraud, and abuse in SEC programs and operations and matters pertinent to the SEC's budget and funding levels.

I am also very pleased to report that during the semiannual reporting period, we received recognition from our peers for our work. The Council of the Inspectors General on Integrity and Efficiency (CIGIE) selected our investigative team that produced a 457-page report entitled, Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme, issued on August 31, 2009, for the Gaston L. Gianni, Jr., Better Government Award in recognition of our "extraordinary efforts in expeditiously conducting this investigation critical to the improvement of financial regulation and the protection of investors."

The accomplishments of my Office have been enhanced by the continued support of the SEC Chairman and Commissioners, as well as the SEC's management team and employees. I look forward to sustaining this productive and professional working relationship as we continue to help the SEC meet its important challenges.



H. David Kotz  
Inspector General



# SEMIANNUAL REPORT TO CONGRESS

## MANAGEMENT AND ADMINISTRATION

### AGENCY OVERVIEW

The U.S. SEC's mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust and characterized by transparency and integrity. The SEC's core values consist of integrity, accountability, effectiveness, teamwork, fairness, and commitment to excellence. The SEC's goals are to foster and enforce compliance with the federal securities laws; establish an effective regulatory environment; facilitate access to the information investors need to make informed investment decisions; and enhance the Commission's performance through effective alignment and management of human resources, information, and financial capital.

SEC staff monitor and regulate a securities industry that includes more than 35,000 registrants, including over 10,000 public companies, about 11,500 investment advisers, about 7,800 mutual funds, and about 5,400 broker-dealers, as well as national securities exchanges and self-regulatory organizations, 600 transfer agents, the Municipal Securities Rulemaking Board, the Public Company Accounting Over-

sight Board, alternate trading systems, and credit rating agencies.

In order to accomplish its mission most effectively and efficiently, the SEC is organized into five main divisions (Corporation Finance; Enforcement; Investment Management; Trading and Markets; and Risk, Strategy, and Financial Innovation) and 16 functional offices. The Commission's headquarters is located in Washington, D.C., and there are 11 regional offices located throughout the country. As of September 30, 2010, the SEC employed 3,748 full-time equivalents (FTEs), consisting of 3,664 permanent and 84 temporary FTEs.

### OIG STAFFING

During the reporting period, the OIG added an investigative specialist, a writer-editor, and a part-time investigator to the staff, thereby further increasing its capacity to conduct its oversight responsibilities.

In February 2011, K. Shane Breffitt joined the OIG as an investigative specialist. Ms. Breffitt comes to us from the SEC's Office of Compliance Inspections and Examinations (OCIE), where she served as a branch chief for investment adviser and investment company

examinations. She began her career with the SEC in the Los Angeles Regional Office in 1997 and later transferred to the headquarters office in 2005. Ms. Breffitt has a Bachelor's degree in accounting, is a Certified Public Accountant in the State of Virginia, and is a Certified Fraud Examiner. She is currently pursuing a Master's degree in Economic Crime Management.

In March 2011, Esther Tepper joined the OIG as a writer-editor. She was previously a communications analyst in the OIG of the U.S. Department of the Treasury. Before serving at the Treasury OIG, Ms. Tepper was a communications analyst in the Government Accountability Office's Financial Management and Assurance team. Ms. Tepper's other federal employment includes nine years at the Environmental Protection Agency, where her responsibilities included managing public outreach activities related to childhood lead poisoning prevention. Ms. Tepper has a Bachelor's degree in American Studies from Smith College and a Master's degree in Business Administration from the Yale School of Management.

In March 2011, Juliet D. Gardner, who had worked for the OIG during the previous semi-annual reporting period on detail from the Office of Investor Education and Advocacy (OIEA), officially joined the OIG as an investigator. In OIEA, Ms. Gardner responded to a wide range of securities-related questions, complaints, and suggestions from investors and industry professionals worldwide and analyzed incoming tips for potential referral to other SEC divisions and offices. Ms. Gardner began her legal career at the SEC in 1996, in the Division of Enforcement, where she investigated allegations of market manipulation, insider trading, financial fraud, and securities offering fraud. Ms. Gardner is a 1991 graduate of Wittenberg University, where she received a Bachelor of Arts degree in Political Science. Ms. Gardner received her Juris Doctor degree *cum laude* from Marquette University in 1996.

Finally, one of our Senior Investigators, Heidi Steiber, left the OIG for an opportunity in the private sector.



# SEMIANNUAL REPORT TO CONGRESS

## CONGRESSIONAL TESTIMONY, REQUESTS, AND BRIEFINGS

During the reporting period, the OIG continued to keep the Congress fully and currently informed of the OIG's investigations, audits, and other activities through testimony and related written follow-up, as well as numerous meetings and telephonic communications. These communications primarily concerned the OIG's audit and investigative work that has identified waste or misuse of government funds by the SEC, previous OIG investigations that impact investor protection, OIG efforts to review various aspects of the SEC's implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and ongoing OIG investigative work. The Inspector General's (IG) testimony and certain other requests and briefings are discussed in detail below.

### INSPECTOR GENERAL TESTIMONY AND RELATED FOLLOW-UP ACTIVITIES

The IG testified before the Subcommittee on Financial Services and General Government of the U.S. House of Representatives Committee on Appropriations on February 10, 2011, regarding the Fiscal Year (FY) 2012 SEC budget. In his testimony, the IG pro-

vided a synopsis of the oversight efforts undertaken by the OIG during the past few years, specifically describing several of the significant investigative and audit reports issued by the OIG.

The IG then provided the Subcommittee with information concerning the OIG's efforts over the past three years to identify waste or misuse of government funds by the SEC. The IG stated that the OIG has issued numerous reports identifying waste and inefficiencies, as well as inadequate oversight on the part of various SEC components. The IG reported that a review of the OIG's audit and investigative reports over the past three years revealed that the two largest areas in which the OIG has identified significant waste and inefficiencies have been (1) procurement and contracting, and (2) costs relating to real property leasing and office moves.

Specifically, the IG noted that, in the procurement and contracting area, the OIG has identified numerous deficiencies in the management and oversight of SEC contracts, a lack of written internal policies and procedures for administering contracts and other agreements, a failure to maintain adequate

records and data regarding contracts and agreements, and improprieties in the selection of vendors and the awarding of contracts. The IG observed that these failures have led to the cancellation of contracts and the expenditure of funds to reprocure required services.

The IG further reported that numerous OIG investigations, audits, and reviews have revealed significant excessive costs and inefficiencies in connection with the SEC's leasing of real property and the relocation of staff offices. The IG stated that the OIG had found numerous situations in which the SEC made excessive payments that could have been avoided if appropriate policies and procedures had existed and been followed. The IG also described the OIG's finding that SEC management approved a project to reconfigure internal office staff space at a significant monetary cost without performing any cost-benefit analysis of the project prior to its undertaking. The IG then noted that an OIG survey to the SEC staff affected by the office moves revealed that they had been satisfied with their workplace locations prior to the project and generally felt the project was a waste of time and money.

In his testimony, the IG also discussed the OIG's efforts to ensure that its recommendations are fully implemented, the funding necessary to implement the OIG's recommendations, and the identification of efficiencies within SEC operations and functions. In particular, the IG noted that where the OIG has identified wasteful expenditures and inefficiencies, the OIG has provided SEC management with detailed descriptions of its findings, as well as concrete and specific recommendations to alleviate the problems and concerns identified. The IG reported that the OIG has followed up to ensure that these recommendations have been agreed to and fully implemented, and that the majority of the OIG's recommendations had been implemented.

The IG then stated that, in certain instances, it has been and will be necessary for the SEC to incur additional expenses to implement the OIG's recommendations. He mentioned by way of example the numerous recommendations made in the OIG's report of investigation related to the Bernard Madoff Ponzi scheme that were designed to reform the SEC's system for handling tips and complaints. He reported that the SEC has implemented these recommendations, instituting a new Tips, Complaints, and Referrals (TCR) system to ensure that complaints are received and acted upon in a timely and appropriate manner at a total cost of approximately \$21 million. The IG noted that additional funding will be required to ensure that the SEC has sufficient resources to implement many of the recommendations that have arisen, and will arise, out of the OIG's audits, reviews, and investigations.

Further, the IG reported in his testimony that senior officials, particularly those within the SEC's Office of Information Technology, had informed the OIG that they are analyzing the SEC's operations and functions to identify efficiencies and areas in which costs can be reduced. The IG specifically mentioned the plans of the SEC's new Chief Information Officer to cancel a \$2 million information technology contract that he found was not cost-effective. The IG noted that the OIG supported and applauded these efforts and will continue to encourage this type of approach in the future.

In concluding his testimony, the IG acknowledged the importance of the SEC's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, particularly as the nation's securities exchanges mature into global for-profit competitors. The IG also pointed out the SEC's responsibility to utilize government funds in an efficient and effective manner and represented that the OIG intends to remain vigilant to ensure that scarce government re-

sources are used wisely and cost-effectively and instances of waste and abuse are eliminated. The full text of the IG's written testimony is contained in Appendix B to this report and can also be found at <http://www.sec-oig.gov/Testimony/index.html>.

Subsequent to the IG's February 10, 2011 testimony, the IG received several questions for the record in connection with the Financial Services and General Government Subcommittee's FY 2012 Budget Hearing with the SEC IG. These questions were received from the Subcommittee Chairwoman, the Honorable Jo Ann Emerson (R-Missouri), the Honorable Barbara Lee (D-California), and the Honorable Jo Bonner (R-Alabama). The topics of these questions included the OIG's investigation into the circumstances surrounding the SEC's proposed settlement with Bank of America that was completed during the previous semiannual reporting period, the impact of the continuing resolution on the SEC, the diversity of the OIG's staff, the OIG's recruiting and hiring practices, the OIG's procurement and contracting with small and disadvantaged business enterprises, enforcement of acquisition procedures applicable to small and disadvantaged business enterprises, and investor protections related to Robert Allen Stanford's alleged Ponzi scheme.

The IG provided responses to the questions for the record on March 18, 2011. In those responses, the IG answered Chairwoman Emerson's questions pertaining to the OIG's Bank of America investigation, noting that our investigation found that the Commission initially approved a waiver of certain qualifications for Bank of America in connection with the SEC's first proposed settlement of its action against Bank of America, notwithstanding the fact that the traditional criteria for determining eligibility for such waivers were not met. The IG also pointed out that the OIG had found that the SEC's Division of Corporation Finance had recommended the waiver for Bank of America based, at least in

part, on its status as a Troubled Asset Relief Program (TARP) participant, but that the OIG did not specifically investigate other instances where the SEC may have treated TARP and non-TARP recipients differently. In addition, the IG stated that while the OIG did not determine that the SEC was inappropriately lenient toward Bank of America, the OIG noted the departure from SEC practice and the inconsistent manner in which the SEC had acted. Further, the IG advised that, while the OIG did not conclude that the SEC was looking out for Bank of America over the interests of retail investors, the OIG's report did find that the waiver in question allowed Bank of America to issue registration statements without SEC review, which could potentially have some impact on retail investors.

In response to Representative Lee's questions regarding the impact of the continuing resolution on the SEC, the IG noted that significant cuts in the SEC's budget may negatively impact the SEC's ability to effectively implement OIG recommendations and new responsibilities under the Dodd-Frank Act. The IG also pointed out that, in certain instances, the SEC will have to incur additional expenses to implement improvements necessary for the SEC to continue to perform its critical functions. The IG added that the SEC must remain vigilant in its mission of protecting investors and conduct aggressive oversight, and that it must have the resources necessary to conduct such oversight, as well as access to up-to-date technology. The IG further observed that budget cuts of 13 percent or more might make it difficult for the SEC to accomplish its mission.

The IG also responded to Representative Lee's questions pertaining to the diversity of the OIG, its recruitment and hiring practices, and its procurement and contracting practices. Specifically, the IG provided information showing that as of February 10, 2011, of the OIG's 17 full-time employees, nine were women (53 percent) and eight were minorities (47 percent). With respect to the OIG's con-

tracts, the IG reported that 33 and 40 percent of the OIG's outside contracts were with small, disadvantaged businesses that were female- or minority-owned in 2009 and 2010, respectively.

In response to Representative Lee's question about how the OIG ensures that the SEC meets all acquisition procedures applicable to small and disadvantaged business enterprises, particularly female- and minority-owned firms, the IG noted that the OIG had recently conducted two audits of the SEC's acquisition procedures. The IG described the pertinent work performed in both of these audits, which included (1) an audit completed in September 2009 of all aspects of the SEC's procurement and contract management processes and functions, and (2) a follow-up review scrutinizing certain time-and-materials and labor-hour contracts, including one contract with a Small Business Administration-certified small and disadvantaged business, to ensure compliance with applicable requirements.

Further, the IG provided answers to several questions from Representative Bonner that related to investor protection and, in particular, Robert Allen Stanford's alleged Ponzi scheme. The IG pointed out that in the OIG's report of investigation in the Stanford matter, the OIG found that the SEC's Fort Worth Enforcement program made no meaningful effort to obtain evidence relating to Stanford's alleged Ponzi scheme. The IG added that the OIG's investigation found that the Fort Worth Enforcement program's decision not to undertake a full and thorough investigation of Stanford was due, at least in part, to the perception that the Stanford case was difficult and novel, and not the type of case favored by the SEC. The IG noted that the OIG recommended that the SEC clarify its procedures to ensure that the Enforcement program makes better decisions in the future and that the SEC consider the significance of bringing cases that are difficult, but important for the protection of investors. The IG also provided information on investigations the

OIG has conducted involving the Fort Worth Office other than the Stanford investigation.

In addition to responding to the questions for the record, the OIG conducted follow-up work requested by the Honorable José Serrano (D-New York), Ranking Member of the Financial Services and General Government Subcommittee, pertaining to the SEC's involvement in U.S. territories and republics. On March 17, 2011, the IG forwarded to Ranking Member Serrano the OIG's report of its review of Commission activities in U.S. territories and republics. The OIG's report set forth the results of the OIG's research regarding the SEC's involvement in U.S. territories and republics, noting that three SEC offices or divisions, the Office of Compliance Inspections and Examinations (OCIE), the Office of Investor Education and Advocacy (OIEA), and the Division of Enforcement (Enforcement), have contacts with investors in U.S. territories. The OIG's report also noted that the SEC's Miami Regional Office has specific responsibility for the U.S. Virgin Islands and Puerto Rico, while the Los Angeles Regional Office is responsible for Guam, and the SEC headquarters office assumes primary responsibility for all other U.S. territories and republics.

Specifically with respect to OCIE, the OIG's report found that OCIE administers the SEC's nationwide examination and inspection program for registered self-regulatory organizations, broker-dealers, transfer agents, clearing agencies, investment companies, and investment advisers, and conducts examinations of investment advisers, broker-dealers, and transfer agents in U.S. territories. The report also noted that OCIE reviews and responds to investor complaints and has fielded complaints from investors located in U.S. territories and from investors outside the territories with respect to subjects located in the territories. The OIG then provided detailed statistics concerning the number of registrants and number of examinations OCIE has conducted in U.S. territories and republics during



the past five years. Additionally, the OIG report provided detailed information concerning a joint broker-dealer/investment adviser examination conducted by OCIE of a firm located in Puerto Rico that revealed numerous concerns and deficiencies in the firm's practices and compliance controls.

The OIG's report next provided detailed information concerning OIEA's contacts with investors located in U.S. territories, showing over 250 contacts coming from Puerto Rico alone. The report noted that OIEA confirmed that it had responded appropriately to all contacts from the territories, forwarding many of them to Enforcement. The OIG then provided several examples of the types of follow-up work OIEA has completed with respect to contacts from U.S. territories.

The OIG's report also described Enforcement's involvement with U.S. territories, noting that Enforcement stated that it obtains evidence of possible violations of the federal securities laws from many sources, including investor tips from U.S. territories and republics. The report pointed out that while Enforcement regularly conducts investigations into allegations concerning entities and individuals located in U.S. territories, and certain matters have involved significant numbers of investors in U.S. territories, a search of public Enforcement Litigation Releases revealed only matters related to Puerto Rico. The OIG's report also noted that effective March 14, 2011, Enforcement deployed its new TCR Intake and Resolution system to capture and track investor complaints, and simultaneously launched a TCR website. During the OIG's review, Enforcement reported that, since 2004, it had received six, 18, and two TCRs from individuals located in Guam, Puerto Rico, and the U.S. Virgin Islands, respectively, and ten and five TCRs where the subject was located in Puerto Rico and the U.S. Virgin Islands, respectively. The OIG's report also provided an example of an enforcement action involving conduct in a U.S. territory in August 2009, which sought a civil injunction

against a Florida resident and company for operating a multi-million dollar fraudulent pyramid scheme involving investors from Puerto Rico.

In conclusion, the OIG's report found that while the SEC does not maintain a presence (as in a physical office) in any U.S. territory or republic, it does respond to complaints from investors in the territories, conducts examinations in the territories, and has filed enforcement actions involving conduct in or related to U.S. territories. The OIG's report also noted that some U.S. territories are assigned to specific regional offices, but many of the territories and all of the republics are not currently assigned to any regional office. Based on its review, the OIG suggested that the SEC reinforce the roles and responsibilities of headquarters and the regional offices regarding investor protection in U.S. territories and republics. The OIG further suggested that OIEA consider performing investor outreach and education in U.S. territories and republics to ensure investors located there have the knowledge and opportunity to have their concerns addressed by the SEC.

## **OTHER REQUESTS AND BRIEFINGS**

During the reporting period, the IG conducted numerous briefings of, and had discussions with, Members of Congress and Congressional staff concerning a wide variety of issues impacting the SEC and the broader financial system, including the implementation and impact of numerous provisions of the Dodd-Frank Act. Specifically, on October 21, 2010, the IG participated in a call with staff of the U.S. Senate and House of Representatives Committees on Appropriations concerning the SEC's budget and the OIG's budget, and whether the OIG had sufficient funds to perform its critical oversight functions. On February 17, 2011, the IG met with staff of the U.S. House of Representatives Committee on Transportation and Infrastructure and its Subcommittee on Economic Development, Public Buildings, and Emergency Manage-

ment, and provided a briefing on the status and progress of the OIG's ongoing investigation into the SEC's leasing practices and activities, including a contract to lease space at Constitution Center in Washington, D.C. The IG also briefed the Committee staff on the OIG's previous audit of the SEC's real estate leasing function, as well as other OIG audit and investigative work pertaining to procurement issues and identified areas of waste within the SEC.

In addition, on February 24, 2011, the IG met with several staff of the U.S. House of Representatives Committee on Financial Services pertaining to the SEC's implementation of the Dodd-Frank Act, the OIG's prior report of investigation related to the Robert Allen Stanford alleged Ponzi scheme, and possible future OIG audit work pertaining to the SEC's economic analysis function and collaboration with other agencies, as well as other issues of interest to the Committee. On March 3, 2011, the IG briefed staff of the Subcommittee on Oversight and Investigations of the U.S. House of Representatives Committee on Government Oversight and Reform regarding a wide variety of issues pertaining to financial management, work force, and operations at the SEC, including the results of the OIG's oversight efforts and the

IG's views on the main challenges facing the SEC.

Further, shortly after the OIG commenced its investigation into the facts and circumstances of the former SEC General Counsel's participation in matters pertaining to the Bernard Madoff Ponzi scheme, on March 15, 2011, the IG, Counsel to the IG, and Assistant Inspector General for Investigations (AIGI) met with the Honorable Darrell Issa (R-California), Chairman of the U.S. House of Representatives Committee on Government Oversight and Reform, regarding the Committee's ongoing efforts with regard to this matter. The IG, Counsel, and AIGI also met with several majority staff from the Government Oversight and Reform Committee and its Subcommittee on Oversight and Investigations, and the Subcommittee on Oversight and Investigations of the U.S. House of Representatives Committee on Financial Services, as well as several other Congressional staff. During this meeting, the IG briefed the staff on the allegations that formed the basis of the investigation the IG was undertaking into these matters. On March 17, 2011, the IG participated in a conference call, which included minority staff from the oversight committees, and provided a similar briefing to the one conducted on March 15, 2011.



# SEMIANNUAL REPORT TO CONGRESS

## **ADVICE AND ASSISTANCE PROVIDED TO THE AGENCY AND THE GOVERNMENT ACCOUNTABILITY OFFICE**

During this semiannual reporting period, the OIG provided advice and assistance to SEC management on various issues that were brought to the OIG's attention during the course of audits and investigations conducted by the Office and otherwise. This advice was conveyed through written communications, as well as in meetings and conversations with agency officials. The advice included comments on draft policies and procedures and suggestions for improvements in existing policies and procedures. The OIG also collaborated with and provided assistance to the Government Accountability Office (GAO) on matters of mutual interest to the GAO and the OIG.

Specifically, during the reporting period, the IG met with consultants performing an organizational study of the agency that was required by Section 967 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The IG also met with a Division of Enforcement representative regarding the SEC's whistleblower program and provided insights as to how that program should be redesigned

based upon information obtained during the course of OIG investigations and audits.

In addition, OIG investigative staff provided assistance to agency management in connection with an inquiry performed into the alleged misappropriation of funds from the SEC Recreation and Welfare Association (SRWA), which is a non-appropriated funding instrumentality. As is described more fully in the Inquiries Conducted Section of this Report, the OIG's inquiry discovered that there was a lack of controls over the SRWA and, in particular, that a former employee was the only signatory on the SRWA's checking account and still maintained the checkbook for the account. In an effort to assist SEC management, the OIG obtained possession of the checkbook and arranged for a current SEC official to become the signatory on the account. The OIG also made several recommendations to management in order to enhance oversight of the SRWA's operations, including that a financial control system be developed and implemented for the SRWA.

Further, as discussed in the OIG SEC Employee Suggestion Hotline Section of this Report, the OIG reviewed a suggestion received from an SEC employee concerning the need for improvement in the timeliness of notifications to employees of changes in the SEC's operating status. The OIG's review of this suggestion disclosed that the SEC's notification of operating status updates during early 2011 occurred several hours after the U.S. Office of Personnel Management (OPM) had updated Federal agency operating status for the Washington, D.C. metropolitan area due to inclement weather. The OIG's review also determined that the SEC's Contingency Plan for Early Dismissal and Closure Days, SEC Regulation (SECR) 5-15 had not been updated since March 1998, and that the emergency notification system currently being used by the SEC, the Nōtifind system, could be used more effectively and consistently to provide SEC employees with timely information about operating status changes. The OIG issued a memorandum to the SEC's Executive Director on March 18, 2011, recommending that the Office of the Executive Director (OED) revise and update SECR 5-15 and post the revised policy to the SEC's intranet site. The OIG's memorandum also recommended that the OED review and revise its current processes to ensure notifications of operating status changes sent by the SEC are provided in a timely manner. The OIG further suggested that the SEC consider improving the current functionality of the Nōtifind system, surveying SEC staff to determine their preferences as to the delivery method for and frequency of weather-related closure and delay information, and reminding employees of their option to designate their preferred communication method through Nōtifind.

In addition, during the reporting period, the OIG reviewed and submitted comments on numerous drafts of Office of Information Technology (OIT) policies and procedures. For example, the OIG provided extensive comments on draft Operating Procedure

24-05.01.02.02 (02.0), "LAN and Telephone Account Creation, Modification, Termination and Transfer," and the accompanying form, "Request for Account Creation, Modification, Termination or Transfer." Overall, the OIG suggested that the draft Operating Procedure be revised to ensure that it clearly specified the time deadlines for the completion of each of the assigned duties outlined in the policy to ensure that the accounts of users who have left the SEC are timely disabled and deleted. The OIG also made numerous detailed comments concerning the clarification of and consistency in terms used in the policy, the assignment of particular tasks to specific individuals or positions, and the specification of time deadlines for the performance of specific tasks.

The OIG also reviewed and provided comments on draft Implementing Instruction 24-04.02.01 (01.1), "Sensitive Data Protection." Through its comments, the OIG sought to ensure that the draft Implementing Instruction fully satisfied recommendations previously made in OIG Report No. 485, *Assessment of the SEC's Privacy Program*, issued on September 29, 2010, that the Chief Operating Officer implement a policy that all portable media must be fully secured when not in use, and that OIT finalize, approve, and implement its operating procedures for "Hard Drive Wiping and Media Destruction." The OIG further suggested that the Implementing Instruction make clear that sensitive information should not be left unattended at any unsecured locations, specify what consequences will follow if an employee or contractor fails to comply with the clean desk policy, and describe the responsibilities of individual employees, contractors, and other users of SEC computing services, including the responsibility for appropriately protecting, securing, and disposing of sensitive information in accordance with the Implementing Instruction. The final Implementing Instruction was issued on February 16, 2011, and incorporated some of the OIG's suggestions.

Similarly, the OIG provided numerous suggestions and comments on draft Implementing Instruction 24-04.04.05 (02.0), “Information Encryption within the SEC.” In particular, the OIG made several suggestions designed to ensure that the Implementing Instruction clearly set forth the policies and procedures for determining whether all data placed on portable media must be encrypted in SEC divisions and offices and how users will be notified of these determinations. The OIG’s comments and suggestions were incorporated into the final implementing instruction, “Encrypting Data on Portable Media,” which was issued on December 1, 2010.

Further, the OIG reviewed and provided comments on draft SECR 24-02 (02.0), “Information Technology Capital Planning and Investment Control.” Specifically, the OIG suggested that the draft policy should be revised to create an enforcement mechanism to address noncompliance with the Capital Planning and Investment Control (CPIC) process, as the OIG had previously recommended in Report No. 466, *Assessment of the SEC Information Technology Investment Process*, issued on March 26, 2010. The OIG also suggested that the draft policy be revised to specify what procedures should be followed when violations or circumventions of the CPIC process are brought to the attention of the appropriate CPIC governance board, and to provide for the prompt reporting of intentional violations to the OIG. The OIG further suggested that the policy specify a process and criteria to be followed pertaining to the granting of exceptions or deviations from the policy, and include a requirement to maintain and track all waivers granted. The OIG’s comments and suggestions were incorporated into the final regulation, which was issued on March 11, 2011. Additionally, the OIG provided comments on and suggested several improvements to a draft “High-Level Acquisition Plan,” Operating Procedure 24-02.01.01.02.T02 (version 2.0).

The OIG reviewed and provided comments on a draft of an updated version of the SEC OIT “Rules of the Road,” SECR 24-04.A01 (version 7.0), which are intended to ensure that agency computing and network resources are used responsibly, safely, and efficiently, thereby maximizing the availability of these resources. In its comments, the OIG suggested that the portion of the Rules of the Road discussing the use of social networking be clarified to reflect whether the use of social networking sites from Commission computers is allowed or prohibited and, if allowed, what limitations are placed on the use of such sites. The OIG also suggested clarifications to the portion of the Rules of the Road pertaining to the use of e-mail encryption when sending nonpublic or sensitive data to non-SEC recipients. OIT incorporated the OIG’s comments into the updated version of the Rules of the Road (version 7.0), which was issued on March 16, 2011.

The OIG also reviewed and commented on draft SECR 24-10 (01.0), “Electronic and Information Technology (EIT) Section 508/Accessibility Program.” The OIG made several suggestions for clarification of the draft regulation, particularly with respect to the identity of “SEC business sponsors” and specification of the “necessary technical standards.” The OIG subsequently reviewed a second draft of the regulation that incorporated the OIG’s prior comments. The OIG made a few additional suggestions for reorganizing and revising the second draft of the policy.

In addition to providing advice and assistance to agency management during the reporting period, the OIG coordinated with and provided assistance to the GAO in connection with a variety of matters. For example, the OIG continued to provide assistance to the GAO regarding its ongoing engagement involving the “revolving door” at the SEC (*i.e.*, SEC staff leaving the agency and then working for or representing firms regulated by the SEC). Specifically, the IG met with GAO

representatives and provided responses to numerous questions they posed with respect to the OIG's findings based upon audit and investigative work performed in the revolving door area, the OIG's views on the potential effectiveness of various possible remedial measures, actions taken by the agency in response to specific OIG recommendations, and the status of pertinent new or ongoing OIG investigations. The IG also participated in a conference call with GAO staff to discuss re-

volving door issues and to facilitate coordination between the GAO and the OIG in this area. In addition, the IG participated in a conference call with GAO staff in connection with a study the GAO is conducting on the regulation and oversight of financial planners. In that call, the IG provided GAO staff with his insights gained through the OIG's previous reviews of the SEC's ability to track examination findings, as well as tips and complaints provided by the public.



# SEMIANNUAL REPORT TO CONGRESS

## OIG SEC EMPLOYEE SUGGESTION HOTLINE

The OIG SEC Employee Suggestion Hotline program was established pursuant to Section 966 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. During the reporting period, the OIG prepared and issued policies and procedures implementing the employee suggestion hotline program. These policies and procedures address both the receipt and handling of employee suggestions, and the non-monetary recognition for employees whose suggestions or disclosures to the OIG may result or have resulted in cost savings to or efficiencies for the Commission.

Section 966 requires the IG to submit an annual report to the Congress describing:

- (1) The nature, number, and potential benefits of any suggestions received.
- (2) The nature, number, and seriousness of any allegations received.

- (3) Any recommendations made or actions taken by the IG in response to substantiated allegations received.
- (4) Any action the Commission has taken in response to suggestions or allegations received.

During this six-month reporting period, OIG received 17 suggestions and eight allegations, for a total of 25 employee hotline contacts. The OIG analyzed all of the 25 employee suggestions and allegations received during this six-month period. The information required to be reported to Congress is set forth below for the six-month period ending March 31, 2011:

In addition, summarized below are several of the suggestions and allegations received and analyzed during the reporting period.

<b>Nature and Potential Benefits of Suggestions*</b>	<b>Number</b>
Increase effectiveness	9
Increase the use of resources or decrease cost	5
Increase efficiency or productivity	4
<b>Nature and Seriousness of Allegations</b>	<b>Number</b>
Mismanagement and/or discrimination	5
Waste of Commission resources	4
Physical harm to person or property	1
Misconduct by an employee	1
<b>Action Taken by OIG in Response to Suggestions or Allegations</b>	<b>Number</b>
Memorandum to, or communication with, agency requesting action be taken	11
Referred to OIG investigations unit	2
Referred to OIG audit unit	1
OIG investigations unit opened preliminary inquiry	1
Researched issue, but no further agency action was deemed necessary	4
<b>Action Taken by Agency in Response to Suggestions or Allegations Referred During the Reporting Period</b>	<b>Number</b>
SEC management took specific action to address the suggestion	2
The agency decided to secure new technology in response to the suggestion	1
SEC management launched internal review	1
The suggestion is still under review by the agency	3
SEC management is considering suggestion in context of existing procedures	3

\* Suggestions and/or allegations may fall into more than one category and, as such, the numbers listed may be greater than the total number of suggestions and allegations received.



## **EXAMPLES OF SUGGESTIONS RECEIVED**

### **Office Real Estate Leases**

An employee suggested that potential cost savings could be achieved if expansion needs for SEC offices were met in part by leasing satellite offices in suburbs of cities where the SEC maintains offices, rather than by increasing the space leased in business districts of those cities. The suggestion stated that this approach might save costs, reduce employee stress and commuting time, and provide an alternate worksite in the event of pandemic or terrorist events.

We believe this suggestion has the potential for cost savings to the SEC, as well as other benefits that are not easily measured in monetary terms. In analyzing this suggestion, OIG staff reviewed relevant statutes, Executive Orders, and guidance from the Comptroller General, as well as OIG Report No. 484, *Real Property Leasing Procurement Process*, issued on September 30, 2010. We also interviewed officials from several other governmental agencies and self-regulatory bodies in the financial industry. We recommended that the agency seriously consider this suggestion, noting that the establishment of one or more satellite offices appears to comply with the federal government's efforts to reduce the costs, stress, and pollution of commuting, and that other agencies have successfully made extensive use of satellite offices. Finally, we pointed out that the availability of an alternate work site or sites in the event of a major catastrophe is an attractive aspect of this employee's suggestion.

Management provided an initial response to the suggestion, noting that the SEC is engaged in several ongoing reviews focused, at least in part, on some of the issues implicated in the employee suggestion. Management further noted that there would be a number of considerations to weigh in deciding whether

to open new satellite offices, not the least of which would be financial impact, and that the SEC currently has several long-term leases in place that do not expire for many years. Management also recognized, however, that in situations where the SEC might have leasing flexibility, it would be appropriate to consider satellite offices and other alternatives when a current lease nears the end of its term, or if management were to decide to revise business processes in ways that would clearly render the implementation cost-effective. We are awaiting more specific information from management regarding the SEC's consideration of satellite offices.

### **SEC Website and EDGAR Database**

The OIG received an employee suggestion that the SEC website and the Electronic, Data Gathering, Analysis, and Retrieval (EDGAR) system should be more easily accessible and user-friendly. EDGAR is the feature on the SEC's website that is most frequently used by the public and, therefore, implementing this suggestion is likely to provide potential benefits by improving the agency's effectiveness. After reviewing the suggestion, OIG staff found that there are several ways in which the SEC's website could be enhanced, and made more user-friendly and aesthetically pleasing. The OIG recommended to management that access to the EDGAR database could be improved by displaying the search link more prominently, and that EDGAR search results might be more usable if commonly sought or recent search results were displayed more prominently. Management responded to the OIG, indicating that they agreed with the employee's suggestion and were taking steps to implement the recommended changes.

### **Receipt of Electronic Documents**

An employee suggested that the SEC could benefit from a better means for sending and receiving voluminous documents elec-

tronically. Specifically, the SEC's e-mail system has size limitations and is burdened when large documents are sent or received. It was suggested that providing a service whereby large files could be uploaded and downloaded would be beneficial and a good use of resources. We determined that this suggestion could potentially improve efficiency and increase the use of resources and recommended to the agency that it be considered.

The agency agreed with the underlying premise of the suggestion and, after conducting an internal analysis, developed what it determined to be a cost-effective and efficient approach to resolve the concern expressed in the suggestion. The agency further agreed to raise staff awareness of the resources available for transmitting large documents and provide training as necessary.

### **Notification of Operating Status**

The OIG received an employee suggestion regarding the need for improvement in the timeliness of notification of the SEC's operating status to employees. The employee expressed concern that notifications from the SEC were sent significantly later than those provided by the U.S. Office of Personnel Management (OPM) and, at times, after some employees had already reported to work. An OIG review of operating status updates for the Washington, D.C. metropolitan area provided during January and February 2011 confirmed that notification was consistently delayed by several hours. After this review of the operating status updates and discussions with various employees responsible for preparing and disseminating closure or delay notifications, we determined that the timeliness and effectiveness of notifications sent from the SEC could be improved.

The SEC utilizes Nōtifind, an emergency notification system that provides information to employees in the event of inclement weather, office closings, disasters, or other

emergencies. Notifications are sent to employees via telephone, e-mail and/or text message. Since the implementation of Nōtifind in March 2008, notifications were provided inconsistently, *i.e.* through varying methods and at various times. The OIG suggested that the functionality of Nōtifind be reviewed and improvements made, as necessary. Although no official response from management has yet been received, we noted that immediate improvements were made to the notification system. Specifically, an e-mail reminder and brochure regarding the Nōtifind system were provided to all employees and, when it was necessary to provide information to employees regarding a possible government shutdown, notifications to employees were significantly improved, as employees received notification through all available communication methods.

### **Referral to Audit Unit**

The OIG also received a suggestion that resulted in a referral to the OIG's audit unit. This suggestion related to shared offices for employees who telework and was referred to the audit unit for inclusion in an ongoing audit involving telework practices and policies at the SEC.

## **EXAMPLES OF ALLEGATIONS RECEIVED**

### **Inappropriate Involvement in Employee's Time and Attendance**

The OIG received an allegation that a non-supervisory employee interfered in working relationships between employees and their supervisors, overruled senior officers' approvals of time and attendance, created conflict, and contributed to a lack of trust and declining morale among staff. Because this allegation primarily raised concerns that would be appropriately addressed by management, the details of the allegation were referred to the appropriate management officials for immediate action.

Upon receipt of the allegation, management officials launched an internal review of the facts and circumstances of the allegation. Management determined that it was necessary to retain an outside mediator to meet with the individuals involved and provide recommendations to management on the best course of action to address the situation. The OIG was informed that these efforts had been completed and the mediator had provided several recommendations to management, which was working with the Office of Human Resources (OHR) to fully implement those recommendations.

## **Referrals to Investigations Unit**

The OIG received three allegations that resulted in referrals to the OIG's investigations unit. Two of these allegations related to waste in leasing of office space and were referred to the investigations unit for inclusion in an ongoing investigation of the SEC's leasing activities. The OIG's investigations unit opened a preliminary inquiry concerning the third allegation regarding retaliation against a former staff member.





# SEMIANNUAL REPORT TO CONGRESS

## COORDINATION WITH OTHER OFFICES OF INSPECTOR GENERAL

During this semiannual reporting period, the SEC OIG coordinated its activities in a variety of ways with those of other OIGs, as is required by Section 4(a)(4) of the Inspector General Act of 1978, as amended. Specifically, the SEC IG, or a senior OIG staff member, attended the monthly meetings of the Council of the Inspectors General on Integrity and Efficiency (CIGIE). The SEC IG was also interviewed by consultants performing an organizational assessment of another OIG, who were seeking information about the structure and position classifications within high-performing OIGs such as the SEC OIG. The SEC IG provided the consultants valuable information about how to structure an OIG in an effective and efficient manner. In addition, the SEC IG met with the newly-confirmed IG of the Federal Housing Finance Agency (FHFA) to discuss strategies for establishing an effective OIG.

The SEC IG is also a member of the CIGIE's Professional Development Committee, the purpose of which is to provide educa-

tional opportunities for members of the CIGIE community and to assist in ensuring the development of competent personnel. The IG or a senior OIG staff member attended the Professional Development Committee's monthly meetings. The OIG also participated in a survey being conducted by the Suspension and Debarment Working Group of the CIGIE Investigations Committee. In responding to that survey, the OIG provided its views concerning a number of topics related to suspension and debarment use, training, and practices.

In December 2010, the Counsel to the SEC IG received an Award for Leadership from the Council of Counsels to the Inspector General (CCIG), which is an informal organization of IG attorneys throughout the federal government who meet monthly and coordinate and share information. The award recognized the Counsel to the SEC IG's exemplary leadership as Chair of the CCIG from 2008 to 2010. The Counsel to the SEC IG also attended the annual meeting of the Fi-

nancial Fraud Enforcement Task Force in December 2010, to which representatives of all federal OIGs were invited.

The SEC IG participated in activities designed to coordinate efforts among the federal financial regulatory IGs and strengthen the oversight of the federal financial regulatory structure as a whole. For example, the SEC IG served on the Troubled Asset Relief Program (TARP) Inspector General Council, along with the Special IG for the TARP, and IGs from the Department of the Treasury, the Board of Governors of the Federal Reserve System (Federal Reserve Board), the Federal Deposit Insurance Corporation (FDIC), the FHFA, the Department of Housing and Urban Development, the Treasury Inspector General for Tax Administration and the Small Business Administration, and the Comptroller General of the United States.

In addition, the SEC IG participated in the activities of the Council of Inspectors General on Financial Oversight (CIGFO), which was

created by Section 989E of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The CIGFO is chaired by the IG of the Department of Treasury and also composed of the IGs of the Federal Reserve Board, the Commodity Futures Trading Commission, the FDIC, the FHFA, the National Credit Union Administration, the SEC, and the TARP. Under the Dodd-Frank Act, this Council is required to meet at least quarterly to facilitate the sharing of information with a focus on the concerns that may apply to the broader financial sector and ways to improve financial oversight. The CIGFO is also required to submit an annual report to the newly-established Financial Stability Oversight Council and the Congress, which must include a section that highlights the concerns and recommendations of each IG who is a member of the CIGFO and a summary of the general observations of the CIGFO. During this reporting period, the SEC IG attended the CIGFO's meetings, and the Deputy Inspector General participated in the CIGFO's conference calls.



# SEMIANNUAL REPORT TO CONGRESS

## AUDITS AND EVALUATIONS

### OVERVIEW

The OIG is required by the Inspector General Act of 1978, as amended, to conduct audits and evaluations of agency programs, operations, and activities. The OIG's Office of Audits focuses its efforts on conducting and supervising independent audits and evaluations of the programs and operations of the various SEC divisions and offices. The Office of Audits also hires independent contractors and subject matter experts to conduct work on its behalf. Specifically, the Office of Audits conducts audits and evaluations to determine whether:

- There is compliance with governing laws, regulations, and policies.
- Resources are safeguarded and appropriately managed.
- Funds are expended properly.
- Desired program results are achieved.
- Information provided by the agency to the public and others is reliable.

Each year, the Office of Audits prepares an annual audit plan. The plan includes work that is selected for audit or evaluation based on risk and materiality, known or perceived

vulnerabilities and inefficiencies, resource availability, and complaints that are received from the Congress, internal SEC staff, the Government Accountability Office (GAO), and the public.

### Audits

Audits examine operations and financial transactions to ensure that proper management practices are being followed and resources are adequately protected in accordance with governing laws and regulations. Audits are systematic, independent, and documented processes for obtaining evidence. In general, audits are conducted when firm criteria or data exist, sample data is measurable, and testing internal controls are a major objective. Auditors collect and analyze data and verify agency records by obtaining supporting documentation, issuing questionnaires, and through physical inspection.

The OIG's audit activities include performance audits that are conducted of SEC programs and operations relating to areas such as the oversight and examination of regulated entities, the protection of investor interests, and the evaluation of administrative activities. The Office of Audits conducts its audits in accordance with the generally accepted govern-

ment auditing standards (Yellow Book) issued by the U.S. Comptroller General, OIG policy, and guidance issued by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

## **Evaluations**

The Office of Audits also conducts evaluations of the SEC's programs and activities. Evaluations consist of reviews that often cover broad areas and are typically designed to produce timely and useful information associated with current or anticipated problems. Evaluations are generally conducted when a project's objectives are based on specialty and highly technical areas, criteria or data are not firm, or needed information must be reported in a short period of time. The Office of Audits' evaluations are conducted in accordance with OIG policy, Yellow Book non-audit service standards, and guidance issued by the CIGIE.

## **Audit Follow-up and Resolution**

During this semiannual reporting period, the SEC offices and divisions made significant efforts to reduce the backlog of open recommendations, while ensuring that the most recent recommendations were fully implemented. Based on the appropriate evidence and documentation management provided to the OIG to support its implementation of the OIG's recommendations, the OIG closed 83 recommendations related to 16 different Office of Audits reports during this semiannual reporting period.

## **AUDITS AND EVALUATIONS CONDUCTED**

### **SEC's Oversight of the Securities Investor Protection Corporation's Activities (Report No. 495)**

#### **Background**

As a result of the collapse or near collapse of several broker-dealers in the late 1960s,

Congress enacted the Securities Investor Protection Act (SIPA) in 1970 to provide investors protection against losses caused by the failure of broker-dealers. SIPA created the Securities Investor Protection Corporation (SIPC), which is a not-for-profit membership corporation. SIPC or a SIPC employee either acts as trustee or works with an independent court-appointed trustee in liquidations of troubled brokerage firms to recover funds for investors with assets in bankrupt or financially troubled brokerage firms. All broker-dealers registered with the SEC under Section 15(b) of the Securities Exchange Act of 1934 are members of SIPC with certain exceptions. The SEC is responsible for monitoring SIPC's activities and, pursuant to SIPA, has delegated authority to conduct inspections of SIPC, review SIPC annual reports, and approve SIPC's bylaws, rules, and any amendments to the bylaws and rules.

The audit's overall objective was to assess the effectiveness of the SEC's oversight of SIPC. The audit examined whether the SEC monitors SIPC's activities in accordance with governing legislation and performs periodic and systematic inspections of SIPC's activities. It also focused on determining whether the Commission conducts meaningful reviews of SIPC's annual reports. The OIG also determined where improvements and best practices could be implemented for the SEC's oversight of SIPC.

## **Results**

The OIG audit found that the SEC's oversight of SIPC is generally in compliance with SIPA. However, the audit found that significant improvements could be made to enhance the SEC's process for monitoring SIPC. We found that the Division of Trading and Markets (TM) and the Office of the General Counsel (OGC) currently do not have adequate written policies and procedures for monitoring SIPC's activities. The written policies and procedures in place for TM's oversight of SIPC are limited to a 1999



memorandum that merely lists the SEC's responsibilities for monitoring SIPC pursuant to SIPA. The 1999 memorandum does not provide detailed information about TM's internal procedures for oversight activities, such as how proposed bylaws or amendments submitted by SIPC are to be processed or how reviews of SIPC's annual reports (including SIPC's financial statements) are to be performed. In addition, we found that some of the limited information contained in the 1999 memorandum is outdated.

The audit also found that OGC does not have adequate documentation pertaining to its role in overseeing SIPC. OGC provides legal guidance to TM related to SIPA liquidations and monitors SIPA proceedings that are handled by independent court-appointed trustees and SIPC. Our audit revealed that internal policies or procedures regarding OGC's role relating to SIPC's oversight are not adequately documented. Moreover, during the timeframe in which we conducted our audit, there was significant staff turnover in the OGC bankruptcy group, as the OGC attorney who had provided oversight of SIPC for a number of years retired and was replaced by another attorney. Due to inadequate documentation of internal OGC policies and procedures, we found opposing opinions on how SIPC monitoring activities should be performed. For instance, the new OGC attorney questioned whether he should conduct certain monitoring efforts that the previous attorney believed were effective mechanisms for scrutinizing SIPA liquidations, stating his opinion that such efforts would be too time-consuming for large SIPA liquidations.

Our audit further found that the SEC does not inspect SIPC's activities in any systematic fashion. The SEC last performed a full inspection of SIPC in 2003, and performed a follow-up inspection in 2005. Despite having made six findings in its 2003 inspection, the SEC does not have any definite plans to inspect SIPC in the near future.

We learned during our audit that the GAO performed an audit of SIPC in 1992, which included a review of the SEC's monitoring of SIPC. In its audit, the GAO found that, since 1985, the SEC had evaluated SIPC's operations only once and had not followed up on the 1985 evaluation to determine if SIPC had addressed its recommendations. The GAO recommended that the SEC periodically review SIPC's operations and its efforts to ensure timely and cost-effective liquidations. In response to the GAO's recommendation, TM agreed to inspect SIPC every four to five years. The OIG previously performed an audit of the SEC's oversight of SIPC's activities in March 2000. In that audit, the OIG found that since SIPC's inception in 1970, the SEC had inspected SIPC only two times, once in 1985 and a second time in 1994. The OIG also identified several areas not addressed in past SIPC inspections that could improve oversight effectiveness and recommended that TM and the Office of Compliance Inspections and Examinations (OCIE) decide on a review schedule and inspection scope for future SIPC inspections. In response to this recommendation made in 2000, TM and OCIE agreed to prepare a review schedule and inspection scope for future SIPC inspections. Notwithstanding this agreement and this recommendation being closed, our inquiry with TM and OCIE regarding this matter revealed that TM and OCIE had never developed a review schedule or an inspection scope for future SIPC inspections.

In addition, we noted that, in the SEC's 2003 inspection of SIPC, the SEC identified several deficiencies in SIPC's operations regarding its controls over fees, an improperly denied claim, internal policies and guidance, education initiatives, and funding options. Yet, without additional inspections, the SEC is unable to ensure that these deficiencies have been appropriately addressed. The SEC has indicated that, as a result of its involvement with the liquidations of Lehman Brothers, Inc. (Lehman) and Bernard L. Madoff In-

vestment Securities, LLC (Madoff), further inspections in the near future are not needed. Due to the lack of periodic and systematic inspections of SIPC by the SEC, 14 liquidations from 2003 to date have not been subject to the scrutiny of an SEC inspection.

Our audit also found that the SEC does not perform a review of trustee fees on a systematic basis. We found that such reviews are particularly necessary because there are few, if any, limits on the fees that may be awarded. First, although SIPA liquidations are similar to ordinary bankruptcy cases, in which trustee fees are subject to legal limits, SIPA does not provide any limit on trustee fees in SIPA liquidations. Second, for liquidations in which trustee fees are paid from the SIPC fund without a reasonable expectation of recoupment, courts have no discretion whatsoever under SIPA to limit fees that SIPC has recommended for trustees or their counsels. Thus, in such situations, even if a court finds the amount of fees awarded to a trustee to be excessive, it is required to approve such excessive fees if SIPC determines that the fees are reasonable. We found that, in one case, a Southern District of New York bankruptcy judge deemed fees to be awarded to the trustee in a SIPA liquidation to be excessive, but found that he had no choice other than to approve the fees. Third, even where SIPC advances the funds and there is reasonable expectation of recoupment, the statute provides the courts with only limited discretion to reduce the amount of trustee fees recommended by SIPC.

The audit further found that significant criticism and concern had been expressed regarding the amount of trustee fees that were awarded in the two largest liquidations in SIPC's history, Lehman and Madoff. According to the latest published report, the fees paid to the trustee and his counsels processing the Lehman claims for the period from September 2008 to September 2010 totaled approximately \$108 million. According to the fourth interim fee application filed by the

Lehman trustee, as of September 30, 2010, the entire administrative fees, including fees for accountants, consultants, and others, totaled approximately \$420 million. We also found that the fees paid to the trustee and his counsels processing the Madoff claims for the period from December 2008 to September 2010 totaled approximately \$102 million. Moreover, the fees paid to date for both the Lehman and Madoff liquidations are a mere fraction of the amounts that will eventually be sought because, despite significant progress in resolving certain customer claims, significant work relating to customer claims with pending litigation remains to be done.

Finally, our audit disclosed that many investors are still confused about SIPA coverage. As indicated by TM and evidenced by the Office of Investor Education and Advocacy's (OIEA) log of complaints and questions regarding SIPC from investors, it is difficult for investors to understand protection against losses available under SIPA and which securities are covered under SIPA. We found that certain public service campaigns by SIPC do not fully describe the exceptions to SIPA coverage. Due to the complexity of various factors that determine coverage under SIPA, it is difficult to explain the limitations of SIPA protection to investors. In addition, many investors are unaware of SIPA until they learn that their broker-dealers have failed.

## **Recommendations**

On March 30, 2011, the OIG issued a final report containing the results of its audit. The report included the following 12 recommendations for improving the SEC's monitoring of SIPC's processes and ensuring that the SEC properly oversees SIPC pursuant to SIPA:

- (1) TM should document its procedures and processes for its oversight and monitoring of SIPC pursuant to SIPA.

- (2) TM should complete its efforts to update its internal memorandum that describes its oversight responsibilities under SIPA and include its current practices and, where appropriate, the legislative amendments that were made to SIPA in July 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act.
- (3) OGC should consult with TM to clarify its role in monitoring SIPC and document the responsibilities and procedures it follows in regard to the Commission's oversight of SIPC.
- (4) OGC should consider the costs and benefits related to certain activities that the retired attorney performed and determine what, if any, other activities are appropriate to adequately monitor SIPC.
- (5) TM and OCIE should conduct meetings, on at least an annual basis, to determine when an inspection of SIPC should occur, based on the ongoing liquidations, to ensure systematic and risk-based monitoring of SIPC's operations. In these meetings, TM and OCIE should develop a schedule for future inspections based upon objective criteria or defined risk factors, such as conducting inspections based upon the number of SIPC liquidations.
- (6) TM and OCIE should perform a risk assessment to determine problematic areas or liquidations that are deemed to be complex prior to the next inspection of SIPC, as they did prior to the commencement of the 2003 inspection of SIPC. The scope of each future inspection should take into consideration the risk assessment conducted prior to the inspection.
- (7) TM, in coordination with OGC, should conduct additional oversight of SIPC's assessments of the reasonableness of trustee fees and encourage SIPC to negotiate with outside court-appointed trustees more vigorously to obtain a reduction in fees greater than ten percent.
- (8) The bankruptcy group in OGC and TM should decide on the scope and frequency of the Commission staff's monitoring of SIPC's assessments of the reasonableness of trustee fees paid by SIPC, rather than relying only on inspections of SIPC, which do not occur on a systematic basis.
- (9) TM, in consultation with the Commission, shall determine whether to request that Congress modify SIPA to allow bankruptcy judges who preside over SIPA liquidations to assess the reasonableness of administrative fees in all cases where administrative fees are paid by SIPC.
- (10) TM, in coordination with OIEA, should encourage SIPC to designate an employee whose responsibilities include improving investor education and preventing further confusion among investors about coverage available under SIPA.
- (11) TM should support SIPC's efforts to improve investor education, including encouraging SIPC to strongly consider and, as appropriate, implement OIEA's suggestions to improve investor awareness.
- (12) TM, in coordination with OIEA and in consultation with the Commission, should utilize more effective

methods to communicate with investors in case of the failure of broker-dealers, such as notifying investors of the status of the Commission's efforts throughout the liquidation process or designating an employee, as appropriate, who can communicate directly with investors on matters unique to each liquidation case.

Management fully concurred with all of the OIG's recommendations. The OIG's report, *SEC's Oversight of the Securities Investor Protection Corporation's Activities*, is available on our website at <http://www.sec-oig.gov/Reports/AuditsInspections/2011/495.pdf>.

## **The SEC's Implementation of and Compliance with Homeland Security Presidential Directive 12 (HSPD-12) (Report No. 481)**

### **Background**

On August 27, 2004, President George W. Bush signed Homeland Security Presidential Directive 12 (HSPD-12), "Policy for a Common Identification Standard for Federal Employees and Contractors." This directive requires federal agencies to have programs in place to ensure that identification issued by each agency to federal employees and contractors meets a common standard. Those standards and technical specifications were set forth in Federal Information Processing Standards Publication (FIPS) 201, "Personal Identity Verification (PIV) of Federal Employees and Contractors," which was initially issued by the Department of Commerce's National Institute of Standards and Technology (NIST) on February 25, 2005, and revised in March 2006. On August 5, 2005, the Office of Management and Budget (OMB) issued memorandum M-05-24, "Implementation of Homeland Security Presidential Directive (HSPD) 12 - Policy for a Common Identification Standard for Federal Employees and Contractors" (M-05-24), which provided implementation instructions for HSPD-12 and FIPS 201.

The SEC has implemented a collaborative effort to comply with HSPD-12 among three SEC offices: the Office of Information Technology (OIT), the Office of Administrative Services (OAS), and the Office of Human Resources (OHR). OIT is responsible for overseeing the implementation of the HSPD-12 program, assigning roles and responsibilities, and for implementing technological solutions for the use of HSPD-12 credentials for identification and authentication to SEC logical information systems. OAS is responsible for enrolling PIV credentials into its physical access control system and providing temporary SEC-issued badges while employees or contractors are awaiting receipt of their PIV credentials. OHR has responsibility for the most essential component of the SEC's implementation of and compliance with HSPD-12, which is sponsoring and adjudicating the background investigation of an applicant.

The primary objective of the audit was to determine if the SEC is fully compliant with HSPD-12 and the implementing standards and guidance. Other specific audit objectives were as follows:

- Evaluate whether the SEC has adequate controls and the necessary processes and procedures to perform background investigations, adjudicate results, and issue credentials.
- Evaluate the roles and responsibilities for the HSPD-12 initiative among the various SEC offices involved in the process, including OAS, OHR, and OIT.
- Assess compliance with HSPD-12 and determine whether all the necessary equipment has been purchased to implement HSPD-12 throughout the SEC.
- Evaluate whether the HSPD-12 processes and procedures are consistently applied throughout the SEC (*i.e.*, at headquarters and regional offices).

## Results

The audit identified deficiencies in nearly every aspect of the SEC's HSPD-12 program, as well as significant concerns about the SEC's authority to determine eligibility for access to classified information and the current process for granting temporary access to SEC facilities. We also found that the SEC has missed virtually all the deadlines established by OMB guidance for implementation of HSPD-12 and continues to remain noncompliant as a result of delays in verifying or completing background investigations for 1,263 employees who have more than 15 years of federal government service.

In addition, the audit found that the SEC is currently unable to determine the actual number of contractors who are employed by the SEC and, thus, there is a serious question as to whether the SEC accurately reported its statistics related to contractors in its December 31, 2010, quarterly HSPD-12 Implementation Status Report to OMB. Further, during our audit, we compared the SEC's September 2010 quarterly HSPD-12 Implementation Status Report with reports of (1) other federal financial agencies, and (2) federal agencies of similar size to the SEC, and we found that the SEC lagged well behind both groups.

The audit also found that since June 30, 2008, the SEC has adjudicated and determined the eligibility of 26 employees and contractors to access classified information without receipt of delegated authority from the Director of National Intelligence (DNI), which Executive Order 13467 established as the final authority to designate an agency to make such determinations. We also found that the SEC's determinations of eligibility for access to classified information were based on incorrect policies and procedures. Additionally, we found that OAS's Physical Security Branch is making eligibility determinations for applicants seeking temporary access to SEC facilities without the proper authority. Moreover, the Physical Security Branch is not

using the appropriate standards for making these determinations.

The audit determined that the SEC's regional offices have not consistently enrolled PIV badges into the SEC's physical access control system. We also found that the SEC's badging policy is outdated and does not include policies and procedures for issuing and revoking badges, or for requiring the use of the PIV credentials as the common means of authentication for access to SEC facilities and information systems. We further found that OHR's Personnel Security Branch does not have policies or procedures specific to adjudicating foreign nationals.

Further, the audit determined that OIT's asset inventory does not account for keyboards (some of which contain card readers that could be used to authenticate PIV credentials) and lacks detail necessary to identify laptops that have card readers, which may cause OIT to unnecessarily purchase new keyboards and laptops with card readers or external card readers. In addition, the audit found that the SEC expended a total of approximately \$144,000 to employ registrars between June 2009 and December 2010, which would have been avoided if the SEC had implemented HSPD-12 within the required timeframes. Moreover, the audit found that based on the average number of transactions processed per day, the SEC requires only one part-time registrar. We concluded that the agency could save \$108,000 annually by employing one part-time registrar rather than two full-time registrars.

Finally, our audit found that OAS's Physical Security Branch is not maintaining visitor record logs in accordance with the National Archives and Records Administration's General Records Schedule retention requirement of two years. We noted that the failure to retain these records for the required time period hampers the Physical Security Branch's ability to analyze visitor logs effectively to determine

if visitors are accessing the agency inappropriately by circumventing the badging process.

## Recommendations

On March 31, 2011, the OIG issued a final report containing the results of its audit. The report included 25 recommendations that, once fully implemented, should ensure the Commission's compliance with HSPD-12. Of the 25 recommendations, seven were directed to OHR, ten were directed to OAS, five were directed to the Office of the Executive Director (OED), and three were directed to OIT. The report's recommendations were as follows:

- (1) OHR should immediately prepare formal, documented plans for initiating background investigations for all current employees who do not have successfully adjudicated background investigations on record, commensurate with risk.
- (2) OHR should immediately, but no later than 90 days after the issuance of this report, initiate background investigations for all current employees who do not have successfully adjudicated background investigations on record, commensurate with risk.
- (3) OAS should identify and develop a consolidated list of all contractors who are employed by the Commission. In addition, OAS should coordinate with the Contracting Officer's Technical Representatives and Inspection and Acceptance Officials to implement policies and procedures for ensuring that the list remains updated.
- (4) OAS should provide the OHR's Personnel Security Branch with a copy of the updated consolidated contractor list on a weekly basis.
- (5) Upon receipt of the updated consolidated contractor list, OHR's Personnel Security Branch should determine which contractors do not have successfully adjudicated background investigations on record and develop a plan to begin the required background investigations immediately.
- (6) Upon receipt of the updated consolidated contractor list, OHR should ensure that accurate status reporting has been made to OMB.
- (7) OED should discontinue adjudicating all eligibility determinations for access to classified information or holding a sensitive position until the SEC has received an appropriate delegation of authority to conduct such determinations from the DNI.
- (8) OED should identify all eligibility determinations for access to classified information or holding a sensitive position adjudicated by the SEC since June 30, 2008, and, upon receipt of authority from the DNI, conduct a quality control assessment to ensure that the determinations were conducted in accordance with the uniform policies and procedures developed by the DNI.
- (9) OED, upon receipt of authority from the DNI to make eligibility determinations for access to classified information or holding a sensitive position, should use the uniform policies and procedures developed by the DNI when making such determinations.
- (10) OAS should immediately discontinue making eligibility determinations for persons requiring temporary access to the SEC's facilities or information systems without proper authorization.

- (11) OAS should immediately provide OHR's Personnel Security Branch with a list of all persons who have been provided or denied access based on the Physical Security Branch's risk assessments, as well as a copy of all fingerprints records, supporting documentation, and the results of the risk assessments.
- (12) OHR, in coordination with OAS, should develop policies and procedures for determining the eligibility of contractors, visitors, and guests requiring temporary access to the SEC's facilities or information systems.
- (13) OAS should communicate to regional office staff its expectations for enrolling PIV credentials into their physical access control systems and using PIV credentials as the primary badge for physical access to the SEC's facilities.
- (14) OAS should require administrative officers in the regional offices, or designated points of contact, to enroll PIV cards in the SEC's physical access control system.
- (15) OED should communicate to all SEC employees and contractors their responsibility to inform the appropriate regional office official that they have been issued a PIV card so that the card can be enrolled into the SEC physical access control system.
- (16) OED should develop and implement a policy requiring the PIV badge to be used as a common and primary means of authentication for physical and logical access.
- (17) OAS should revise and update its "Identification Cards, Press Passes and Proximity Access Control Cards" policy to reflect current and proper practices for issuance and revocation of badges, including PIV cards, to SEC employees and contractors at all Commission facilities and post the revised policy on the Commission's intranet site. In addition, OAS should communicate the new policy to all employees and contracting officials.
- (18) OAS should develop and implement a plan to systematically revoke all Commission-issued badges for all employees and contractors who have been issued HSPD-12 badges and ensure that the plan is implemented no later than six months after the date of issuance of the OIG's report.
- (19) OHR should develop, implement, and post in multiple locations (*e.g.*, agency intranet site, human resources offices, regional offices, contractor orientation) its appeals procedures for individuals who are denied credentials or whose credentials are revoked.
- (20) OHR should develop internal policies and procedures for suitability determinations for foreign nationals.
- (21) OIT should immediately conduct an audit of its inventory to identify and track all keyboards and laptops that contain card readers.
- (22) OIT should promptly deploy appropriate technology (*e.g.*, laptops with internal card readers, keyboards with card readers, or external card readers) to employees and contractors who do not have card readers.
- (23) OIT should eliminate one full-time registrar and split the time of the other full-time registrar between the SEC's Operations Center in Alexandria, Virginia, and its headquarters location.

- (24) OAS should retain visitor control logs for a period not less than two years after final entry or two years after date of document in accordance with the National Archives and Records Administration's General Records Schedule.
- (25) OAS should perform periodic analysis of visitor data to ensure that visitors are not circumventing the HSPD-12 requirements.

Management fully concurred with all 25 recommendations and has initiated actions to address the issues described in the report. The OIG's report, *The SEC's Implementation of and Compliance with Homeland Security Presidential Directive 12*, is available on our website at <http://www.sec-oig.gov/Reports/AuditsInspections/2011/481.pdf>.

## **OCIE Regional Offices' Referrals to Enforcement (Report No. 493)**

### **Background**

The mission of OCIE is to conduct and coordinate the nationwide examination program for entities over which the SEC has regulatory authority. While conducting inspections and examinations, OCIE staff review the books and records of regulated entities, conduct interviews with management and firm employees, and analyze the entities' operations. One goal of the examination or inspection is to determine if the registrant is in compliance with federal securities laws and regulations. When the registrant's noncompliance or internal control failures are considered serious, the staff may refer the matter to the Division of Enforcement (Enforcement), which then determines whether to investigate the matter further and, ultimately, whether to recommend an enforcement action to the Commission. Many of the Commission's enforcement actions each year are derived from the examination program's referrals to Enforcement.

On March 31, 2010, the SEC OIG issued a Report of Investigation entitled *Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme* (OIG Investigative Report No. 526). In that report, the OIG found that the SEC's Fort Worth Regional Office had been aware since 1997 that financier Robert Allen Stanford was likely operating a Ponzi scheme. The investigation also discovered that after a series of OCIE examinations of Stanford Group Company (Stanford's registered investment adviser) in which each examination concluded that the likelihood of a Ponzi scheme or similar fraud existed, the SEC's Fort Worth Enforcement unit did not take significant action to investigate such suspected fraud until late 2005. The OIG investigation found that SEC-wide institutional influences within Enforcement did factor into its repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. The OIG investigation found that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called "stats," and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered "quick-hit" or "slam-dunk" cases, were not encouraged.

On September 22, 2010, the U.S. Senate Committee on Banking, Housing, and Urban Affairs held a hearing on the SEC's investigation and response to Robert Allen Stanford's alleged Ponzi scheme. The Committee heard testimony from SEC officials about the Stanford matter and sought information concerning the steps the agency was taking to prevent future financial frauds and restore investor confidence. Then-Committee Chairman Christopher J. Dodd (D-Connecticut) expressed concern that there may be other instances in which Enforcement did not pursue cases identified by regional office examiners because of the perception that SEC headquarters in Washington was only interested in "stats" and "quick hit" cases. Chairman



Dodd requested that the SEC OIG conduct a review to determine if the concerns about the Fort Worth Regional Office found in the OIG's Stanford report also existed in other SEC regional offices.

The objectives of the OIG's audit were as follows:

- Determine whether and to what extent OCIE examiners were frustrated in matters other than Stanford where Enforcement did not pursue cases identified by examiners in the SEC regional offices.
- Determine if Enforcement has taken appropriate and sufficient action to address referrals received from OCIE examination staff in the SEC regional offices.
- Determine if problematic trends exist where appropriate action was not taken based on an OCIE referral and where improvements are needed and best practices can be identified to enhance the OCIE examination referral process in the SEC regional offices.

## Results

The OIG found that examiners across the SEC regional offices are generally satisfied with their Enforcement attorney counterparts. For example, the OIG found through a survey of all OCIE examiners throughout the SEC regional offices that most survey respondents indicated that they are either "completely satisfied" or "somewhat satisfied" with actions taken by Enforcement in response to examination-related referrals. Specifically, the OIG found that when combining the responses for "completely satisfied" and "somewhat satisfied" for respondents, the majority of SEC regional offices had a combined level of satisfaction ranging from 70 to 87 percent. We further found that where there was dissatisfaction with the referral process, the level of concern dramatically dropped over time and par-

ticularly in FY 2010, with some respondents identifying Enforcement's newly-created Asset Management Unit as having significantly assisted with the acceptance rate of OCIE referrals.

We also found that the large majority of examiners do not believe that Enforcement will only take referrals that involve high dollar value amounts and cases that can easily be brought against the violator. In addition, many of the survey participants who did believe that Enforcement was particularly concerned with dollar thresholds or "stats" noted that this approach was more evident in the past, *i.e.*, "prior to Madoff."

The OIG audit did find certain aspects of the referral process that could use improvement. We found that OCIE sometimes presents referrals informally to Enforcement prior to proceeding with the formal referral process. As a result, there is a concern that not all referral-worthy matters may be captured. We also found that internal concerns over incentives and metrics with regard to the percentage of OCIE referrals being accepted by Enforcement may have led OCIE senior officials to request that a particular referral not be captured in the Tips, Complaints, and Referrals (TCR) system to avoid the risk of having large numbers of outstanding referrals. We also found that the level of communication between OCIE and Enforcement after a referral is not always consistent in the regional offices. As a result, a number of examiners indicated that they were unaware of the current status of referrals they provided to Enforcement. Further, OCIE and Enforcement use different systems to track referrals, and those systems do not currently interface with each other. In addition, while the SEC established a Home Office Enforcement Referral Review Committee to serve as an integral part of the oversight of the referrals process, the lack of full cooperation from some regional offices limited the Committee's ability to bring more transparency and consistency to Enforcement decisions to pursue referrals.

## Recommendations

On March 30, 2011, the OIG issued a final report containing the results of its audit. The report included the following seven recommendations that were designed to result in significant improvements to the enforcement referrals process and ensure that all referral-worthy matters are appropriately captured and tracked:

- (1) OCIE and Enforcement should carefully review the information provided from the OIG survey regarding the situations where OCIE examiners expressed serious concerns that enforcement action was unsatisfactory, particularly where the examiners believed there was ongoing wrongdoing, and take appropriate action, including potentially reversing previous Enforcement decisions, as necessary.
- (2) OCIE and Enforcement should take appropriate actions to enforce the policy in all regional offices that all OCIE referrals are made in writing using the standard Enforcement Referral Cover Memorandum or an equivalent record, as appropriate in light of the new TCR system and other programmatic changes.
- (3) OCIE should issue policy or guidance requiring OCIE examiners in regional offices to formally refer all significant matters to Enforcement, not merely the matters that Enforcement has already decided to accept.
- (4) OCIE should take appropriate actions to enforce its policy in all regional offices that all OCIE referrals be uploaded into the TCR system regardless of whether Enforcement has accepted the referral.
- (5) OCIE should ensure that all referrals currently in the Super Tracking and Reporting System (STARS) are appropriately and adequately updated with the information in the Home Office Enforcement Referral Review Committee spreadsheet.
- (6) OCIE and Enforcement should continue their efforts to establish a complete interface between STARS or its equivalent, the Hub Enforcement case tracking system, and the TCR system.
- (7) OCIE and Enforcement should determine the future of the Home Office Enforcement Referral Review Committee. If the Committee will not continue, they should ensure that its responsibilities are carried out by another office or group that will continue to oversee the referral process and track outstanding referrals in a meaningful way.

Management fully concurred with all of the OIG's recommendations. The OIG's report, *OCIE Regional Offices' Referrals to Enforcement*, is available on our website at <http://www.sec-oig.gov/Reports/AuditsInspections/2011/493.pdf>.

## Audit of the SEC Budget Execution Cycle (Report No. 488)

### Background

The OIG contracted the services of Acuity Consulting, Inc. (Acuity) to conduct an audit of the SEC's budget execution process and to identify potential areas for improvement. The SEC is financed through an annual general fund appropriation that is enacted by Congress that may remain available until expended, and through occasional supplemental appropriations that are available for a specified period of time. During FYs 2009 and 2010, as in other years, the SEC's annual general fund appropriation consisted of a

“Salaries and Expenses” account within the President’s Budget. In FYs 2009 and 2010, the SEC obligated over \$966 million and \$1.1 billion, respectively, against the funds available. Pursuant to Public Law 111-32, enacted on June 24, 2009, the SEC received a supplemental appropriation of \$10 million that was available for FYs 2009 and 2010 for the statutory purpose of “investigation of securities fraud.”

The SEC’s Office of Financial Management (OFM) administers the agency’s financial management and budget functions. OFM’s Planning and Budget Office is responsible for the formulation and execution of the SEC’s budget. OFM uses two software applications for the budget development and budget execution processes: (1) the Budget and Program Performance Analysis System (BPPAS), an activity-based costing/performance-based budgeting software application that is used for the budget planning and formulation process and for developing the annual operating budget, and (2) Momentum, the SEC’s core financial system of record, which is used to record all the SEC’s budget execution and accounting transactions.

Although the SEC budget process consists of formulation, submission, approval, execution, and reporting, the focus of our audit was the budget execution process, which includes the enactment of an appropriation, obtaining the OMB’s approval of an apportionment (*i.e.*, a plan to spend resources that identifies amounts legally available for obligations and expenditures), and making allocations and suballocations to the SEC’s various offices and divisions. After apportionment, OFM staff load the funding allocations as reflected in BPPAS to Momentum, and these amounts are then available for commitment and obligations.

The overall objective of the audit was to determine whether sufficient management controls over the SEC’s budget execution process were in place and operating effectively.

## Results

The audit identified a number of control deficiencies concerning the SEC’s budget execution process. Specifically, the audit found that the SEC may have violated 31 U.S.C. § 1301, commonly referred to as the Purpose Statute, due to inconsistent appropriations selection on contract modifications for information technology acquisitions and expert witness fee services once an appropriation had been selected for the initial contract. The audit identified a total of eight contracts that inconsistently cited appropriations once the initial appropriation was selected.

Guidance found in the GAO’s “Principles of Federal Appropriations Law” provides that when two appropriations are available for the same purpose, an agency is required to select one appropriation and continue to use that appropriation consistently throughout its availability, unless the statutory language clearly demonstrates Congressional intent to make one appropriation available to supplement or increase a different appropriation for the same type of work. We found no express language in the act containing the supplemental appropriation that clearly demonstrated Congressional intent to have both appropriations available for the same type of work. As a result of the SEC’s failure to select and use one appropriation consistently, the SEC may have violated the Purpose Statute during the period when the supplemental appropriation was available for obligation. In addition, we determined that the SEC may have violated the Antideficiency Act, 31 U.S.C. § 1341(a), as the supplemental appropriation no longer had sufficient funds to accommodate adjustment of the potential Purpose Statute violation. We consulted with the GAO and were advised that a formal opinion was appropriate to resolve the matter.

The audit also found that an OFM staff member inactivated the Momentum financial system budgetary controls to facilitate the processing of payroll transactions without

authorization from senior or executive management. The inactivation of Momentum budgetary controls allowed the sum of the allocation amounts issued in FY 2010 to exceed the FY 2010 apportionment. We determined that the SEC's allocations exceeding the apportionment was contrary to both OMB guidance and the SEC's internal regulations, and that the inactivation of budget controls by OFM staff could lead to a violation of the Antideficiency Act, 31 U.S.C. § 1517(a).

Further, the audit found that the BPPAS system is configured to track only one appropriation symbol. As a result, the SEC does not have full visibility of its budgetary authority and the purposes for which it is used. In an environment of multiple appropriations, as will be the case in FY 2012 with the establishment of the SEC reserve fund appropriation established under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC needs to have BPPAS configured to accept more than one appropriation to avoid an increased level of manual override activity and mitigate the increased effort required to support additional Congressional reporting requirements. In the absence of full visibility of purpose and use of funds, the SEC may be at risk of future Purpose Statute and Antideficiency Act violations related to multiple appropriations.

The audit also found that OFM does not have a formal budgetary training program to ensure that its personnel with budgetary responsibilities are appropriately trained and are aware of the requirements associated with their job functions. In addition, the audit identified a deficiency in the design of internal controls in that OFM does not require written authorization of reprogramming and realignment actions between two-digit Budget Object Classes. Further, OFM's reprogramming and realignment actions are subject to a diminished audit trail and a lack of timely monitoring throughout the year of budget execution. As a result, the SEC has an increased risk of exceeding established Appropria-

tions Act reprogramming thresholds during the year of execution.

## Recommendations

On March 29, 2011, the OIG issued a final report containing the result of its audit. The report included the following nine recommendations to OFM that were designed to address vulnerabilities identified in the audit:

- (1) In consultation with OGC, request a formal opinion from the Comptroller General as to whether the SEC violated the Purpose Statute and, as a consequence the Antideficiency Act, by charging certain costs of information technology projects and expert witness fees to both the general and supplemental appropriations.
- (2) In consultation with OED and OGC, establish policies and guidance on how to fund expenditures where there are multiple appropriations available for the same purpose.
- (3) Complete a risk reassessment and include the inactivation of Momentum budget controls as a high-risk area in the OFM Reference Guide 01-06, "General Guidance: Override of Internal Control."
- (4) Revise the Internal Control Override Template included in OFM Reference Guide 01-06, "General Guidance: Override of Internal Control," to include a section for follow-up actions to ensure financial integrity or statutory compliance and ensure that significant overriding of financial controls be required to be approved by senior-level officials.
- (5) Formally document its allotments as required by Appendix H of OMB Circular A-11 to evidence the transfer of legal responsibility for funds to the recipient.

- (6) Initiate a review of the BPPAS capability to accommodate multiple appropriations.
- (7) In consultation with OHR, develop and establish a formal, ongoing SEC-focused budgetary training program.
- (8) Revise the current reprogramming and realignment procedures to require that the Budget Officer or the Assistant Director, Planning and Budget, approve all reprogramming and realignment actions that cross two-digit Budget Object Classes in writing.
- (9) Establish a process to sufficiently and accurately track reprogramming and realignment activities in one central location.

Management fully concurred with all of the OIG's recommendations and has initiated action to address the issues described in the report. The OIG's report, *Audit of the SEC Budget Execution Cycle*, is available on our website at <http://www.sec-oig.gov/Reports/AuditsInspections/2011/488.pdf>.

## **Review of Time-And-Materials and Labor-Hour Contracts (Report No. 487)**

### **Background**

The Office of Acquisitions in the SEC's OAS is responsible for the Commission's contract and procurement activities and processes, which are governed by the Federal Acquisition Regulation (FAR). While OA oversees the procurement responsibilities, the SEC divisions and offices are responsible for preparing initial procurement requisitions and statements of work. OA consists of four primary branches, each led by a branch chief and staffed with contracting officers, contract specialists, and contractor support personnel.

The OIG contracted with Regis and Associates, PC (Regis), an independent public accounting firm, to review select time-and-materials and labor-hour contracts to determine whether payments on the contractor invoices were properly supported and whether the goods and services provided conformed to contractual requirements. The specific objectives of the review were to determine whether:

- (1) The qualifications of employees billed to the contracts, by labor category, met the contractual qualification requirements for the positions.
- (2) Assigned Contracting Officer's Technical Representatives (COTR) properly reviewed contractors' invoices, corresponding timesheets, and other necessary supporting documentation to ensure that costs were allowable, reasonable, and allocable to the contracts, and that the rates and amounts billed did not exceed contract rates and ceiling amounts.
- (3) The SEC adequately monitored all aspects of current and past contractors' performance to ensure that goods and services provided conformed to contractual requirements.

Regis reviewed the following two contracts:

- SEC Contract No. SECHQ1-06-C-0436, a time-and-materials contract awarded to XBRL US, Inc.
- SEC Contract No. SECHQ1-07-C-0313, a labor-hour contract awarded to Dozier Technologies, Inc.

The SEC awarded Contract Number SECHQ1-06-C-0436 to XBRL US, Inc., to develop a U.S. Generally Accepted Accounting Principles Financial Statement Taxonomy,

as well as other deliverables described in the contract. The principal purpose of the taxonomy is to provide a basis for public companies to report their financial information in an interactive data format. The SEC awarded this time-and-materials contract on March 5, 2007, and issued six modifications that extended the performance period of the contract through June 28, 2008, and increased the contract amount from \$5,905,420 to \$11,889,462.

The SEC awarded Contract Number SECHQ1-07-C-0313 to Dozier Technologies, Inc., on September 7, 2007. The contract had a base value of approximately \$1,525,157, with options to increase the value to \$3,500,000. The purpose of this labor-hour contract was to provide contracting support services and to assist in the administration of a new procurement system. The SEC exercised the options in the form of 15 modifications to the full value of \$3,500,000.

## Results

The review identified a number of deficiencies concerning the contracts reviewed related to documentation, the qualifications of SEC staff responsible for the day-to-day oversight of the XBRL US, Inc. contract, and inclusion of labor category qualifications in the XBRL US, Inc., contract. These controls help to ensure that the government's surveillance of contractor performance provides reasonable assurance that efficient methods and effective cost controls are being used in time-and-materials and labor-hour contracts.

The review found that the acceptance of deliverables was not adequately documented. Although the assigned Technical Point of Contact (TPOC) for the XBRL US, Inc., contract stated that a panel comprised of individuals from the Division of Corporation Finance, the Office of the Chief Accountant, and OIT reviewed and accepted or rejected deliverables for the contract, the TPOC could not provide documentation to substantiate this

review process for accepting contract deliverables, valued in excess of \$11 million.

The review also found that the XBRL US, Inc., contract was managed daily by an SEC employee who did not have the requisite contract training. We found that the Contracting Officer appointed an SEC employee as the TPOC for the contract, who essentially served as an Inspection and Acceptance Official. No COTR was appointed, even though the contract was (1) highly technical, (2) a time-and-materials contract requiring monitoring of hours and approval of other direct costs, including travel, and (3) valued at almost \$6 million at the time of award. Additionally, we found that the TPOC performed COTR-type duties, such as overseeing the contract on a daily basis by providing guidance and direction to the contractor, and approving monthly invoices. Without proper training, an individual assisting the Contracting Officer in managing a complex contract may not be aware of all the requirements he or she is obligated to follow. As a result, there is a significant risk that the Commission's policies and procedures may not be followed and that value may not have been received for services provided.

For the Dozier Technologies, Inc., contract, the review found inconsistent documentation support for various invoices, including eight invoices totaling approximately \$156,532 that appeared unsupported by timekeeping records or similar documentation. Two of the invoices submitted by the contractor, totaling approximately \$12,398, contained no supporting documentation other than summary information on the invoice stating the labor category, labor rate, and total hours billed. The other six invoices could only be substantiated with sign-in sheets provided by OAS for some of the billed labor amounts. The supporting documentation for these eight invoices did not contain the same level of support as the other invoices submitted for this contract by the contractor. Accordingly, the OIG identified questioned costs of \$156,532 as a result of this review.

Additionally, the XBRL US, Inc., contract did not include the qualifications for labor categories that were charged to the contract, as required by the FAR. We found that the SEC did not include in the terms of the contract qualifications for the labor categories upon which hourly charges would be based (e.g., Taxonomist I, Architect I, Subject Matter Expert, Project Support Specialist). In February 2007, FAR Section 16.6, “Time-and-Materials and Labor-Hour Contracts,” expanded the definition of “hourly rate” to the “rate(s) prescribed in the contract for payment of labor that meets the labor category qualifications . . . .” Additionally, FAR § 52.232-7, “Payments under Time-and-Materials and Labor-Hour Contracts,” which was incorporated by reference in the contract, states in part that “the Contractor shall substantiate vouchers (including any subcontractor hours reimbursed at the hourly rate in the schedule) by evidence of actual payment and by . . . [r]ecords that verify the employees meet the qualifications for the labor categories specified in the contract . . . .” Within the first seven months of the contract, the SEC executed three modifications, which increased the number of labor categories from 11 to 23 and the funding from \$5,905,420 to \$11,889,461. These modifications did not include the specifications for additional labor categories.

## Recommendations

On December 22, 2010, the OIG issued its final report containing the results of its review. The report included the following six recommendations to OA that were designed to improve OA’s management of time-and-materials and labor-hour contracts:

- (1) Develop a standardized inspection and acceptance form or similar medium to document the acceptance of goods and services for all deliverables, and include in such documentation information regarding who accepted the deliverables and

whether deliverables met applicable criteria and quality standards in the contract.

- (2) Revise or update the appropriate SEC regulations to explicitly require use of a standardized inspection and acceptance form or similar medium for all deliverables.
- (3) Review active contracts to ensure agency contracts are appropriately assigned a COTR or Inspection and Acceptance Official.
- (4) Issue guidance within one month of the issuance of the final report to the acquisition staff and approving officials, such as COTRs and Inspection and Acceptance Officials, regarding the proper procedures for review, approval, and documentation of contractor payments for time-and-materials and labor-hour contracts.
- (5) Review, in consultation with OFM, the \$156,532 in unsupported payments made to Dozier Technologies, Inc., to determine what, if any, corrective actions are warranted (e.g., requiring the contractor to provide adequate support, refund monies for unsupported costs).
- (6) Ensure that all future time-and-materials and labor-hour contracts contain applicable labor category qualifications in accordance with the FAR.

Management fully concurred with all six recommendations and has begun to take appropriate steps to implement them. The OIG’s report, *Review of Select Time-and-Materials and Labor-Hour Contracts*, is available on our website at <http://www.sec-oig.gov/Reports/AuditsInspections/2010/487-Final.pdf>.

## 2010 Annual FISMA Executive Summary Report (Report No. 489)

The OIG contracted the services of C5i Federal, Inc. (C5i), to assist with the completion and coordination of the OIG's input to the Commission's response to OMB Memorandum M-10-15, FY 2010 Reporting Instructions for the Federal Information Security Management Act and Agency Privacy Management. The OMB memorandum provided instructions and templates for meeting the FY 2010 reporting requirements under the Federal Information Security Management Act of 2002 (FISMA). It also included instructions for reporting on the agency's privacy management program.

FISMA provides the framework for securing the federal government's information technology resources. All federal agencies must implement the requirements of FISMA and report annually to OMB and Congress on the effectiveness of their information security and privacy programs. OMB uses the reported information to evaluate agency-specific and government wide privacy program performance, develop OMB's annual security report to Congress, assist in improving and maintaining adequate agency security and privacy performance, and assist in the development of the E-Government scorecard under the President's Management Agenda.

C5i began work on this project in September 2010. The overall objective of the OIG's FISMA assessment was to independently evaluate and report on how the Commission has implemented its mandated information security requirements. The assessment was also designed to provide background information, clarification, and recommendations for the OIG's response and input to the OMB reporting template for FISMA.

### Results

The OIG's FISMA assessment found the following:

- The Commission has developed a Certification and Accreditation (C&A) program that is compliant with applicable regulatory and statutory requirements. However, as noted in OIG Report No. 485, *Assessment of the SEC's Privacy Program*, issued on September 29, 2010, OIT's categorization of network vulnerabilities may impact the C&A process, and OIT is reevaluating its risk categorization process.
- The SEC has a Security Configuration Management program that has policies and procedures, baselines, and an inventory of software and hardware. However, as also noted in OIG Report No. 485, OIT has not fully implemented the Federal Desktop Core Configuration, exceptions have not been reported to the National Institute of Standards and Technology (NIST), and justifications for identified "exceptions" have not been fully documented.
- OIT has an Incident Response and Reporting Program with documented policies and procedures, detailing SEC employee and contractor roles and responsibilities in reporting and responding to incidents.
- Annual Security Awareness Training was provided to all SEC employees and contractors. As of November 15, 2010, 4,732 of 4,778 SEC employees and contractors (99.04 percent) successfully completed this training.
- OIT maintains a Plan of Actions and Milestones (POA&M) process that details the vulnerability, associated NIST controls, remediation/mitigation strategy, risk level, and projected/planned remediation date. The POA&M is reviewed and updated quarterly and tracked using the Cyber Security Assessment and Management tool.



- The SEC has a Remote Access Program that complies with federal guidance and employs security measures such as a two-factor authentication requirement consisting of an account password and an RSA token with a personal identification number.
- The SEC has an Account and Identity Management Program with policies and procedures for both establishing and deactivating physical and logical (network) accounts. However, the HSPD-12 card program completion date was delayed for both physical access and logical access. Additionally, OIT has not effectively applied “least privilege” for network accounts (*i.e.*, allowing only access required to perform the user’s required functions) for certain network accounts that provided the user with the ability to install software and change mandatory settings.
- The SEC has a Continuous Monitoring Program that includes vulnerability scanning, patch management policies and procedures, and ongoing assessment of security controls. However, as noted in OIG Report No. 485, a problem exists with the timely implementation of new patches. Further, OIT maintains insufficient documentation on which patches have been deployed and the date of deployment.
- The SEC has a Contingency Planning Program with documented policies and procedures. Contingency plan testing is performed biannually, in April and November, and “lessons learned” from the testing exercises are developed and addressed.
- The SEC has a Contractor Oversight Program, as well as documented policies and procedures utilizing adequate security controls in accordance with NIST and OMB guidance.

## Recommendations

On March 3, 2011, the OIG issued a final report containing the results of its assessment. The report included the following eight recommendations that were designed to address vulnerabilities identified in our assessment:

- (1) OIT should identify all exceptions to the Federal Desktop Core Configuration standards and submit them to NIST within 90 days of the issuance date of the OIG’s FISMA report.
- (2) OIT should ensure that justifications for deviations from Federal Desktop Core Configuration requirements are fully documented.
- (3) OIT should:
  - (a) perform a thorough review and identify the universe of all Commission user accounts;
  - (b) once the universe has been identified, identify all active and inactive user accounts and determine whether any accounts should be disabled; and
  - (c) take immediate action to disable the accounts of employees and contractors who no longer work at the Commission.
- (4) OIT should review its policies and procedures for disabling accounts to ensure that they are well-documented and thorough, and should provide training to appropriate staff regarding account termination procedures.
- (5) OIT should complete the logical access integration of the HSPD-12 card program no later than December 2011, as it reported to OMB on December 31, 2010.

- (6) OIT should conduct a full review, and identify the universe, of all users with elevated privileges.
- (7) Based on the review results of Recommendation 6, OIT should enforce or develop procedures to ensure that:
  - (a) only users whose job functions require permanent elevated access have the needed privileges;
  - (b) business justifications are fully documented; and
  - (c) elevated privileges are only issued for the finite amount of time needed to complete an assigned task.
- (8) OIT should establish and maintain an accurate and current list of all users who have elevated privileges.

Management fully concurred with all eight recommendations and has initiated actions to address the issues described in the report. The OIG's report, *2010 Annual FISMA Executive Summary Report*, is available on our website at <http://www.sec-oig.gov/Reports/AuditsInspections/2011/489.pdf>.

## PENDING AUDITS AND EVALUATIONS

### **Oversight of and Compliance with Conditions and Representations Related to Exemptive Orders and No-Action Letters**

The SEC has authority to provide firms with exemptions to the requirements of the federal securities laws through the issuance of exemptive orders. Firms request exemptions from the SEC for proposed transactions, products, or services that might not comply with current securities law requirements. If the SEC grants an application for an exemption, the requestor must adhere to the conditions of the exemptive order issued by the Commission, or a division acting pursuant to

delegated authority. Additionally, the SEC staff may provide relief to firms in the form of a “no-action” letter. A staff no-action letter includes the specific representations made in a firm’s request, and advises the firm that if it proceeds as described in the request for no-action relief, the SEC staff will not recommend an enforcement action against the firm. Exemptive orders and no-action letters provide the industry with the flexibility to introduce new and novel products and services to the securities markets without risking an SEC enforcement action for violating the securities laws.

The OIG is performing an audit to evaluate the SEC’s processes for ensuring adherence to the conditions under which exemptive orders are granted and the representations based upon which no-action letters are issued. In this audit, the OIG will assess the applicable SEC policies, procedures and processes and make recommendations for improvement, as warranted. The OIG will also interview SEC managers and staff involved in the exemptive order and no-action letter processes, which primarily include staff in the Divisions of Investment Management, Corporation Finance, and Trading and Markets. In addition, the OIG will conduct a review of relevant documents and analyze pertinent data in order to determine whether applicants are complying with the conditions and representations in the exemptive orders and no-action letters that have been granted or issued.

### **Audit of Alternative Work Arrangements, Overtime Compensation, and the COOP Program at the SEC**

The U.S. Office of Personnel Management (OPM) has recognized the importance of alternative and flexible work schedules in the federal government. Specifically, OPM’s Handbook on Alternative Work Schedules (AWS) provides that “AWS programs have the potential to enable managers and supervisors to meet their program goals while, at the same time, allowing employees to be more flexible

in scheduling their personal activities. As employees gain greater control over their time, they can, for example, balance work and family responsibilities more easily, become involved in volunteer activities, and take advantage of educational opportunities. The employee benefits provided by AWS programs also are useful recruitment and retention tools.” In addition, Section 622 of the Consolidated Appropriations Act of 2005, Public Law 108-447, required the SEC, not later than two months after the date of the enactment of the Act, to certify that telecommuting opportunities are made available to 100 percent of the eligible workforce. The Act further provided that the agency shall designate a telework coordinator to be responsible for overseeing the implementation and operations of telecommuting programs, and serve as a point of contact on such programs for the U.S. Senate and House of Representatives Committees on Appropriations. More recently, the Telework Enhancement Act of 2010, Public Law 111-292, was enacted on December 9, 2010, providing a framework for agencies to better leverage technology and maximize the use of flexible work arrangements.

The OIG is conducting an audit of the SEC’s AWS and telework programs. The OIG is also reviewing the SEC’s Continuity of Operations Plan (COOP), remote access capabilities, and overtime compensation practices as they relate to AWS and telework. Specifically, the OIG will examine the SEC’s (1) implementation and oversight of its AWS and telework programs, (2) compliance with applicable federal laws and SEC policies and procedures pertaining to AWS, telework, and overtime, and (3) information technology capabilities and access support for the telework and COOP programs.

### **Audit of the SEC’s Employee Recognition Program and Retention, Relocation, and Recruitment Incentives**

The SEC employee recognition program (ERP) is designed to motivate employees and

recognize employee contributions above and beyond normal job requirements with monetary and non-monetary awards. Awards may be granted for contributions either within or outside of the employee’s job responsibilities; however, if the contribution is within the employee’s job responsibilities, the contribution must be so superior or meritorious that it warrants special recognition. The SEC also provides recruitment, relocation, and retention incentives to its employees that are based on the “best interest” of the SEC. The SEC’s OHR is responsible for ensuring the integrity of awards and incentives that are provided to SEC employees.

The SEC OIG is performing an audit of the ERP and retention, relocation, and recruitment incentive programs to determine whether awards and incentives were made in accordance with applicable governing policies and procedures. Additionally, the SEC OIG will examine whether awards and incentives are linked to the SEC’s human capital and succession plans, as applicable.

### **2010 Federal Information Security Management Act Assessments**

As part of the OIG’s FISMA assessment, we contracted with an outside consultant to conduct assessments of two major SEC information technology security components: (1) the SEC’s continuous monitoring efforts for its information technology operations, and (2) the SEC’s oversight of contractors’ handling of SEC Personally Identifiable Information.

The assessment of the SEC’s continuous monitoring efforts will identify strengths and weaknesses in that program. The assessment of the SEC’s oversight of contractors’ handling of SEC Personally Identifiable Information will determine whether SEC contracts with third-party vendors contain appropriate language addressing requirements of the Privacy Act of 1974 pertaining to protection of Personally Identifiable Information.





# SEMIANNUAL REPORT TO CONGRESS

## INVESTIGATIONS

### OVERVIEW

The OIG’s Office of Investigations responds to allegations of violations of statutes, rules, and regulations, and other misconduct by SEC staff and contractors. The misconduct investigated ranges from criminal wrongdoing and fraud to violations of SEC rules and policies and the government-wide standards of ethical conduct.

The Office of Investigations conducts thorough and independent investigations into allegations received in accordance with the Quality Standards for Investigations of the Council of the Inspectors General on Integrity and Efficiency (CIGIE). During this reporting period, the Office of Investigations issued a new Investigations Manual that governs the procedures by which the OIG conducts its investigations and preliminary inquiries and implements the CIGIE’s Quality Standards. The Investigations Manual addresses the following areas: (a) authority and general policy of the OIG; (b) requisite qualifications for the OIG’s investigators, including education and experience, character, physical capabilities and fitness program, age, knowledge, skills and abilities, entry-level and in-service training, and professional development; (c) independence of the OIG’s investigators and investigations, including managing personal, external, and or-

ganizational impairments; (d) procedures and criteria for initiating an investigation or preliminary inquiry; (e) conducting investigations and preliminary inquiries, including initial investigative steps, scheduling and conducting testimony and interviews, applicable warnings and rights, protecting nonpublic information in testimony and interviews, and witness requests for confidentiality; (f) case reviews; (g) procedures for coordination with the U.S. Department of Justice (DOJ), when appropriate; (h) safeguarding grand jury information; (i) issuing reports of investigation; (j) guidelines for closing preliminary inquiries; (k) maintaining administrative files; and (l) requests for information from persons outside the SEC.

The OIG receives complaints through the OIG Complaint Hotline, an office electronic mailbox, mail, facsimile, and telephone. The OIG Complaint Hotline consists of both telephone and web-based complaint mechanisms. Complaints may be made anonymously by calling the Hotline, which is staffed and answered 24 hours a day, seven days a week. Complaints may also be made to the Hotline through an online complaint form, which is accessible through the OIG’s website. In addition to a mechanism for the receipt of complaints, the OIG’s website also provides the public with an overview of the work of the Office of Investigations, as well as links to

some investigative memoranda and reports issued by the Office. The OIG also receives allegations from SEC employees of waste, abuse, misconduct, or mismanagement within the Commission through the OIG SEC Employee Suggestion Hotline, which was established pursuant to Section 966 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and is described in the OIG SEC Employee Suggestion Hotline Section of this Report.

The OIG reviews and analyzes all complaints received to determine the appropriate course of action. In instances where it is determined that something less than a full investigation is appropriate, the OIG may conduct a preliminary inquiry into the allegation. If the information obtained during the inquiry indicates that a full investigation is warranted, the Office of Investigations will commence an investigation of the allegation. Upon the opening of an investigation, the primary OIG investigator assigned to the case prepares a comprehensive plan of investigation that describes the focus and scope of the investigation, as well as the specific investigative steps to be performed during the investigation. The OIG investigator interviews the complainant whenever feasible and conducts significant interviews under oath and on-the-record. In certain circumstances, the OIG may give assurances of confidentiality to potential witnesses who have expressed a reluctance to come forward.

Where allegations of criminal conduct are involved, the Office of Investigations notifies and works with the DOJ and the Federal Bureau of Investigation (FBI), as appropriate. The OIG also obtains necessary investigative assistance from the SEC's Office of Information Technology (OIT), including the prompt retrieval of employee e-mails and forensic analysis of computer hard drives. The OIG investigative staff meets with the Inspector General frequently to review the progress of ongoing investigations. The OIG investigative staff also consults as necessary with the

Commission's Ethics Counsel to coordinate activities.

Upon completion of an investigation, the OIG investigator prepares a comprehensive report of investigation that sets forth in detail the evidence obtained during the investigation. Investigative matters are referred to the DOJ and SEC management as appropriate. The OIG does not publicly release its reports of investigation because they contain nonpublic information. Decisions regarding whether an OIG investigative report should be publicly released, in response to a Freedom of Information Act request or otherwise, are made by the agency.

In many investigative reports provided to SEC management, the OIG makes specific findings and recommendations, including whether the OIG believes disciplinary, or other action, should be taken. The OIG requests that management report back disciplinary or other actions taken in response to the OIG's recommendations within 45 days of the issuance of the report. The OIG follows up as appropriate with management to determine the status of disciplinary action in matters referred by the OIG. The OIG also often makes recommendations for improvements in policies, procedures, and internal controls in its investigative reports, and these recommendations are tracked in a manner similar to how the OIG tracks its audit recommendations.

## **INVESTIGATIONS AND INQUIRIES CONDUCTED**

### **Investigation of Failure of an SEC Regional Office to Uncover Fraud and Inappropriate Conduct on the Part of a Senior-Level Official (Report No. OIG-533)**

The OIG opened an investigation after receiving an anonymous complaint on March 15, 2010, alleging that a senior official in the investment adviser examination program in an

SEC regional office “instructed (and even bullied) examiners to not pursue certain red flags in [a 2009] examination where the exam staff uncovered a massive fraud,” and that his motive was related to his involvement in a previous 2005 examination of the firm. The anonymous complaint also alleged that the senior official lied to OIG investigators during testimony given in a previous OIG investigation.

The OIG investigated the allegations in the complaint, focusing on the failure of the regional office to detect the fraud during its 2005 examination. In conducting the investigation, the OIG searched over 68,000 e-mails and took the testimony of 17 witnesses who had knowledge of the facts and circumstances surrounding the matter. The OIG investigation found that the regional office missed a significant opportunity to uncover a \$554 million Ponzi scheme, failed to conduct a competent and thorough examination of the investment adviser in 2005, and did not take the necessary steps to ensure that a follow-up examination of the adviser’s affiliated broker-dealer was conducted.

Specifically, the OIG investigation found that the 2005 examination of the investment adviser was flawed in numerous respects. We found that significant portions of the field work and the writing of the examination report were conducted by a very inexperienced examiner. We further found that while the examination team became aware of obvious red flags about the firm’s operations that should have been scrutinized in the examination, the examination team failed to follow up on these matters and minimized the concerns they found.

The examiners who conducted the 2005 examination acknowledged that the firm’s structure, in which clients became limited partners in the broker-dealer, was a red flag in and of itself, and that the firm’s complex investment strategy, combined with its goal of

circumventing Regulation T and unusually high leverage, was highly questionable.

In addition, the 2005 examiners made a decision before the examination to “focus on custody issues.” However, the actual examination did not include a thorough custody analysis. In fact, although 80 to 85 percent of client assets were invested in an affiliated broker-dealer, the 2005 examination team made no effort to examine these assets, even though they admitted that they were “uncomfortable” with the activities at the broker-dealer.

The 2005 examination team also identified numerous “red flags” during the course of the examination, which they noted in their examination report, but on which they did not follow up. One of the most significant concerns the 2005 examination team identified related to the poor compliance culture at the firm. The examination team concluded that the firm had “ineffective compliance procedures and practices.” They also concluded that the firm “did not consider compliance with the federal securities laws to be a priority.” They documented that the firm, a \$1.3 billion company, had hired a completely inexperienced compliance officer and purportedly could not afford compliance seminars. In addition, the 2005 examination team also found unopened boxes of trade blotters, which were supposed to have been reviewed by the firm to verify the investment strategy their investors were utilizing. However, these concerns did not trigger further scrutiny or examination.

The 2005 examination team also found “a myriad of inaccuracies” in the firm’s Form ADV. The examination report noted 15 incidents of inaccurate or incomplete information on the Form ADV, including failing to disclose that the firm gave advice on interests in partnerships, which was 80 to 85 percent of the firm’s business. However, these inaccuracies were attributed to the firm’s compliance culture, which the examination team dismissed as being merely “sloppy.”

The 2005 examination team also disclosed that the firm's marketing materials contained significant omissions and failed to clearly describe its investment strategy, yet the examiners did not attach significance to these findings. The examination team also uncovered that the firm's stated policy was to delete all e-mails after a hardcopy was printed. Although, as a result, the examination team was unable to review e-mail documentation as part of their examination, the examiners did not ascribe improper motives to this finding, concluding that the firm's officials were simply "not technology savvy."

The OIG investigation further found that after conducting the examination, the 2005 examination team actually not only failed to follow up on obvious red flags but, inexplicably, decided to lower the firm's risk rating from high risk to medium risk as a result of their examination. The 2005 examination report justified the decision to downgrade the firm's risk rating as follows: "Registrant's investment strategy and implementation of the strategy do not appear to involve a high degree of risk." However, the report did not elaborate on this determination, and the very same page of the report stated that "there are significant risks associated with the operations of [the registered broker-dealer]."

Moreover, the OIG investigation found that a brief, cursory review of the firm conducted four years later, but which was based upon information available to the 2005 examiners, immediately determined that the firm had numerous, significant red flags and risk factors that warranted immediate scrutiny and examination.

While the 2005 examination team dismissed the red flags relating to the investment adviser, they did have enough concerns about the operations at the affiliated broker-dealer that they decided to recommend that another regional office conduct a broker-dealer examination. Several times in the 2005 report, the

2005 examination team noted its intention to refer its report for an examination of the broker-dealer. However, the OIG found that the referral never happened. The OIG investigation determined that none of the members of the 2005 examination team could recall actually referring the matter, and no one in the other regional office recalled ever receiving a referral. In addition, the OIG, as well as regional office staff, conducted numerous e-mail searches and the results showed no e-mails between the two regional offices regarding the firm and no internal e-mails discussing a referral.

The OIG investigation further found that, in the timeframe of the 2005 examination, the examining regional office had no policies that governed the referral of examination findings and no instructions on how a referral was to be made. In addition, there was no procedure for following up on a referral and, in fact, no one on the 2005 examination team made any effort to confirm that a referral had been made, or inquired as to whether the receiving office received the referral, conducted an examination, or found any fraud. Thus, no examination was conducted of the broker-dealer, allowing the fraud to continue.

The OIG found that in 2009, when an experienced examination team conducted a joint examination of both the investment adviser and the broker-dealer, following up partially on a referral from another agency, the fraud was easily uncovered. The examiners acknowledged that the firms were both operating in the "exact same fashion" in 2009 as they were in 2005, and the OIG investigation found that when the 2009 examination team followed up on the same "red flags" identified in 2005, the 2009 team immediately discovered the fraud.

Perhaps most significantly, the 2009 examination team conducted a custody analysis, something that the 2005 team had planned to conduct, but never did. The 2009 examina-



tion team determined that the investment adviser had custody of assets invested in the broker-dealer because the managing partners of the broker-dealer were owners and, thus, supervised persons of the investment adviser and had access to all client funds that were invested in the broker-dealer. As a result, the 2009 examination team determined that the investment adviser was not in compliance with the custody rules. The OIG investigation found that the 2009 examination team made this custody determination based on the same facts that existed in 2005.

The 2009 examination team also obtained the records of an unregistered entity that was being used as a “pass-through” vehicle and, in those records, uncovered evidence of the fraud. The 2005 examination team did not even request records of the unregistered entity during their examination and seemed confused about whether the SEC had any authority to obtain documents from unregistered entities even where fraud was suspected.

The OIG investigation found a major difference between the manner in which the two examinations were conducted related to the fact that the 2009 examinations were conducted after the “Madoff” scandal. The OIG found that after Bernard Madoff confessed to operating a \$50 billion Ponzi scheme and the OIG issued a report of investigation regarding the failure of the SEC to uncover that scheme, SEC examiners focused more acutely on custody of assets, conducted more joint examinations, and were more aggressive in seeking records from unregistered firms. The OIG investigation found that, unfortunately, the 2005 examination was conducted under “pre-Madoff” procedures by examiners, who were aware of and had evidence of potential fraud, but did not take the basic steps necessary to investigate the matter further and, as with Madoff, a significant fraud was not uncovered timely.

The OIG also specifically investigated the allegation in the anonymous complaint that

the senior official “instructed (and even bullied) examiners to not pursue certain red flags” in the 2009 examinations in an attempt to hide his failures in the 2005 examination. While the OIG investigation did not find evidence substantiating the claim that the senior official instructed or bullied examiners to ignore “red flags” in the 2009 examinations, the OIG did find that examiners were uncomfortable with the senior official’s involvement in the 2009 examinations and that this created an appearance of impropriety, which could have been avoided if the senior official had been recused from the 2009 examinations. In the course of its investigation, the OIG also found evidence that many employees had significant concerns about the senior official’s management style in general. Yet, the OIG also found that there was little, if any, evidence that any action was taken by management to resolve or even address these concerns. We found that many employees at this regional office were fearful to complain because of possible retaliation. The OIG did not substantiate the allegation that the senior official lied in previous OIG testimony.

The OIG issued its report of investigation to management on October 26, 2010. In its report, the OIG recommended that SEC management carefully review the portions of the report that relate to the performance failures by those employees who still work at the SEC, so that appropriate action could be taken, on an employee-by-employee basis, as appropriate. The OIG also specifically recommended that the senior official not be placed back in a supervisory role. The OIG further recommended that the regional office (1) establish a staff recusal policy for examinations, and (2) include, in its examination referral policy and procedures, a mechanism for tracking the outcome of an examination referral. Finally, the OIG recommended that management take the necessary actions to establish appropriate mechanisms in the regional office to ensure that employee feedback about supervisors is appropriately and sufficiently addressed so that employees feel com-

fortable conveying feedback about their superiors without fear of retaliation.

In response to the OIG's recommendation, on January 10, 2011, the regional office examination staff was notified that the Office of Compliance Inspections and Examinations (OCIE) Labor-Management Forum Committee within the regional office had been designated as the forum through which employees can draw attention to their concerns. In addition, the senior official who the OIG recommended not be placed in a supervisory role resigned from the agency, and management proposed disciplinary action against one of the supervisors on the 2005 examination of the investment adviser. As of the end of the semi-annual reporting period, corrective action regarding the OIG's remaining recommendations was pending.

A public version of the OIG's report is available on the agency's website at <http://www.sec.gov/foia/foiadocs.htm>.

### **Investigation of Whether a Former Senior Official Violated Conflict-of-Interest Restrictions in Connection With Employment at a Trading Firm (Report No. OIG-540)**

On June 14, 2010, the Honorable Charles E. Grassley, United States Senator (R-Iowa), sent a letter to the OIG regarding the "revolving door between" employment at the SEC and "the securities industry, which the SEC is charged with regulating." Senator Grassley's letter specifically referenced a senior SEC official who left the agency in June 2010 to join a trading firm. According to Senator Grassley, the employee's departure from the SEC to work at the firm raised questions about (1) the extent to which the former employee was personally involved in the SEC's review of recent market events and related rulemaking activities, (2) when the former employee had contact with the firm about the possibility of employment there and whether the former employee was recused from matters related to the SEC's review and rulemaking after that point, and (3)

the extent to which SEC and government-wide ethic rules would limit the former employee's communications with former colleagues at the SEC on behalf of the firm going forward. Accordingly, Senator Grassley requested that the OIG conduct a review of the circumstances surrounding the former employee's departure from the SEC and disclose the results so that Congress and the public can more accurately assess the integrity of the SEC's operations.

In response to Senator Grassley's request, the OIG opened this investigation and, in conducting the investigation, researched and analyzed post-employment conflict-of-interest restrictions that apply to executive branch officers and employees generally, as well as rules that specifically apply to current and former SEC employees. The OIG also obtained from OIT and searched over 250,000 employee e-mails. In addition, the OIG reviewed numerous documents including, but not limited to, (1) supporting documents produced by the SEC Ethics Office and certain witnesses, (2) the former employee's personnel file, (3) letters filed in compliance with the SEC's notice of representation requirement from 2007 through 2010, and (4) comment letters submitted to the SEC by the trading firm that hired the former employee from 2009 through 2010. Finally, the OIG took sworn testimony from six current and former SEC employees.

The OIG issued its report of investigation on January 25, 2011, indicating that it found no evidence that the former employee violated any conflict-of-interest provisions or acted in an improper manner in connection with employment at the trading firm. The evidence and testimony obtained by the OIG showed that almost immediately after being contacted by the firm about future employment, the former employee contacted the SEC Ethics Office and filed an online recusal form. The evidence obtained further showed that the former employee promptly informed the applicable division director of the former employee's recusal and, soon thereafter, the former employee was recused from particular rulemakings.

The OIG did find, however, that a lack of proper record keeping at the SEC made it difficult to determine from which matters the former employee was, in fact, recused and on which matters the former employee continued to work after beginning employment discussions. Specifically, the OIG found that neither the Ethics Office nor the division in which the former employee worked created or maintained records of the matters from which the former employee was recused, and that the online recusal form did not have an area in which an employee can enter recusal information for particular matters. Additionally, the OIG found that the SEC's Ethics Office does not require its employees to document the advice they provide to employees and that the practice of not documenting meetings held and advice provided does not support the interests of employees or those of the Commission.

The OIG investigation also found that, although many employees on the SEC's SK pay scale would be subject to the one-year "cooling off" ban on communications back to the agency that is applicable to senior employees, the U.S. Office of Government Ethics (OGE), at the SEC's request, had exempted all SEC SK employees from the prohibition. This automatic exemption for SK employees has enabled some former SEC employees who were highly compensated and held influential positions to evade the ban, even though they are the very type of employees the ban was intended to cover. The OIG concluded, therefore, that the blanket exemption for SK employees opens the door to potential abuse and that efforts should be made to seek modification to the blanket exemption from OGE.

In light of its findings, the OIG recommended that the SEC Ethics Office (1) document the advice provided to SEC employees, (2) add a field to the online recusal system in which employees can add information regarding the specific matters from which they are recused, (3) rectify the on-line recusal database's inability to store certain information

entered on the recusal form, and (4) seek modification from OGE of the blanket exemption for SK employees from the one-year "cooling-off" ban. The OIG also recommended that the former employee's division designate an administrative contact to maintain a list of specific matters from which senior officers are recused. As of the end of the reporting period, no action had yet been taken by management with respect to the OIG's recommendations. Management indicated that it plans to implement the OIG's recommendations simultaneously with any recommendations that may arise from GAO's ongoing revolving door audit.

### **Improprieties in the Selection and Award of a Sole-Source Contract (Report No. OIG-523)**

On September 24, 2009, the OIG opened an investigation into the SEC OIT's August 2008 acquisition of approximately \$1 million of certain equipment intended to serve as virtual storage. The acquisition was one of four OIT projects reviewed by the OIG as part of its audit of the SEC's Capital Planning and Investment Control (CPIC) process, entitled *Assessment of the SEC Information Technology Investment Process*, Report No. 466, issued March 26, 2010. Based on the findings of that audit with respect to this particular acquisition, the OIG decided to open an investigation.

During the course of its investigation, the OIG obtained and searched approximately 1.2 million e-mails from 13 SEC staff members. The OIG also reviewed numerous documents related to the acquisition, including vendor proposals, meeting minutes of the SEC's Information Officers Council and OIT's Project Review Board, requisition requests, and purchase orders and supporting documentation. Further, the OIG conducted 12 testimony or interview sessions of witnesses with knowledge of the facts and circumstances surrounding the acquisition and/or knowledge of information otherwise pertinent to the investigation.

The OIG investigation found that OIT's decision to purchase the equipment initially was made primarily based on a very simple sales pitch from a vendor. OIT purchased the equipment without conducting any technical analysis or review and decided to forgo an opportunity to test the equipment at no cost. Key OIT staff members were not consulted about the decision to acquire the equipment. OIT also allowed the vendor to use information it improperly obtained from the SEC to submit a quote in its proposal for the exact amount that was budgeted by the SEC for the contract. Immediately after OIT attempted to install the equipment, it was apparent that the storage system was a failure. It was quickly demonstrated that it was impossible for the equipment to be installed properly and that the equipment not suitable for the SEC.

The OIG investigation found that the acquisition violated several provisions of the Competition and Contracting Act (CCA) and the Federal Acquisition Regulation (FAR). The Office of Administrative Services (OAS) approved the acquisition on a non-competitive basis; however, the OIG found that the justification cited for the award on that basis, "only one responsible source . . . will satisfy [the SEC's] requirements," was inapplicable. Consequently, the acquisition violated the central tenet of the CCA and the FAR, which is that "except in the case of procurement procedures otherwise expressly authorized by statute, an executive agency in conducting a procurement for property or services shall obtain full and open competition through the use of competitive procedures."

In addition, the OIG found several other FAR violations, including: (1) the written justification for the award of the contract on a non-competitive basis did not include the estimated cost of the acquisition; (2) the equipment was purchased before the written justification had been approved by the contract officer; (3) one of the requisition requests and purchase orders for the acquisition was im-

properly split into two orders; and (4) OIT shared budget information with the vendor in order for the vendor to tailor its proposal for the first order within the SEC's budget parameters, even though that proposal omitted essential equipment that the SEC was subsequently forced to purchase, and tied that order to two larger orders that were placed one week later.

Moreover, the OIG found that the acquisition was not reviewed and approved by the SEC's Competition Advocate as required by the CCA and the FAR. The OIG further found that if the acquisition had been reviewed by the SEC's Competition Advocate, it would not have been approved. The OIG also found that OIT violated the SEC's CPIC procedures by waiving a pre-acquisition review of the purchase. Finally, the OIG found that as a direct result of those numerous violations of the CCA, the FAR, and the SEC's CPIC procedures, the SEC invested approximately \$1 million in technology that immediately failed to perform its intended function.

The OIG issued its report of investigation on December 14, 2010, and recommended that appropriate action, including performance-based action and/or training, be taken with respect to four employees. The OIG also recommended that OIT institute appropriate procedures to ensure that any significant information technology acquisition undergo an adequate pre-acquisition review of its technical merits and compatibility with existing information technology architecture. Finally, the OIG recommended that OAS institute appropriate procedures, including training of its contract specialists, to ensure that future procurements are done in accordance with federal statutes and regulations. As of the end of the reporting period, no action had been taken by management with respect to the OIG's disciplinary recommendations, while management had begun to implement the procedural and training recommendations.

## **Abusive and Intimidating Behavior Within a Headquarters Branch (Report No. OIG-537)**

On May 13, 2010, the OIG opened an investigation into an anonymous complaint that an SK-14 employee at SEC headquarters had engaged in abusive and intimidating behavior towards contract staff, used profane language, and threatened their job security. The complaint further claimed that the employee had lied to his supervisor about certain of these events and that his supervisor appeared to be unaware of the employee's abusive and intimidating conduct. The complaint also alleged an inappropriate relationship between this employee and one particular contractor. Included with the anonymous complaint were the statements of seven witnesses that were submitted in support of the complaint. The complainant requested that the statements be safeguarded to protect the privacy and job security of the witnesses, who feared retribution.

During the investigation, the OIG took the sworn testimony of 15 individuals, including both SEC staff members and contractor personnel. The OIG also conducted interviews of three other SEC staff members and additional follow-up interviews. In addition, the OIG obtained and reviewed security camera recordings and numerous relevant documents. The OIG also obtained from OIT and searched the e-mails of ten individuals and obtained additional e-mails directly from certain witnesses.

The OIG investigation found evidence to support virtually all of the allegations contained in the anonymous complaint. The investigation uncovered evidence that on many occasions, the employee who was the subject of the complaint engaged in abusive and intimidating conduct towards contract staff, frequently using profanities. The evidence also showed that the employee habitually made comments that the contract staff perceived as threats to their jobs and many of the contract

staff feared losing their jobs if they complained about the employee. In addition, the investigation found that the employee's managers took no steps to rein him in and or investigate his conduct, despite the availability of the statements of seven contract staff detailing his misbehavior. In all, we found that there was an atmosphere of bullying and intimidation and an appearance that the employee could do as he pleased with little or any restrictions placed on his behavior.

The investigation further found that the environment was such that the contract staff feared retribution if they complained about the employee and felt complaining would be useless, as he appeared to be able to do as he pleased and get away with it. While there was evidence that the Contracting Officer's Technical Representative (COTR) for the particular contract at issue had personally witnessed the employee becoming boisterous and using profanities on several occasions and counseled the employee, this counseling was ineffective and the employee continued to engage in inappropriate conduct. The employee's supervisor testified that while he was not aware of any complaints about the employee cursing or yelling at anyone, he had been made aware that some people felt intimidated by the employee. Yet, despite these expressed concerns, the supervisor did not take sufficient steps to ensure that the employee was acting appropriately.

The OIG investigation also uncovered problems with respect to the operation and management of an office overseen by the employee. The evidence showed that the supervisor had assigned the employee responsibility over this particular office and that the employee was the COTR for the contract of an individual who worked in this office. The OIG investigation found evidence that the employee and this contractor had a personal relationship that went beyond the "arms-length" relationship that is required between a COTR and a contractor. We found they exchanged e-mails of a flirtatious nature that they both admitted were inappropriate for the

workplace, lunched together quite frequently and sometimes socialized outside of work.

Based upon all of the evidence obtained, the OIG investigation concluded that there was inadequate supervision of the employee and serious problems in the management of the applicable headquarters branch. While the supervisor maintained to have an open door policy and to talk frequently with the contract staff, the OIG obtained evidence that he took a hands-off approach to management and, prior to learning of our investigation, had little contact with the contract staff. We also learned during the investigation that there was a great emphasis placed on going through the chain of command, which had the effect of discouraging complaints being brought directly to the supervisor's attention. Moreover, there was an expressed reluctance to escalate incidents to the supervisor's level.

Finally, the OIG investigation found that the employee demonstrated a lack of candor in significant aspects of his testimony before the OIG. In particular, in the face of the overwhelming evidence that the employee repeatedly and frequently yelled and used profanity towards contract staff, he denied ever doing so. Further, the employee's account of the events of the particular day mentioned above was not credible and stood in stark contrast to the evidence we obtained from the contract staff, the contractor managers and the SEC COTR for the applicable contract.

The OIG issued a comprehensive report of investigation to management on November 10, 2010. Based upon the evidence obtained, the OIG recommended disciplinary action, up to and including dismissal, for the employee and disciplinary action, up to and including removal from her contract, for the contractor. We also recommended appropriate management training for the supervisor and additional training in contract management and oversight for the COTR for the applicable

contract. In addition, we recommended that a thorough review of the overall management and structure of the headquarters branch be conducted and that significant changes be made, including, but not limited to, (1) instituting a strong and effective anti-retaliation policy and ensuring that no retaliation occurred as a result of the OIG investigation, (2) implementing a mechanism for making anonymous complaints or suggestions to the branch supervisor, (3) instituting periodic meetings between branch management and the contractor onsite managers, and (4) developing and implementing written policies and procedures for management of the contract.

In response to the OIG's report, management took no action against the employee prior to his resignation and acceptance of other government employment, while the contractor was removed from her contract. As of the end of the reporting period, corrective action regarding the OIG's remaining recommendations was pending.

### **Abuse of Compensatory Time for Travel by a Headquarters Manager and Ineffective Supervision by Management (Report No. OIG-538)**

The OIG opened an investigation on August 19, 2009, after receiving an anonymous complaint, dated August 13, 2009, regarding a headquarters manager. The complaint alleged that the manager was regularly leaving the office 30 to 50 minutes early without taking proper leave for the past six years, and may have also arrived late to work. The complaint added that the manager's requests for travel expense reimbursement for cash expenditures sometimes exceeded official expenses. The complaint also requested an audit of the manager's requests for compensatory time for travel.

The OIG found in its investigation that the manager had been systematically requesting and receiving compensatory time for travel

well beyond his actual hours in travel status. In fact, during the 21-month period reviewed by the OIG, the OIG found that the manager claimed and received 63.5 hours of compensatory time for travel in excess of what he was entitled to under SEC regulations, costing the government \$5,274.74. In addition, the OIG found that the manager was overpaid for meals and incidental expenses (M&IE) on one occasion in the amount of \$71.00, and claimed reimbursement for telephone calls during travel totaling \$475.00, despite having an SEC-issued BlackBerry® telephone.

All of these infractions happened despite the supposed oversight of management. The OIG found that the supervisor approved all of the manager's requests for compensatory time for travel without question, even though the supervisor knew the manager's trips did not take as long as he claimed. The OIG also found that the supervisor did not require his subordinates to submit the mandatory "Worksheet for Determining Amount of Compensatory Time for Travel." The OIG further found that a senior supervisor approved the manager's travel reimbursements, which included telephone call reimbursements, despite knowing the manager had an SEC-issued BlackBerry® telephone.

In addition to compensatory time and travel reimbursement issues, the OIG investigation found that the manager was regularly leaving the office early each day with his supervisor's knowledge and approval. Although the OIG concluded that the manager was working a full 8½ hour day, the OIG found that the manager was not working his regularly scheduled hours. In addition, the OIG found that the manager would sometimes come in before 6:30 a.m., which is before the SEC's flexible band of hours, and count that time as hours worked, in violation of SEC policy.

The OIG issued its report of investigation to management on February 15, 2011. In its report, the OIG recommended that (1) disci-

plinary action be taken against the manager, (2) the manager pay back \$5,274.74 in compensatory travel time overages, \$475.00 in unjustified telephone call reimbursements, and \$71.00 in excess M&IE, (3) the manager be trained on SEC policies and rules concerning compensatory time for travel, and (4) the manager be required to either work his currently scheduled hours, taking leave when he departs early, or request an alternate schedule. The OIG further recommended that the supervisor and senior supervisor receive management training. Finally, we recommended that the Ethics Office issue an SEC-wide e-mail reminder concerning compensatory time for travel, including specific information about using the mandatory "Worksheet for Determining Amount of Compensatory Time for Travel."

As of the end of the reporting period, the agency had issued a written reprimand to the manager and commenced efforts to recoup the excess compensatory time and improper reimbursements claimed. In addition, the Ethics Office distributed the recommended e-mail on February 28, 2011, and management was in the process of scheduling the suggested training.

### **Investigation Concerning the Role of Political Appointees in the Freedom of Information Act Process (Report No. OIG-543)**

On September 2, 2010, the OIG opened an investigation in response to an August 23, 2010 letter from the Honorable Charles Grassley (R-Iowa) and the Honorable Darrell Issa (R-California), requesting that OIG conduct an inquiry into the SEC's Office of Freedom of Information Act Services (FOIA Office) to determine whether, and if so, the extent to which, political appointees are made aware of information requests and have a role in request reviews or decision-making.

During the course of this investigation, the OIG requested the e-mail records of employees who may have sent, received, or been cop-

ied on e-mails relevant to this investigation. The OIG estimates that it obtained and searched over 137,000 e-mails during the course of its investigation. The OIG also took the sworn testimony of 13 current SEC employees, including seven employees of the FOIA Office. In addition, the OIG obtained and reviewed (1) documents describing the process for responding to FOIA requests, (2) a list of SEC FOIA liaisons, and (3) a list of all SEC political appointees.

The OIG report of investigation, issued on December 3, 2010, did not find evidence that political appointees at the SEC played an improper role in the review of or response to FOIA requests for SEC records. The OIG investigation found that the SEC's responses to requests for OIG reports by Members of Congress are subject to review and approval by the agency's five Commissioners, who are political appointees. We also found that the SEC attempts to provide the same response to FOIA requesters as that provided to Members of Congress who request OIG reports. As a result, the Commission's review process for requests for OIG reports by Members of Congress affects the responses to FOIA requests for these same OIG reports. However, the OIG investigation did not find that the limited role played by the Commissioners in the process of responding to requests for OIG reports by Members of Congress had a political impact on the SEC's response to these requests.

### **Unauthorized and Improper Disclosure by a Regional Office Staff Attorney (Report No. OIG-550)**

On October 26, 2010, the OIG opened an investigation into a complaint it received from the FBI. An FBI agent alleged that an SEC regional office staff attorney had improperly disclosed information regarding a confidential informant who was assisting in an FBI investigation.

In conducting the investigation into this allegation, the OIG (1) took sworn testimony

of the regional office staff attorney and conducted a follow-up interview of him, (2) conducted telephone interviews of the FBI agent, and (3) conducted a telephone interview of the person to whom the SEC attorney allegedly made the disclosure about the confidential informant. The OIG also reviewed several documents provided by the FBI, including notes of a meeting with the attorney and a file memorandum prepared by the FBI agent regarding the improper disclosure. Finally, the OIG reviewed the information from an internal database associated with the SEC investigation that is related to the FBI matter.

The OIG found that the staff attorney had disclosed to an investor and witness in the matter: (1) the name of the confidential informant, (2) the fact that the informant was cooperating with the FBI, and (3) the fact that the informant's cooperation included secretly tape recording conversations with the subjects of the FBI investigation. The OIG further found that the SEC staff attorney did so despite the fact that the FBI had given him the recording with the express agreement that he not disclose the existence of the recording or the informant's status as a confidential informant. Even absent such an agreement, the staff attorney acknowledged that such disclosure, which he denied making, was serious and improper.

The OIG issued its report of investigation on February 7, 2011, and referred the matter to management, recommending disciplinary action against the staff attorney. As of the end of the reporting period, management had not taken action in response to the OIG's recommendation.

### **Improper Access to SEC Facilities and Computer Systems (Report No. OIG-544)**

The OIG opened this investigation on June 9, 2010, based on a complaint from a former headquarters contract employee. Specifically, the former contract employee alleged that when he began his tenure as a subcon-



tractor to an SEC contractor, he was improperly granted access to SEC buildings and computer systems, including sensitive internal databases containing nonpublic information, before having his background investigated and being cleared and issued an official SEC badge.

In conducting its investigation into these allegations, the OIG interviewed the former contract employee and requested documents and follow-up information from him, which he later provided. The OIG took the sworn testimony of the COTR for the applicable contract, a current SEC contract employee, and a branch chief. In addition, the OIG obtained e-mails for relevant contract employees for the approximate dates of the former contract employee's tenure.

The OIG investigation determined that the former contract employee, as well as other contractors, had been improperly granted access to SEC buildings and computer systems in direct violation of security requirements applicable to federal employees and contractors. In fact, the investigation revealed that the former contract employee worked at the SEC for several weeks before receiving a favorable suitability determination based upon his background investigation and being issued an official SEC badge.

The investigation further established that SEC officials, including the COTR, were aware of the former contract employee's pending suitability status. We found that the COTR not only made no attempt to prevent the former contract employee from working at the SEC until his background investigation was successfully completed, but purposely circumvented proper security procedures to allow the former contract employee to enter an SEC building and conduct SEC work before he was granted an official SEC badge.

In addition, the former contract employee told the OIG that he routinely used another SEC contractor's password and identification

to enter SEC computer systems and applications, in direct violation of OIT rules. While the SEC contractor denied sharing his password and identification, he did admit to having a password like the one the former contract employee remembered using to access SEC computer systems and having the former contract employee standing at his computer while he logged on. In addition, the former contract employee told the OIG, and the evidence established that, he used his personal e-mail account to perform SEC work on his own laptop computer, also in direct violation of OIT rules.

In all, the OIG investigation revealed that it has been a practice in a headquarters office to allow contractors to begin work at the SEC before receiving a background investigation clearance and being issued an official SEC badge, in violation of federal security requirements. Moreover, the evidence also established that these contractors were accessing the SEC computer systems and applications during that time. As a result, the OIG referred this matter to management for disciplinary action against the COTR, up to and including termination from federal service, and the contractor, up to and including removal from the contract.

Given the potentially detrimental consequences of this practice in the headquarters office, the OIG also specifically recommended that (1) OHR take immediate measures to determine whether every employee and contractor in the headquarters office has been properly cleared by a background investigation and issued an official SEC badge, (2) OHR issue written policy on proper issuance, and documentation of, visitor badges, specifically noting that visitor badges cannot be issued in lieu of, or while awaiting, the issuance of a permanent official SEC badge, (3) the headquarters office issue a directive ending its practice of allowing contractors (or others) to begin work of any kind before being cleared in a proper background investigation and being issued an official SEC badge, and (4) the

Commission take steps to deactivate official SEC badges and terminate access to SEC computer systems for terminated or separated employees and contractors.

The OIG issued its report of investigation on January 20, 2011. As of the end of the reporting period, management had solicited comments from the OIG on new draft operating procedures which address specific steps the headquarters office should perform to ensure that SEC computer network and telephone accounts of SEC employees and contractors are properly created, terminated, and transferred. No action had been taken on the OIG's disciplinary recommendations as of the end of the reporting period.

### **Unauthorized Disclosure of Nonpublic Information During an Active SEC Investigation (Report No. OIG-558)**

On February 7, 2011, the OIG opened an investigation into allegations from a regional office senior official that an employee at SEC headquarters was providing false, misleading, and nonpublic information to investors about an active enforcement investigation and litigation from as early as October 2010 to February 2011. According to the regional office senior official, the headquarters employee repeatedly told investors, of whom he was one, that a particular investment company was legitimate and that these investors would be receiving considerable sums of money from their investments. The SEC, however, believed the company was actually a Ponzi scheme that targeted certain investors, and on October 6, 2010, the SEC filed an action against the purported company in federal court, obtaining an emergency asset freeze. The SEC later was granted a default judgment against the purported company on February 14, 2011, which included a permanent injunction and an order for millions in disgorgement and prejudgment interest.

The regional office senior official was concerned that the employee's actions not only

threatened to jeopardize the ongoing investigation, but also misled several investors into believing that the purported company was legitimate. Moreover, some or all of the investors knew that the employee worked at the SEC and, therefore, believed incorrectly that he had first-hand knowledge of the SEC's investigation and that his representations were credible. After the regional office senior official e-mailed the employee and inquired as to whether he was communicating with investors about the investigation, the employee was placed on administrative leave.

During this investigation, the OIG obtained and reviewed nearly 10,000 e-mails for the relevant time period and took the employee's sworn testimony. The OIG also received and reviewed a production of additional supporting documentation from the regional office, including investigative transcripts, court documents, Internet postings, and other relevant information.

The OIG found that the employee, by his own admission, communicated with several investors during the SEC's investigation of, and litigation against, the purported company. In so doing, the employee shared nonpublic, false, and misleading information with investors. As a result, the OIG found that his conduct not only confused certain investors and gave them a false sense of hope, but it also had the potential to adversely affect an ongoing enforcement investigation.

Based on the foregoing, the OIG issued its report of investigation on March 31, 2011, and referred the matter for disciplinary action, up to and including dismissal from federal service. The OIG recommended further that all staff in the employee's office (1) receive comprehensive instructions on what constitutes nonpublic information and the proper way to handle such information, and (2) be required to certify that they have successfully completed training and understand the proper way to handle nonpublic information before they are allowed access to such information.

Because the OIG's report of investigation was issued just prior to the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendations.

### **Improper Comments by a Regional Office Senior Counsel and Alleged Abuse of Leave by a Regional Office Senior Counsel and Senior Official (Report No. OIG-545)**

On September 20, 2010, the OIG opened an investigation as a result of a September 17, 2010 complaint from a witness who was involved in a civil action filed by the SEC. The witness alleged that an SEC regional office senior counsel had made a sexist remark to him at video deposition testimony. In addition, on November 2, 2010, the OIG received an anonymous complaint involving the same senior counsel. This complaint alleged that the senior counsel and another senior official consistently arrived late to work, took long lunches, and left early without taking leave.

During the course of this investigation, the OIG took the sworn testimony of multiple regional office staff members, including senior management. The OIG also reviewed e-mail records and the video deposition.

On February 4, 2011, the OIG issued its report of investigation in this matter. The OIG did not find sufficient evidence to support the allegations against the senior official and the senior counsel regarding their work schedules. However, the OIG did find that the senior counsel made an inappropriate remark during a break in the video deposition, in violation of the Commission's Conduct Regulation and Canon of Ethics. In light of the foregoing, this matter was referred to management for disciplinary action. No action had yet been taken by management with respect to the OIG's recommendation at the end of this semiannual reporting period.

### **Allegation of Negligence in the Conduct of an Enforcement Investigation (Report No. OIG-510)**

During the semiannual reporting period, the OIG concluded an investigation into a complaint received by a former attorney that the Division of Enforcement (Enforcement) committed acts of negligence in conducting an initial insider trading investigation of a hedge fund. The complaint was based upon recently-discovered information showing that Enforcement had access to specific evidence that insider trading had occurred prior to closing its initial investigation.

The OIG took the sworn testimony of the complainant, two headquarters employees, and a regional office employee. Further, the OIG interviewed a former Assistant United States Attorney for the Southern District of New York, who conducted a parallel criminal investigation during Enforcement's initial investigation. The OIG reviewed approximately 85,000 e-mails of current and former SEC employees relevant to this matter. The OIG also reviewed hundreds of other documents related to this matter, including documents produced by Enforcement related to the investigations of the hedge fund and documents provided by the complainant.

The OIG learned that on November 14, 2003, Enforcement opened an investigation of the hedge fund regarding possible insider trading in several different securities. In June 2005, the complainant, who was then the principal SEC staff attorney assigned to the matter, met with his supervisors and presented a chronology of events related to the hedge fund's April 2001 trades in a security that the staff attorney believed evidenced insider trading by the hedge fund in advance of a positive earnings announcement.

Enforcement removed the staff attorney on September 1, 2005. On November 30,

2006, Enforcement closed the initial investigation of the hedge fund without taking any action, in part because it claimed that it had not found evidence that an employee who had accepted a job with the hedge fund had obtained any inside information regarding an upcoming earnings announcement of his former employer.

New evidence regarding the hedge fund's trading that had occurred in April 2001 emerged in December 2008 as a result of a recent divorce proceeding. On December 16, 2008, Enforcement opened a new investigation of possible insider trading by the same hedge fund in response to the new information. In January 2009, the second hedge fund investigation was transferred from SEC headquarters to an SEC regional office.

On May 27, 2010, the SEC announced a settled civil enforcement action against the hedge fund and its Chief Executive Officer (CEO) in connection with insider trading. The SEC's action was predicated on the allegation that the hedge fund employee had provided the CEO with inside information that he had obtained from an employee of his former employer.

On January 5, 2011, the OIG issued its report of investigation in this matter, finding that Enforcement staff who conducted the first investigation did pursue evidence of insider trading. However, the staff believed there was insufficient evidence to support an action without being able to identify the source of the inside information. The new information that was discovered during the divorce proceeding provided that evidence. The OIG found that Enforcement staff conducting the first investigation had issued a subpoena that encompassed the evidence, but that this evidence was not produced to the staff.

Apart from the new evidence, the OIG found that the SEC regional office, in conducting its own independent and thorough

investigation, uncovered a significant body of evidence of insider trading by the hedge fund and others that the staff in the first investigation possessed but was unaware of, or could have easily obtained. The OIG provided the specifics of its findings regarding the evidence uncovered by the regional office and the remainder of its conclusions to senior SEC management.

### **Allegations of Unauthorized Disclosure of Nonpublic Information (Report Nos. OIG-542, OIG-551, and OIG-552)**

The OIG received two outside complaints and one internal SEC referral in April, August, and October 2010, each alleging unauthorized disclosures of nonpublic information to the media by SEC staff during active enforcement investigations. The first complaint involved unauthorized disclosures of nonpublic information during the investigation and litigation stages of a high-profile insider trading case, and specifically alleged that SEC staff anonymously leaked detailed information about the SEC's investigation, including the identities of alleged co-conspirators, to the media. The second complaint made similar allegations of leaks by SEC staff during the late stages of settlement negotiations with a hedge fund, specifically alleging that one or more SEC staff members improperly disclosed to a reporter nonpublic information regarding an investigation of the company, including information as specific as the proposed settlement amount. The third complaint was an internal referral from management in an SEC regional office, requesting that the OIG investigate an allegation that SEC staff provided information to a reporter about a proposed deficiency letter that was drafted but never sent to a hedge fund. After careful review, the OIG opened investigations into each of the aforementioned complaints and referral to determine whether SEC staff had made unauthorized disclosures of nonpublic information.

In its investigation of these allegations, the OIG obtained and reviewed over 750,000

e-mails and supporting documents from over 15 current and former SEC employees in both SEC headquarters and regional offices. The OIG also reviewed additional supporting materials including, but not limited to, internal memoranda and numerous press articles. The OIG requested and obtained BlackBerry® telephone records from the SEC, issued several subpoenas to major cellular phone service carriers after obtaining employee consent, and took sworn testimony from several current and former SEC employees.

The OIG found that, with respect to the allegations of the deficiency letter leak, the letter, and details regarding the letter, were leaked to the press and that the source must have been someone at the SEC who believed incorrectly that the letter had been issued to the registrant when, in fact, it had not been issued. However, the OIG found no evidence in the e-mails reviewed or witness interviews conducted to identify the source of the leaked information.

With respect to the allegations regarding the leak of the proposed settlement with the hedge fund, the OIG again found that there was a leak of nonpublic information to the media and that the source of this leak must have been someone within the SEC. The OIG found, however, no evidence in the e-mails reviewed or witness interviews conducted to identify the source of the leak. The OIG also found that the leak may have come from someone within the SEC who was not directly involved with either the investigation or settlement.

With respect to the insider trading matter, the OIG found that nonpublic information about the insider trading case was leaked to the media, but found no evidence that the source of the leaks was an SEC employee. The OIG found it equally likely that the source of the leaks was someone outside the SEC.

On March 30, 2011, the OIG issued its report of investigation in these matters, recommending that the SEC, in the most economically efficient manner possible, employ technology that will enable the agency to better track employees' communications. Because the report of investigation was issued just prior to the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendation.

### **Allegation of Illegal and Unauthorized Disclosure of Employment Status by Regional Office Senior Official (Report No. OIG-549)**

On March 10, 2010, the OIG opened this investigation after receiving a complaint from a former SEC attorney who was terminated from employment with a regional office in 2009. The former SEC attorney alleged that the senior official disclosed his employment "status" to others outside the agency, that the disclosure damaged his reputation and had an adverse impact on his ability to respond to the SEC's notice of proposed termination, and that this disclosure also constituted a violation of the Privacy Act of 1974 (Privacy Act).

During the course of this investigation, the OIG took the sworn testimony of the former SEC attorney, the relevant regional office senior official, and the outside party to whom the disclosure was allegedly made. In addition, the OIG obtained and reviewed relevant e-mail records and the former SEC attorney's electronic official personnel folder.

The OIG found that after the former attorney filed a complaint against the regional office senior official with the SEC's Chief Freedom of Information Act and Privacy Act Officer (Privacy Act Officer), the Privacy Act Officer reviewed the former SEC attorney's claim and responded that he could not determine whether the alleged disclosure constituted a Privacy Act violation because it was "not clear that whatever information may

have been disclosed was from a system of records covered by the Privacy Act.” The OIG investigation further revealed that the regional office senior official did disclose to an outside party, who was a friend of the former SEC attorney, that the regional office would be asking the former SEC attorney to leave the SEC, but gave no details regarding the proposed termination. The OIG also found that the outside party later learned details about the termination from the former SEC attorney himself. Moreover, the OIG determined that the former SEC attorney’s friend, to whom the disclosure was made, still held him in high professional regard after the disclosure.

The OIG concluded that the disclosure of the termination to an outside party, albeit well-intentioned, may have been in violation of the agency’s general policy against “publish[ing] or mak[ing] available to any person matters that are . . . related solely to the . . . termination . . . of any Commission employee.” However, a definitive determination of whether the regional office senior official violated the Privacy Act is a matter that is appropriately within the purview of the Privacy Act Officer.

The OIG issued its report of investigation to management on March 2, 2011. The report was also referred back to the Privacy Act Officer for a determination, based on the full evidentiary record developed by the OIG, of whether the disclosure violated the Privacy Act.

### **Theft by a Headquarters Contractor (Report No. OIG-548)**

On October 4, 2010, OIG opened an investigation as a result of information that an employee had personal checks stolen from his office. The OIG contacted the Washington, D.C. Metropolitan Police Department (MPD) the same day and conducted a joint interview of the SEC employee with MPD Officers. During the course of the investigation, the OIG communicated with an MPD Check and Fraud Unit detective on multiple occasions.

The OIG also obtained numerous evidentiary documents related to the case from the SEC employee whose checks had been stolen.

The OIG learned that in or about July 2010, an OIT contractor upgraded the victimized SEC employee’s computer. The employee stated that his checkbook was on his desk when he left his office while his computer was being upgraded. According to the employee, an unauthorized debit payment was made from his bank account to a utilities company in August 2010. The OIG learned that the utilities company account on which the payment was made belonged to a then-SEC contractor. The employee further stated that two other unauthorized payments were made from his bank account in September 2010.

The OIG discovered during the course of its investigation that the subject SEC contractor was terminated from the SEC’s contract in September 2010, for “unreliable attendance.” On October 28, 2010, at the MPD detective’s request, the OIG faxed to the detective the former SEC contractor’s contact information and a copy of the stolen check.

On November 17, 2010, the OIG issued its report of investigation in this matter, finding that the evidence showed that the former SEC contractor had stolen a checkbook from an SEC employee and forged the employee’s signature to cash a check and pay his personal bills. Because the subject SEC contractor had already been removed from his contract position at the SEC, the OIG referred its report to management for informational purposes. The OIG also followed up with the MPD with respect to the potential arrest and conviction of the subject based on D.C. Code theft and fraud charges.

### **Investigation into Unauthorized Disclosure of Nonpublic Information (Report No. OIG-546)**

In 2010, the OIG conducted an investigation, OIG-534, into allegations of improper

coordination between the SEC and other governmental entities concerning the SEC's enforcement action against Goldman Sachs & Co. (Goldman). In the course of OIG-534, the OIG found e-mails suggesting that an SK-16 headquarters attorney had shared nonpublic information concerning Enforcement's investigation of Goldman with a friend outside the agency. After the conclusion of OIG-534, the OIG opened this investigation on October 4, 2010, to further analyze whether the attorney had improperly shared nonpublic information with anyone outside the SEC.

The OIG searched the e-mails of employees who may have sent, received, or been copied on e-mails relevant to the current investigation for the pertinent time period. The OIG also reviewed the portions of the transcript of the attorney's testimony taken during OIG-534 that addressed his communications with his friend. In addition, the OIG interviewed the attorney's friend and reviewed a declaration he provided concerning his communications with the attorney.

The OIG issued its report of investigation to management on December 17, 2010. Although the OIG investigation found that the attorney had shared with his friend information that the SEC would make two announcements on April 16, 2010, that might have significant but opposite effects on the SEC's image, the OIG investigation did not find sufficient evidence to conclude that the attorney had shared any detailed nonpublic information with his friend or anyone else outside the SEC.

### **Misuse of Computer Resources and Official Time to View Pornography (Report No. OIG-547 and Pls 11-05, 11-06, and 11-07)**

During this semiannual reporting period, the OIG continued to receive from the OIT Information Security Group lists of SEC employees or contractors who had numerous attempts to access pornographic websites from

SEC computers that were blocked by the agency's Internet filter, as well as instances where they successfully accessed pornography or inappropriate material. Depending on the frequency of the accesses and attempted accesses and the nature of the materials accessed, the OIG conducted a full investigation or a more limited inquiry as discussed below.

Beginning on October 4, 2010, the OIG conducted an investigation (OIG-547) into information showing that an SK-14 staff accountant at SEC headquarters had used his SEC-assigned computer hundreds of times attempting to access Internet pornography resulting in access denials. The information obtained from OIT also showed that the staff accountant successfully accessed numerous sexually-explicit photographs from his SEC computer, including graphic depictions of sexual acts. Many of these sexually-explicit photographs were accessed during normal SEC work hours.

The OIG had scheduled the sworn testimony of the staff accountant during the course of the investigation. When initially contacted by the OIG, the staff accountant did not deny that he had viewed inappropriate material on his work computer, but asked the OIG to keep in mind that he reviewed the websites of private companies in connection with his Commission work. Prior to the date of the scheduled testimony, the staff accountant's union representative informed the OIG that the staff accountant was asserting his Fifth Amendment privilege against self-incrimination and was declining to testify in the OIG's investigation.

The OIG issued a report of investigation to management on October 22, 2010, detailing the results of the investigation and finding that the staff accountant's inappropriate use of the Internet violated Commission policies and rules, as well as the government-wide standards of ethical conduct. The OIG referred the matter to management for disciplinary

action against the staff accountant, up to and including removal from federal service. As of the end of the reporting period, management had proposed the staff accountant's removal.

The OIG also conducted inquiries during the reporting period into the misuse of SEC computer resources to view pornography by two SEC employees and one contractor. In each of these matters, the OIG reviewed and analyzed the data provided by OIT, including forensic analysis reports, and records reflecting the individuals' completion of information technology security awareness training, which included specific information on the SEC's rules pertaining to appropriate use of agency computing and network facilities.

In one matter involving an SK-14 headquarters attorney (PI 11-05), the evidence showed that the attorney, while using his SEC computer, had received hundreds of access request denials for websites classified as pornography during a two-month period. A review of the information provided by the OIT Security Group also revealed many instances in which the attorney had successfully accessed pornographic and sexually-explicit websites from his SEC-assigned computer. The OIT Security Group's analysis of Internet logs also showed that the attorney had performed searches for pornographic material, and that much of the inappropriate activity occurred during normal SEC work hours.

During its inquiry, the OIG scheduled the attorney's sworn testimony but, before that testimony took place, the attorney notified the OIG that he was resigning from the SEC. As a consequence, the OIG did not proceed with the attorney's testimony and issued a memorandum report to management on January 11, 2011. In that report, the OIG indicated that based upon the evidence obtained during the inquiry, the OIG would have referred the attorney for disciplinary action, up to and including removal. In light of the attorney's then-impending resignation, however, the

OIG report was instead provided to management for informational purposes.

In a second matter involving another SK-14 headquarters attorney, the evidence showed that this attorney (PI 11-07), while using his SEC computer, had also received hundreds of access request denials for websites classified as pornography during a two-month period. A review of the information provided by the OIT Security Group further revealed numerous instances, over a prolonged period of time, in which the attorney successfully accessed, using his SEC-assigned computer, inappropriate images of partially or fully nude women. Specifically, the evidence showed that during the limited time periods examined, the employee had accessed from his SEC-assigned computer approximately 70 images of partially or fully nude women. The OIG attempted to schedule the attorney's testimony during the course of the investigation. However, the attorney's union representative notified the OIG that the attorney was declining to testify before the OIG concerning alleged inappropriate computer use.

The OIG issued a memorandum report to management in this matter on January 13, 2011. The OIG found that the evidence reviewed established that the attorney's inappropriate use of the Internet violated Commission policies and rules, as well as the government-wide standards of ethical conduct. The OIG referred the matter to management for disciplinary action, up to and including removal. Subsequent to the issuance of the OIG's report, the OIG received from OIT additional evidence showing that the attorney had accessed from his SEC-assigned computer numerous additional images of nude women at periods of time other than those examined in the OIG's initial inquiry, and forwarded this information to management. As of the end of the reporting period, management had proposed the employee's removal from federal service.



In a third matter involving an SEC contractor (PI 11-06), the evidence showed that the contractor had accessed numerous sexually-explicit images from his SEC-assigned computer, including graphic depictions of sexual acts. The OIG took the sworn testimony of the contractor to inquire about his Internet use. During that testimony, the contractor admitted that he accessed pornographic images during work hours from his SEC-assigned computer, stating that he had been doing so for about a year or a year and a half. Upon being shown particular images found on the hard drive of his SEC computer that depicted nude women and a variety of sexual acts, the contractor admitted he had accessed these images. The contractor further admitted in his testimony that he was aware of the prohibition on viewing pornographic or sexually-explicit images from SEC computers, had taken the required information technology security awareness training courses, and had received notices informing users of SEC computing systems that it was inappropriate to view Internet pornography from work computers.

The OIG issued a memorandum report to management in this matter on January 6, 2011, finding that the contractor's inappropriate use of the Internet violated Commission policies and rules. The OIG referred the matter for disciplinary action, up to and including removal from the contract. In response to the OIG's report, management had the contractor escorted from the building and removed from the SEC contract.

## **Other Inquiries Conducted**

### **Failure to Submit a Conflict-of-Interest Letter by Former Regional Office Senior Official (PI 10-38)**

The OIG opened this preliminary inquiry on May 6, 2010, after an interview with an individual who requested confidential informant status. This confidential informant alleged that a former regional office senior offi-

cial, during part of the time period in which the regional office investigated a publicly-traded company, participated in an independent investigation of the company after he had left the SEC for private practice.

In the course of this inquiry, the OIG searched multiple internal SEC databases for relevant records concerning all SEC investigations of the company, and reviewed relevant records for the regional office's investigations of the company. The OIG obtained several nonpublic internal memoranda relating to the regional office's investigations of the company. We also searched the e-mails of several current regional office employees who may have sent, received, or been copied on e-mails relevant to this inquiry for the pertinent time period.

Further, we interviewed two senior headquarters officials to obtain their specialized knowledge of the circumstances surrounding the allegation. Specifically, the OIG interviewed the SEC Ethics Counsel in order to obtain her opinion as to whether the facts found by the OIG in this inquiry potentially violated any ethics statutes, regulations, or rules. The OIG also interviewed the SEC Secretary to verify whether the Office of the Secretary's records reflected any letters sent from the former senior official concerning the company in 2005, 2006, or 2007, pursuant to the Commission's Conduct Regulation.

The OIG found that the former senior official made a communication or appearance before an employee of the SEC in connection with his representation of the company's audit committee and the SEC's options backdating investigation of the company. However, the SEC investigation of the company's options backdating appeared to deal with a sufficiently different set of issues and facts from the earlier SEC investigation of the company's revenue recognition practices so as not to be considered one "particular matter" for purposes of a federal conflict-of-interest statute.

The OIG did find, however, that the former senior official violated a provision of the Commission's Conduct Regulation by communicating with regional office employees in connection with his representation of the company's audit committee within two years of his departure from the SEC without filing a statement with the SEC Secretary, as required by the Conduct Regulation.

On December 21, 2010, based upon the foregoing, the OIG referred the matter to the Commission's Ethics Counsel for consideration as a supplement to a previous referral concerning this former senior official to the Bar Counsel offices in two jurisdictions. In addition, the OIG referred the matter to the SEC General Counsel for consideration of whether to recommend that the former senior official be denied the privilege of appearing or practicing before the Commission as a result of: (1) the former senior official's apparent violation of the SEC's Conduct Regulation; and (2) the senior official's apparent violation of the Rules of Professional Conduct of two jurisdictions, as was found in a previous OIG investigation.

**Falsification of Time and Attendance Records, Abuse of Telework and Lack of Supervisory Review (PI 10-05)**

The OIG opened this inquiry upon receipt of an anonymous complaint alleging that a regional office staff member had regularly falsified her time and attendance records to indicate excess work hours, and was not actually teleworking during the hours that she claimed telework in her time and attendance submissions.

The OIG took sworn testimony of the subject employee as well as her supervisor. We also examined the subject employee's current position description, e-mail records, building entry logs, personnel records, time and attendance records, and telework-related documentation. We also received and analyzed records of the employee's remote computer access to

the SEC network for a period of almost a year.

The OIG inquiry found that for the period of time examined, there was a pattern of little or no access to the SEC server from the employee's remote computer during the majority of the 44 days that she allegedly teleworked, despite the fact that the employee required access to a computer to perform her job duties. Our inquiry also revealed that the employee had improperly coded time and attendance work hours on numerous occasions.

We further concluded that the employee's supervisor did not adequately monitor the time and attendance submissions or telework activity. We also determined that the supervisor acknowledged that employees are required to code telework hour entries distinctly from regular in-office work hours in the time and attendance system used by the SEC, and that he specifically asked this employee to be careful to code her time accurately. However, we found that the supervisor did not sufficiently follow up with the employee even after she made numerous errors when coding her time.

On December 23, 2010, the OIG issued a memorandum report and referred the matter to management for consideration of disciplinary or other management-based action against the subject employee and her supervisor. We also recommended that the employee's existing leave balance be adjusted to appropriately record the time she worked in accordance with the findings in the report.

Based on the OIG's referral, the SEC proposed a suspension from federal service for the employee, while no action had yet been taken regarding the supervisor at the end of the reporting period.

**Improper Travel Expenditures and Lack of Supervisory Review (PI 09-113)**

The OIG opened this inquiry after receiving an anonymous complaint alleging that

four unnamed regional office staff members received reimbursement for lodging and per diem to which they were not entitled in connection with official travel to Washington, D.C., in August 2009. The complaint asserted that the subject staff should not have been paid during the period between training conferences held at SEC headquarters over two concurrent weeks. Specifically, the complaint alleged that the cost to stay in Washington, D.C., between conferences exceeded the cost of travel back and forth from the staff's home office to Washington, D.C., to attend the conferences. The complaint also claimed that these employees inappropriately claimed telework during the period they were away from their permanent duty stations. Based upon a review of applicable training and travel records, we determined that two regional office managers had been reimbursed for travel expenses for the days between the two training sessions.

In the course of this inquiry, the OIG obtained and reviewed the pertinent official travel authorization and expense documents. The OIG took sworn testimony of the two regional office managers and also interviewed their respective supervisors. We obtained and reviewed e-mails and SEC headquarters building entry and exit logs for the two regional office managers for the pertinent period of time. We also researched typical travel costs associated with travel to and around Washington, D.C.

The OIG inquiry found that the two regional office managers submitted improper travel expenses in connection with their official travel to Washington, D.C. Specifically, one manager's selection of privately owned vehicle transportation was inappropriate because the excess costs to the SEC were not justifiable under the Federal Travel Regulation (FTR). We also concluded that this traveler's supervisor insufficiently reviewed and improperly authorized this costly expenditure. The OIG further found that the other manager's taxicab fare receipts were likely inflated, and

these excesses were exacerbated by poor receipt recordkeeping. Moreover, the OIG concluded that this SEC employee improperly charged the government for a baggage fee assessed due to personal purchases made while in Washington, D.C. Finally, we concluded that the manager's supervisors did not properly review these excessive expenses prior to approving them for reimbursement.

The OIG issued its memorandum report to management on November 23, 2010, recommending disciplinary and/or management action against the two managers. Additionally, the OIG recommended that (1) the travel expense overpayments be repaid to the government, (2) the managers and their supervisors receive training on the FTR and SEC travel policies, and (3) the agency establish a policy regarding when to consider the use of a privately owned vehicle for official travel. As of the end of the reporting period, the agency determined that both managers should repay to the government a portion of the identified excess reimbursements, but decided not to take any disciplinary action against them. Corrective action regarding the OIG's policy recommendation was pending.

### **Disclosure of Nonpublic Personnel Information and Lack of Candor at Headquarters (PI 11-18)**

On January 19, 2011, the OIG opened an inquiry as a result of information received from a headquarters employee. The complainant alleged that an employee in her office had divulged nonpublic information about the complainant's disability to an SEC coworker.

The OIG took the sworn testimony of multiple witnesses and reviewed numerous e-mails. Several SEC employees gave consistent testimony that the subject employee communicated with a coworker about the complainant having been hired under an authority used for applicants with disabilities and that he did not believe she had a valid disability. Such testimony was also corroborated by

rated by a contemporaneous memorandum and e-mails. The subject employee claimed in his sworn testimony that he never said anything to the coworker about the complainant's disability.

Although the OIG did not uncover conclusive evidence of how the subject employee learned nonpublic information regarding the complainant's disability, the OIG found that there was substantial evidence that the subject did know and reveal nonpublic personnel information to another SEC employee. The OIG investigation further found that the subject provided false statements and lacked candor in numerous aspects of his sworn testimony before the OIG.

Accordingly, the OIG found that the subject violated a criminal statute by knowingly and willfully making a material false statement under oath in an official federal inquiry or investigation, and lacked candor in his testimony before the OIG.

In light of the foregoing, on February 11, 2011, the OIG referred this matter to management for disciplinary action, up to and including dismissal. We also referred the matter to the DOJ, which declined prosecution. As of the end of the reporting period, management had placed the employee on administrative leave and proposed his removal from federal service.

#### **Allegation of Misappropriation of Funds from the SEC Recreation and Welfare Association (PI 10-50)**

On June 16, 2010, the OIG received a letter from an SEC headquarters employee, alleging that a former headquarters employee, who had been involved with the SEC's Recreation and Welfare Association (SRWA) store, cashed an SRWA check for several thousand dollars just one day prior to his leaving the SEC. In conducting this inquiry, the OIG took the former employee's sworn testimony and interviewed a senior OHR official. In

addition, the OIG reviewed the former employee's e-mail records and obtained copies of invoices from clothing merchant suppliers. Further, the OIG subpoenaed and reviewed the SRWA's bank statements and other documents.

In his testimony before the OIG, the former employee stated that he worked in the SRWA store and was in charge of buying merchandise. He further stated that he was owed the money in question because he had used his personal credit card to purchase merchandise from a vendor on the SRWA's behalf. Therefore, before he left the SEC, he wrote a check from the SRWA account to himself. The OIG determined that between 2006 and 2010, the former employee used his personal credit cards to purchase over \$128,700 of SRWA store merchandise, and used the SRWA checking account to reimburse himself. The OIG found that the credit cards the former employee used for SRWA activities provided cash back rewards, and he admitted receiving rewards points or cash back for purchases he made for the SRWA store.

Based on the evidence reviewed in this inquiry, the OIG concluded that the former SEC employee improperly wrote a check to himself using the SRWA account as reimbursement for the purchases he made on behalf of the SRWA store, and that he also improperly received personal benefits from the use of his credit card for SRWA purchases. The OIG referred the receipt of personal benefits to the DOJ, which declined prosecution.

The OIG further found that there was a lack of effective oversight of the SRWA and that no procedures or regulations had been established concerning the SRWA's operations or the SEC's oversight of those operations. Therefore, the OIG recommended that OHR establish and implement bylaws for the SRWA and effectively oversee the operation of the SRWA, which would include a financial control system for the SRWA.

The OIG issued its memorandum report to management on December 16, 2010, for review and implementation of our recommendations, which remained pending as of the end of the reporting period.

### **Inappropriate Use of a Commission Database by a Headquarters Attorney (PI 10-62)**

The OIG opened this inquiry on July 19, 2010, based on evidence found in a previous OIG investigation. We conducted this inquiry to determine whether a headquarters attorney improperly sent nonpublic information obtained from a Commission database to another SEC attorney. The OIG found in a prior investigation that the second attorney received this nonpublic information about a party with whom he was personally connected, in violation of SEC policy. Based on the OIG's prior report of investigation in that matter, the second attorney was terminated for this and other violations of applicable policies and rules.

In the course of this inquiry, the OIG obtained and reviewed the first attorney's internal SEC database usage history and e-mail records for the pertinent time period. We also took the first attorney's sworn testimony and reviewed the transcript of the sworn testimony of the second attorney, which had been taken in the previous OIG investigation.

As a result of this inquiry into the actions of the first attorney, the OIG found that he accessed nonpublic information from a secure database at the request of the second attorney, who claimed that the information was for official SEC business. We further found that the first attorney provided this nonpublic information to the second attorney, even though they had not worked on any matters together and the first attorney did not ask any specific questions about the matter to which the information pertained. While we did not find evidence that the first attorney had any knowledge that the second attorney was seeking this

information for improper purposes, we did find that the first attorney could have exercised more caution in undertaking such a confidential search.

Based on our findings, the OIG issued a memorandum report on March 4, 2011, recommending that management consider counseling and/or training for the first attorney. Because the OIG's memorandum report was issued just prior to the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendation.

### **Allegation of Conflicts of Interest by Former Regional Office Senior Attorney (PI 10-53)**

The OIG opened this preliminary inquiry on June 25, 2010, in response to information contained in an anonymous complaint. The complaint alleged that shortly after a senior attorney left the SEC, he began representing a defendant in a matter that was under SEC investigation while the senior attorney was employed at the SEC. In addition, the complainant alleged a conflict of interest arising from the fact that the former senior attorney and another SEC attorney were named as defendants in a civil action unrelated to the case in question.

The OIG reviewed and analyzed the applicable statutory, regulatory, and state bar rule provisions, as well as SEC Ethics Office guidance relevant to post-employment representation. We reviewed SEC databases that identify and track complaints and investigations, and obtained copies of SEC Orders and Litigation Releases in the relevant cases. We further contacted the SEC's Ethics Counsel and obtained a copy of a notice of representation submitted by the former senior attorney. We also interviewed three current SEC attorneys, who were familiar with the investigation and litigation in question.

Our inquiry found that prior to undertaking representation of the defendant, the former senior attorney had filed the necessary notice of representation with the SEC pursuant to Commission rules, and that his request for clearance to represent the defendant was approved. We found no evidence that he had participated personally and substantially in, or had any official responsibility for, the related investigation while he was at the SEC. We also found that the former senior attorney was not subject to the one-year restriction on communicating with or appearing before the agency because the SEC had requested and obtained an exemption from the one-year restriction for senior SK-level SEC personnel, and this exemption covered the former SEC attorney.

Finally, we found that the complainant's allegation of a conflict of interest arising from the fact that the former senior attorney and another SEC attorney were named as defendants in a civil action unrelated to the case in question was not substantiated. Accordingly, our inquiry found insufficient evidence of misconduct by the former senior attorney, and we closed this inquiry on January 6, 2011.

### **Complaint of Conflict of Interest in the Awarding of Contracts (PI 09-97)**

The OIG conducted an inquiry into a complaint received through the OIG's Complaint Hotline, alleging that an SEC manager had improperly steered business to an outside company due to a personal relationship with an executive of that company, even though the quality of the company's work for the SEC had been poor. During its inquiry, the OIG requested and searched the e-mails of the manager in question for a two-year period. The OIG also met with the current SEC Ethics Counsel and spoke with the former Ethics Counsel concerning any advice or counseling provided to the manager by the SEC Ethics Office. In addition, the OIG took the sworn testimony of the manager to inquire about his relationship with the outside company and his

role in awarding SEC contracts to that company.

The OIG's inquiry found no evidence of a personal relationship between the manager and officials for the outside company. The manager testified that he became familiar with the company only through his work at the SEC. Our e-mail review also disclosed no evidence of a personal relationship between the manager and the company executive identified in the complaint. In fact, the e-mails reviewed showed that the manager had declined a lunch invitation from the executive, indicating that he refrained from having lunch with vendors as a matter of policy to avoid creating any improper impression.

The inquiry also did not find evidence that the manager improperly steered business to the company. We did learn during our inquiry that the manager had recused himself from the specific selection process for an SEC blanket purchase agreement for reasons unrelated to the company mentioned in the complaint, but that he did not seek any ethics advice in connection with this recusal. We suggested that the SEC Ethics Counsel meet with the manager to counsel him concerning the importance of seeking ethics advice, as well as the appropriate process for recusal in the future, and the Ethics Counsel agreed to do so.

### **Allegations of Improper Relationship Between a Headquarters Senior Manager and an SEC Contractor (PI 10-33)**

The OIG opened this preliminary inquiry on April 28, 2010, in response to information received from a former headquarters manager. The former manager alleged that a headquarters senior manager had an improper relationship with an SEC contractor. The complaint further alleged that the senior manager and the SEC contractor had ongoing social interactions which led the senior manager to exhibit favoritism and award contracts to certain outside contractors, including the contractor's company. Subsequent to the

opening of this inquiry, and unrelated to our findings, the senior manager was removed from her position and transferred to a non-supervisory position.

During the course of this inquiry, the OIG reviewed and analyzed the information provided by the complainant. The OIG also reviewed the senior manager's and the contractor's e-mail records and conducted interviews of other headquarters managers.

The OIG found no evidence to substantiate the former manager's allegation that the senior manager had an inappropriate relationship with contractor personnel or engaged in improper favoritism. Specifically, we found no evidence that the senior manager had a close personal or social relationship with the particular SEC contractor identified, or that she favored any particular contractor. Therefore, the OIG closed this preliminary inquiry on December 2, 2010.

### **Complaints Regarding Procurement Violations (PI 09-02)**

The OIG conducted an inquiry into a series of complaints from the owner of a court reporting services firm alleging that an SEC regional office senior counsel and support specialist conspired to improperly prevent the firm from obtaining any contracting opportunities, in exchange for material benefits conveyed by a competitor. In its inquiry, the OIG reviewed the applicable acquisition policies and procedures, examined the relevant procurement records, obtained pertinent e-mails, and interviewed SEC attorneys and support staff with knowledge of the matter.

The OIG inquiry found that the regional office, throughout the period in question, consistently procured court reporting and deposition services according to existing protocol in compliance with the applicable FAR requirements and SEC procedures. Furthermore, the OIG found that the complainant's firm had, in fact, been utilized in numerous instances throughout the period in question. Our in-

quiry also found no evidence of instances where the senior counsel or support specialist accepted material benefits from a prohibited source. Accordingly, we closed this inquiry on December 1, 2010.

### **INDICTMENT ARISING OUT OF PREVIOUS OIG INVESTIGATION**

An investigation conducted by the OIG during a prior reporting period (Report No. OIG-493) had found evidence that an employee had intentionally falsified her employment application and supporting documents submitted to the SEC concerning her position and grade at another federal agency. During the OIG's investigation, the employee admitted falsifying this data because she did not believe she would qualify for the position at the SEC based upon her actual information. Because the employee admitted to committing serious criminal offenses, the OIG had referred the matter to the Public Integrity Section of the Criminal Division of the DOJ for consideration of prosecution.

During this reporting period, on March 16, 2011, an indictment was returned against the former employee in the United States District Court for the Eastern District of Virginia with four counts of making false statements, three counts of submitting false documents, and one count of engaging in a concealment scheme. According to the indictment, the former employee had worked in various positions with the U.S. Department of Defense from 1991 until March 2005, when she was notified she was being fired for performance failures. In October 2006, according to the indictment, she resigned retroactive to March 2005 pursuant to a settlement agreement reached with the Department of Defense.

According to the indictment, the former employee applied for jobs at the U.S. Departments of State, Commerce, and Defense, as well as with the SEC, between 2006 and 2008. Among the documents she submitted in applying for these positions were SF-50 forms,

which are used by the federal government to document and report certain personnel actions such as hirings, promotions, conversions, and separations; OF-306 forms, which are used to determine an applicant's acceptability for federal employment; and SF-86 forms, which are used in conducting background investigations for applicants and employees requiring a security clearance. According to the indictment, the former employee made false statements on her OF-306 and SF-86 forms and provided two federal agencies with fraudulent versions of her SF-50 form. Specifically, the indictment alleged that the former employee concealed and falsified information in her application materials pertaining to her prior arrests, charges, convictions, and prison terms; the unfavorable circumstances under which she resigned from prior federal employment; her roles and responsibilities at previous federal jobs; and her salary history.

The SEC OIG and the FBI's Washington Field Office investigated the case, which is being prosecuted by the DOJ Criminal Division's Public Integrity Section and the U.S. Attorney's Office for the Eastern District of Virginia.

## **PENDING INVESTIGATIONS**

### **Allegations of Conflict of Interest by Former Senior Official (Case No. OIG-560)**

During the reporting period, the SEC Chairman requested that the OIG investigate the facts and circumstances surrounding the SEC former General Counsel's involvement in activities relating to the Bernard L. Madoff Ponzi scheme, after she learned that he and his brothers had been sued by the trustee appointed in the Madoff liquidation under the Securities Investor Protection Act for the return of approximately \$1.5 million in fictitious profits received from the Ponzi scheme. The OIG immediately commenced the requested investigation and met with the Honorable Darrell Issa (R-California), Chairman of the

U.S. House of Representatives Committee on Oversight and Government Reform, and numerous Congressional staff concerning their requests for information pertaining to this matter.

As of the end of the reporting period, the OIG had collected approximately 1.7 million e-mails of current and former SEC employees with knowledge of the relevant facts and had begun to search for and analyze pertinent e-mails and document attachments. The OIG also requested and obtained numerous documents from various attorneys in the Office of the General Counsel, as well as pertinent information from the Office of the Secretary, conducted research of the applicable statutes and regulations and commenced informal interviews of individuals with knowledge of the facts at issue.

In the next semiannual reporting period, the OIG will continue its e-mail review and will request and search the e-mails of additional witnesses identified during the course of the investigation. The OIG will also take the sworn testimony of numerous individuals, both inside and outside the SEC, who have knowledge of the relevant facts and circumstances. The OIG plans to complete its investigation and issue a report of its findings prior to the end of the next reporting period.

### **Allegation of Improprieties in the SEC's Leasing Activity (Case No. OIG-553)**

During the reporting period, the OIG opened an investigation after receiving several complaints concerning actions and practices related to the SEC's leasing activities. These activities include the SEC's execution of a letter contract dated July 28, 2010, committing the agency to lease 900,000 square feet of space at Constitution Center in Washington, D.C.

In particular, the OIG is investigating the basis for the decision that the SEC needed an additional 900,000 square feet of space for its D.C. headquarters. The OIG is specifically



investigating whether the SEC may have improperly used inflated data and incorrect assumptions regarding the amount of personnel the SEC would add to its headquarters staff through FY 2013.

The OIG is also investigating whether there were improprieties in connection with the preparation of the Justification and Approval for Other than Full and Open Competition used by the SEC to support its decision to lease space at Constitution Center.

Further, the OIG is investigating whether the SEC violated the Antideficiency Act in obligating funds in connection with its commitment to lease space at Constitution Center, and whether the SEC failed to properly notify the Office of Management and Budget about the SEC's commitment to lease space at Constitution Center.

During this reporting period, the OIG requested and reviewed numerous documents provided by the Office of Administrative Services. The OIG also obtained and reviewed the e-mails of 27 SEC employees for the relevant time period, which amounted to a total of over 1.5 million e-mails. The OIG took the sworn testimony of 15 SEC employees during this reporting period. The OIG also conducted interviews of four SEC employees and five other individuals. The OIG plans to take further testimony, complete its investigative work, and issue its report of investigation during the next semiannual reporting period.

### **Complaint of Investigative Misconduct by Various Enforcement Attorneys (Case No. OIG-511)**

During the reporting period, the OIG continued its investigation of a complaint received from counsel for a defendant in an SEC enforcement action, alleging numerous instances of misconduct by Enforcement attorneys during the course of an investigation. As noted in the OIG's previous Semiannual Report to Congress, the OIG investigation

had been stayed pending a court ruling on a motion in which the complainant made similar allegations to those contained in the initial complaint to the OIG. Because the court had direct jurisdiction over these similar claims, and was in a position to grant the relief sought by the complainant, the OIG had deferred further investigation of the matter pending a determination by the court on these claims.

In September 2010, the court entered an ordering denying without prejudice the complainant's motion containing the pertinent allegations that were brought to the OIG's attention and did not address the merits of the claims. In light of the court's ruling, the OIG decided to move forward with its investigation.

During this reporting period, the OIG obtained additional documentary evidence regarding the matters alleged in the complaint. The OIG also searched the e-mails of eight SEC employees for the relevant time period, which amounted to a total of over 400,000 e-mails. In addition, the OIG took the sworn testimony of an important witness and scheduled the testimony of several other witnesses. The OIG intends to conclude its investigative work and issue its report of investigation in the next semiannual reporting period.

### **Allegation of Improper Preferential Treatment (Case No. OIG-559)**

During the reporting period, the OIG commenced an investigation into an anonymous complaint that a prominent defense counsel was granted special access to a senior SEC official and received special treatment from that senior official. Specifically, the complaint alleged that the senior official had a secret conversation with a prominent defense lawyer representing the company, who was also a good friend and former colleague of the senior official, and that during this secret conversation, the senior official agreed to drop the contested fraud charges against an individual. The complaint also alleged that the staff was later forced to drop the fraud charges that

were part of the settlement with another individual.

The complaint further alleged that the senior official's failure to apprise the staff of the conversation before it occurred was contrary to previous OIG recommendations designed to address concerns about the appearance problems created by special access and preferential treatment.

The OIG obtained and reviewed thousands of e-mails from approximately nine SEC employees and prepared a detailed chronology of events. The OIG also began scheduling testimony of individuals with knowledge of the facts and circumstances of this matter and plans to conduct testimony and complete its investigation during the next reporting period.

#### **Allegation of Failure to Investigate at a Regional Office (Case No. OIG-554)**

The OIG opened an investigation into an anonymous complaint alleging that a regional office Enforcement program failed to timely investigate a financial fraud referred by a regional OCIE program for investigation in late 2004. According to the complaint, OCIE's examination report detailed illegal conduct by an individual and his brokerage firm in connection with the purchase and sale of mortgage-backed securities. The OIG is reviewing case documentation in preparation for upcoming sworn witness testimony. The OIG hopes to complete its investigation and issue a report of investigation in the next reporting period.

#### **Allegation of Improper Preferential Treatment and Failure to Investigate Alleged Obstruction of SEC Investigation at Regional Office (Case No. OIG-536)**

The OIG is continuing its investigation of a complaint that attorneys at a regional office failed to properly investigate a prominent law firm for alleged obstruction of an ongoing

SEC case, allegedly as a result of improper preferential treatment. In addition, it was alleged that regional office staff improperly provided information related to that matter to the law firm.

In this reporting period, the OIG neared completion of its investigative work. Specifically, we have reviewed numerous documents and taken the sworn testimony of the parties with knowledge of the facts or circumstances surrounding the allegations. The OIG intends to conclude its investigative work and issue its report of investigation in the next semiannual reporting period.

#### **Allegation of Unauthorized Disclosures (Case No. OIG-555)**

The OIG opened an investigation into an internal referral alleging that a senior SEC official made numerous unauthorized disclosures to the subject of an ongoing SEC enforcement investigation and his related entities. The complaint alleged that the aforementioned disclosures occurred as far back as 2006, and included legal advice provided by the senior SEC official to the subject of the enforcement investigation.

During the reporting period, the OIG reviewed case documentation in preparation for sworn witness testimony, which is scheduled for the next reporting period. The OIG hopes to complete its investigation and issue a report of investigation in the next reporting period.

#### **Allegation of Procurement Violations (Case No. OIG-556)**

During the reporting period, the OIG continued its investigation of an anonymous complaint alleging that the SEC awarded a contract for an unnecessary assessment to a firm that the OIG previously found had conveyed material benefits to SEC employees in 2005.

Specifically, the OIG obtained and reviewed over 30,000 e-mails of eight former

and current SEC employees and reviewed evidence provided by headquarters offices and various witnesses related to the procurement of the assessment. In particular, the evidence included vendor proposals, requisition requests, and supporting documentation. In addition, we researched laws and regulations regarding government solicitations, competition requirements, and contract award requirements. Finally, the OIG took sworn testimony of three individuals with knowledge of the facts and circumstances surrounding the allegation. The OIG has nearly completed its investigative work and intends to issue its report of investigation in the next reporting period.

### **Complaint of Mismanagement and Inappropriate Use of Government Funds (Case No. OIG-557)**

During the reporting period, the OIG opened an investigation into anonymous alle-

gations that SEC employees mismanaged a computer security lab and inappropriately used SEC funds to obtain equipment and training associated with that lab. The complaint alleged that SEC staff used agency funds for training without filing appropriate training forms, and inappropriately allocated and spent significant budget dollars on purchasing equipment for the lab without justification or planning. The complaint also included allegations regarding hiring procedures, abuse of authority, and waste of SEC resources.

The OIG plans to conduct sworn testimony or interviews of individuals with knowledge of the relevant facts or circumstances surrounding the allegations and complete its investigation during the next reporting period.





# SEMIANNUAL REPORT TO CONGRESS

## REVIEW OF LEGISLATION AND REGULATIONS

During the semiannual reporting period, the OIG reviewed legislation and proposed and final rules and regulations relating to the programs and operations of the SEC, pursuant to Section 4(a)(2) of the Inspector General Act.

In this reporting period, the OIG continued to review various portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Public Law 111-203, enacted on July 21, 2010, that imposed new responsibilities on both the OIG and the SEC as a whole. Specifically, the OIG carefully reviewed the provisions of Section 966 of the Dodd-Frank Act, 15 U.S.C. § 78d-4, in establishing policies and procedures for the OIG Employee Suggestion Hotline, which were issued on March 30, 2011. The OIG also reviewed provisions of the Dodd-Frank Act that imposed new responsibilities on the SEC with a view toward performing future audit work to ensure the SEC properly implements its new responsibilities in a manner that serves their intended purpose.

The OIG also reviewed statutes, rules, regulations, and requirements, and their impact on Commission programs and operations, within the context of audits, reviews,

and investigations conducted during the reporting period. For example, in connection with the OIG's audit of the *SEC's Oversight of the Securities Investor Protection Corporation's (SIPC) Activities* (Report No. 495), the OIG closely reviewed and analyzed the various provisions of the Securities Investor Protection Act (SIPA) of 1970, as amended, 15 U.S.C. § 78aaa, *et seq.* During our audit, we particularly reviewed and analyzed the amendments to SIPA that were made by the Dodd-Frank Act and applicable to SIPA liquidations filed on or after July 22, 2010. In its audit report, which was issued on March 30, 2011, the OIG recommended that the SEC's Division of Trading and Markets update its internal guidance to include, where appropriate, the amendments to SIPA that were made by the Dodd-Frank Act. In addition, the OIG's report recommended that the Division of Trading and Markets, in consultation with the Commission, determine whether to seek a legislative change to SIPA that would allow bankruptcy judges who preside over SIPA liquidations to assess the reasonableness of administrative fees in all cases where administrative fees are paid by SIPC.

In addition, in the course of the OIG's *Audit of the SEC Budget Execution Cycle* (Report

No. 488), the OIG reviewed the requirements of 31 U.S.C. § 1301, commonly referred to as the Purpose Statute, and the Antideficiency Act, 31 U.S.C. §§ 1341(a) and 1517(a), in the course of analyzing whether the SEC had properly charged expenditures during the availability of a supplemental appropriation. During this audit, the OIG also reviewed Section 991 of the Dodd-Frank Act, which established a separate SEC reserve fund appropriation effective in FY 2012. In its audit report, which was issued on March 29, 2011, the OIG made recommendations designed to ensure that the SEC's Office of Financial Management has appropriate policies and guidance in place to ensure the proper charging of expenditures where multiple appropriations are available for the same purpose and that the SEC's budgetary system is capable of accommodating multiple appropriations.

During the OIG's investigation involving the revolving door between employment at the SEC and the securities industry, the OIG carefully reviewed and analyzed the criminal statute and Office of Government Ethics (OGE) regulations imposing restrictions on matters on which federal employees may work while they are seeking or negotiating employment with entities outside the federal government, 18 U.S.C. § 208 and 5 C.F.R. §§ 2635.402 and 2635.603. Likewise, the OIG reviewed and analyzed the criminal statute and OGE regulations imposing restrictions on

employees who leave executive branch employment, 18 U.S.C. § 207 and 5 C.F.R. §§ 2641.104, 2641.201, and 2641.202. The OIG also reviewed the SEC Rule of Conduct provision containing post-employment requirements specifically applicable to SEC employees, 17 C.F.R. § 200.735-8(b). In its investigation, the OIG observed that the OGE's exemption, granted at the SEC's request, of all employees on the SEC's SK pay scale from the one-year ban on communications back to the agency that applies to senior employees has allowed some highly-compensated SEC employees holding prominent positions to evade the ban. The OIG recognized that the blanket exemption for SK employees opens the door to potential abuse and recommended that the SEC Ethics Office seek modification of the blanket exemption from OGE.

Finally, in coordination with the Legislation Committee of the Council of the Inspectors General on Integrity and Efficiency and other Inspectors General, the SEC OIG reviewed, tracked, and analyzed various legislation of interest to the Inspector General community. This legislation included bills introduced in the 111<sup>th</sup> Congress, such as S. 372, "The Whistleblower Protection Enhancement Act," and bills introduced in the 112<sup>th</sup> Congress, such as S. 241, "The Non-Federal Whistleblower Protection Act," and S. 300, "The Government Charge Card Abuse Prevention Act."



# SEMIANNUAL REPORT TO CONGRESS

## **STATUS OF RECOMMENDATIONS WITH NO MANAGEMENT DECISIONS**

Management decisions have been made on all audit reports issued before the beginning of this reporting period.

## **REVISED MANAGEMENT DECISIONS**

No management decisions were revised during the period.

## **AGREEMENT WITH SIGNIFICANT MANAGEMENT DECISIONS**

The Office of Inspector General agrees with all significant management decisions regarding audit recommendations.

## **INSTANCES WHERE INFORMATION WAS REFUSED**

During this reporting period, there were no instances where information was refused.





# Table 1

## List of Reports: Audits and Evaluations

Audit / Evaluation #	Title	Date Issued
481	The SEC's Implementation of and Compliance with Homeland Security Presidential Directive 12	3/31/2011
487	Review of Select Time-and-Materials and Labor-Hour Contracts	12/23/2010
488	Audit of the SEC Budget Execution Cycle	3/29/2011
489	2010 Annual FISMA Executive Summary Report	3/3/2011
493	OCIE Regional Offices' Referrals to Enforcement	3/30/2011
495	SEC's Oversight of the Securities Investor Protection Corporation's Activities	3/30/2011



## Table 2

# Reports Issued with Costs Questioned or Funds Put to Better Use (Including Disallowed Costs)

	Number of Reports	Value
A. REPORTS ISSUED PRIOR TO THIS PERIOD		
For which no management decision had been made on any issue at the commencement of the reporting period	4	\$2,609,575.00
For which some decisions had been made on some issues at the commencement of the reporting period	1	\$4,567,619.00
B. REPORTS ISSUED DURING THIS PERIOD	5	\$1,351,889.00
TOTAL OF CATEGORIES A AND B	10	\$8,529,083.00
C. For which final management decisions were made during this period	6	\$7,183,716.00
D. For which no management decisions were made during this period	3	\$1,345,367.00
E. For which management decisions were made on some issues during this period	0	\$0.00
TOTAL OF CATEGORIES C, D AND E	9	\$8,529,083.00



# Table 3

## Reports with Recommendations on Which Corrective Action Has Not Been Completed

### RECOMMENDATIONS OPEN 180 DAYS OR MORE

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
439 - Student Loan Program	3/27/2008	In consultation with the Union, develop a detailed distribution plan.
446B - SEC's Oversight of Bear Stearns and Related Entities: Broker-Dealer Risk Assessment (BDRA) Program	9/25/2008	Ensure the BDRA system includes financial information, staff notes, and other written documentation and is used to generate management reports.
450 - Practices Related to Naked Short Selling Complaints and Referrals	3/8/2009	Improve analytical capabilities of the Enforcement Complaint Center's e-mail complaint system.
		Improve the Complaints, Tips and Referrals database to include additional information about and better track complaints.
		Ensure the Office of Internet Enforcement updates and resumes using previous complaint referral tracking system or develops a new system.
456 - Public Transportation Benefit Program	3/27/2009	Implement additional management controls over regional office program operations.
458 - SEC Oversight of Nationally Recognized Statistical Rating Organizations (NRSROs)	8/27/2009	Develop guidance regarding the types of deficiencies, (e.g., overly broad disclosures) that should prompt the Division of Trading and Markets to (1) seek consent from the applicant to waive the 90-day statutory time period for granting an application for registration as an NRSRO, or (2) recommend instituting proceedings to determine whether registration should be denied.
460 - Management and Oversight of Interagency Acquisition Agreements (IAAs) at the SEC	3/26/2010	Identify the universe of open IAAs and the corresponding amounts obligated and expended on each IAA, and reconcile the universe of open IAAs with the financial information maintained by the Office of Financial Management (OFM) regarding open IAAs and the corresponding amounts obligated and expended.
		Maintain IAA data in the appropriate centralized automated system to ensure appropriate access to and accuracy of data and to provide for report generation capabilities.
		Establish appropriate internal controls to provide reasonable assurance that, in the future, IAA data is accurate, timely, complete, and reliable.

<b>Audit/Inspection/ Evaluation or Investigation # and Title</b>	<b>Issue Date</b>	<b>Summary of Recommendation</b>
		Promptly identify all IAAs that have expired but have not been closed, and deobligate any funds that remain on the expired agreements.
		Take action to close the IAAs identified for which the performance period expired and deobligate the \$6.9 million in unused funds that remain on the IAAs, in accordance with the appropriate close-out procedures.
		Assess the Mid-Atlantic Cooperative Administrative Support Unit (CASU) IAA to determine if the costs incurred are reasonable and the CASU IAA is in the best interest of the Commission.
		Consider sources of administrative support services that charge lower amounts if it is determined that the Mid-Atlantic CASU IAA does not provide the best value to the Commission.
		Provide additional training to contracting staff and customers regarding IAAs, which includes training on developing and ensuring the adequacy of statements of work and statements of objectives according to applicable guidance and requirements.
461 - Review of the Commission's Restacking Project	3/31/2009	Develop and adopt policies and procedures for investments in space consistent with Office of Management and Budget (OMB) guidance.
466 - Assessment of the SEC Information Technology (IT) Investment Process	3/26/2010	Formally delegate authority to the Chief Information Officer (CIO) necessary for the management and oversight of the Capital Planning and Investment Control (CPIC) process, to include the full authority to develop and execute all IT policy, as approved by the Chairman.
		Revise 17 C.F.R. § 200.13 to provide the CIO with full authority to develop and issue IT policies and carry out the prescribed substantive responsibilities under 44 U.S.C. § 3506 and OMB guidance M-09-02, and remove the CIO/Director of the Office of Information Technology (OIT) from under the supervision of the Executive Director or any position other than the Chairman for those substantive responsibilities.
		Revise SEC Regulation (SECR) 24-02 to add a responsibility that the division directors, office heads, and regional directors ensure that all IT investments within their responsibility adhere to the CPIC policies and procedures, and create an enforcement mechanism for the CIO and the Information Officers Council to utilize when they discover investments that have been funded outside of the CPIC process.

<b>Audit/Inspection/ Evaluation or Investigation # and Title</b>	<b>Issue Date</b>	<b>Summary of Recommendation</b>
471 - Audit of the Office of Acquisitions' Procurement and Contract Management Functions	9/25/2009	Determine the universe of active and open contracts and the corresponding value of the contracts and reconcile this information with the OFM's active contract list.
		Develop an internal process to ensure procurement data is accurately and fully reported in the Federal Procurement Data System for both SEC headquarters and regional offices.
		Develop an acquisition training plan to ensure compliance with OMB's Office of Federal Procurement Policy training requirements.
		Revise and finalize data migration plan and include key controls or steps to ensure accuracy of migrated data.
474 - Assessment of the SEC's Bounty Program	3/29/2010	Develop a communication plan to address outreach to both the public and SEC personnel regarding the SEC bounty program, which includes efforts to make information available on the SEC's intranet, enhance information available on the SEC's public website, and provide training to employees who are most likely to deal with whistleblower cases.
		Develop and post to the SEC's public website an application form that asks whistleblowers to provide information, including, e.g., (1) the facts pertinent to the alleged securities law violation and an explanation as to why the subject(s) violated the securities laws; (2) a list of related supporting documentation available in the whistleblower's possession and available from other sources; (3) a description of how the whistleblower learned about or obtained the information that supports the claim, including the whistleblower's relationship to the subject(s); (4) the amount of any monetary rewards obtained by the subject violator(s) (if known) as a result of the securities law violation and how the amount was calculated; and (5) a certification that the application is true, correct, and complete to the best of the whistleblower's knowledge.
		Establish policies on when to follow up with whistleblowers who submit applications to clarify information in the bounty applications and obtain readily available supporting documentation prior to making a decision as to whether a whistleblower's complaint should be further investigated.
		Develop specific criteria for recommending the award of bounties, including a provision that where a whistleblower relies partially upon public information, such reliance will not preclude the individual from receiving a bounty.

<b>Audit/Inspection/ Evaluation or Investigation # and Title</b>	<b>Issue Date</b>	<b>Summary of Recommendation</b>
		Examine ways in which the Commission can increase communications with whistleblowers by notifying them of the status of their bounty requests without releasing nonpublic or confidential information during the course of an investigation or examination.
		Develop a plan to incorporate controls for tracking tips and complaints from whistleblowers seeking bounties into the development of the Division of Enforcement's (Enforcement) tips, complaints, and referrals processes and systems for other tips and complaints, which should provide for the collection of necessary information and require processes that will help ensure that bounty applications are reviewed by experienced Commission staff, decisions whether to pursue whistleblower information are timely made, and whistleblowers who provide significant information leading to a successful action for violation of the securities laws are rewarded.
		Require that a bounty file (hard copy or electronic) be created for each bounty application, which should contain at a minimum the bounty application, any correspondence with the whistleblower, documentation of how the whistleblower's information was utilized, and documentation regarding significant decisions made with regard to the whistleblower's complaint.
		Incorporate best practices from the Department of Justice (DOJ) and the Internal Revenue Service (IRS) into the SEC bounty program with respect to bounty applications, analysis of whistleblower information, tracking of whistleblower complaints, recordkeeping practices, and continual assessment of the whistleblower program.
		Set a timeframe to finalize new policies and procedures for the SEC bounty program that incorporate the best practices from the DOJ and the IRS, as well as any legislative changes to the program.
480 - Review of the SEC's Section 13(f) Reporting Requirements	9/27/2010	Renew efforts that were begun in 2005 and implement checks in the Electronic Data Gathering and Retrieval (EDGAR) system that will detect and/or correct errors contained in the Forms 13F that are uploaded in EDGAR.
		Update Form 13F to a more structured format, such as Extensible Markup Language (XML), to make it easier for users and researchers to extract and analyze Section 13(f) data.



Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Ensure that the SEC enters into a formal contract or agreement with the third party that prepares the official list required by Section 13(f)(3) of the Securities Exchange Act of 1934 (Exchange Act). This contract or agreement should document the third party's responsibilities for providing the official list on a quarterly basis and explicitly state that the SEC has no financial obligation and the firm has no expectation of payment from the government.
		Determine whether legislative changes to Section 13(f) of the Exchange Act should be sought, specifically with the respect to expanding the definition of Section 13(f) securities, requiring separate reporting of securities held in proprietary accounts and customer accounts, reporting average positions in Section 13(f) securities, and increasing the Section 13(f) reporting threshold.
		Update analysis of the impact of increasing the reporting threshold of \$100 million for Section 13(f) of the Exchange Act.
		Determine whether to recommend to the Commission that it adopt a rule requiring institutional investment managers to report aggregate purchases and aggregate sales of securities required to be reported under Section 13 (f) of the Exchange Act.
483 - Audit of the FedTraveler Travel Service	9/22/2010	Request a legal opinion from the Office of the General Counsel regarding the amount and frequency of fees charged by FedTraveler to ensure that the charges are appropriate and in accordance with the General Service Administration's (GSA) Master Contract and the Commission's task order.
484 - Real Property Leasing Procurement Process	9/30/2010	Revise SECR 11-03 and draft Operating Procedure (OP) 11-03 to ensure that they are adequate and complete and include the information identified in the audit report, finalize OP 11-03, and ensure that the revised documents are posted to the Commission's intranet site and circulated to staff with leasing-related responsibilities.
		Amend SECR 11-03 to include a complete list of relevant authorities (federal statutes, regulations, executive orders, OMB circulars, and internal SEC policies) that apply to real property leasing and finalize detailed guidance to ensure compliance with those authorities.
		Measure the SEC's real property leasing policies and procedures against pertinent provisions of GSA regulations, including the GSA Acquisition Manual and Subchapter C of the Federal Management Regulation, as appropriate.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Ensure that the Leasing Branch's policies and procedures, including OP 11-03 and the attached checklists, provide comprehensive guidance, including pertinent forms and examples, for SEC leasing officials regarding the leasing process that will assist in ensuring compliance with the applicable policies, regulations, and best practices.
		Utilize the "Required Components" section of the Federal Real Property Council's (FRPC) Guidance for Improved Asset Management to develop and finalize the SEC's real property leasing asset management plan, as appropriate. If there are any required components in the FRPC Guidance that are found not applicable to the SEC, the plan should include an explanation as to why the SEC's unique circumstances render those components unnecessary.
		Amend leasing policies and procedures to require the tracking and monitoring of all leasing expenses ( <i>i.e.</i> , rent, operating costs, and taxes) for informational and budget formulation purposes.
		Develop performance goals for the SEC's real property leasing activities, including both lease acquisition and the monitoring and administration of existing leases; identify key external factors that could significantly affect the achievement of these goals; and periodically evaluate whether these goals are met.
		Develop performance measures to assist in evaluating the effectiveness of the major functions of real property acquisitions and operations, and periodically evaluate performance based on these measures. The performance measures should include metrics for all of the OAS Branches that have a role in real property leasing, including the Real Property Leasing, Construction, and Security Branches.
		Revise SEC Regulation 11-03 and draft OP 11-03 to include complete written policies and procedures for timely acquisition planning pertinent to real property leases, including the preparation of a project plan and schedule with projected dates for achieving various milestones well in advance of the scheduled commencement of a lease.
		Adopt evaluation procedures that involve scoring and ranking various options prior to deciding to vacate leased premises or to terminate a lease, and develop a transparent methodology for formulating scores and rankings.

<b>Audit/Inspection/ Evaluation or Investigation # and Title</b>	<b>Issue Date</b>	<b>Summary of Recommendation</b>
		Ensure that the SEC's real property leases provide appropriate protections in the event the SEC needs to terminate a lease before the expiration date, such as, for example, the use of a termination for convenience clause under Part 49 of the Federal Acquisition Regulation, another appropriate clause, or a flexible-term lease.
		Revise the Security and Safety Survey document to include more specific information, such as the number of recent incidents in the vicinity, the likelihood that future incidents will occur or vulnerabilities will be exploited, recommended countermeasures, and cost estimates for such countermeasures.
		Implement final policies and procedures to ensure that the Real Property Leasing Branch consistently includes the Building Security Survey document in all solicitations for leased building space.
		Implement final policies and procedures to ensure that the Security Branch performs a physical review of prospective building locations and determines the threat within the immediate area prior to entering into a lease for any facility.
485 - Assessment of the SEC's Privacy Program	9/29/2010	Apply patches and updates to the Commission's networks, workstations, and laptops on a timely basis. All future patches should be applied within a specified time period of vendor release, with emergency patches being applied on an ad hoc basis to protect the agency's systems and data.
		Evaluate risk assessment processes for scoring risk to ensure that all appropriate factors are adequately weighed, including the identification of risk levels by vendors.
		Submit a completed list of common security standard deviations to the National Institute of Standards and Technology per OMB requirements.
		Implement an agency-wide policy regarding shared folder structure and access rights, ensuring that only the employees involved with a particular case have access to that data. If an employee backs up additional information to the shared resources, only the employee and his or her supervisor should have access.
		Ensure personal storage tab (PST) files are saved to a protected folder.
		Ensure all file rooms and file cabinets are secured.
		Conduct additional training to ensure that staff fully understand the rules and policies concerning the handling of Personally Identifiable Information and sensitive data and their responsibilities in protecting SEC information.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Finalize, approve, and implement operating procedures for "Hard Drive Wiping and Media Destruction," and make staff aware of the procedures and their roles and responsibilities for the disposal of portable media storage devices. These operating procedures must include information concerning the roles and responsibilities of all Commission employees in the proper destruction of portable media storage devices.
		Provide Commission staff training on handling, disposal, and storage of portable media storage devices.
		Provide secured bins for the disposal of portable media storage devices that are easily accessible to all Commission employees and clearly communicate the use and locations of these bins to all employees.
486 - Review of PRISM Automated Procurement System Support Contracts	9/30/2010	Review the adequacy of trained project officers who are available to manage all current and anticipated projects. If it is determined that sufficient qualified project officers are not available to manage all current and anticipated projects, the situation should be remedied by either providing an adequate number of qualified personnel, or implementing an alternative process for ensuring oversight of the projects.
		Implement internal procedures to limit contracting officers from also assuming project management and a Contracting Officer's Technical Representative's (COTR) responsibilities on the same project.
		Review existing contracts to ensure that a COTR is assigned to each contract, as appropriate.
		Evaluate the PRISM and financial system reconciliation tool to determine, on a cost-benefit basis, whether it would be feasible to correct the deficiencies identified, and then decide whether the corrections should be performed by Commission personnel, or by technically-competent contractor personnel.
PI-09-05 - SEC Access Card Readers in Regional Offices	2/22/2010	Ensure, on a Commission-wide basis, that all regional offices are capable of capturing and recording building entry and exit information of Commission employees.
PI-09-07 - Employee Recognition Program and Grants of Employee Awards	3/10/2010	Review and update internal regulation and policy for the SEC's Employee Recognition Program (ERP), and post the revised regulation and/or policy to the SEC's intranet site.
		Ensure the revised ERP regulation and/or policy specifically addresses whether informal recognition awards are authorized and, if so, what criteria, standards, and approvals pertain.

<b>Audit/Inspection/ Evaluation or Investigation # and Title</b>	<b>Issue Date</b>	<b>Summary of Recommendation</b>
		Ensure the revised ERP regulation and/or policy makes clear that appropriated funds may not be used to pay for employee parking as an award.
		Review various Budget Object Class (BOC) codes currently used for non-monetary employee awards, select the most apposite BOC and ensure all properly authorized non-monetary awards are charged to that BOC.
		Approve requests to use appropriated funds for non-monetary employee awards only after ensuring an authorized agency officer has approved the awards under statutory and regulatory authority.
ROI-470 - Allegations of Conflict of Interest and Investigative Misconduct	2/24/2010	Institute procedures to require that a decision be made, documented, and approved where Enforcement has informed the Commission it is continuing to consider recommending charges.
ROI-491 - Allegation of Fraudulently Obtained Award Fees	3/29/2010	Make efforts to recapture a portion of additional award fees a contractor obtained based on potentially inaccurate data.
		Assign all contracts over \$1 million to staff at the level of Assistant Director or higher, as well as the Office of Acquisitions, which provides oversight for various SEC acquisitions.
ROI-496 - Allegations of Conflict of Interest, Improper Use of Non-Public Information and Failure to Take Sufficient Action Against Fraudulent Company	1/8/2010	Consider methods to ensure no appearance of impropriety when a former SEC attorney represents a company shortly after SEC work provided specific, sensitive information related to the company.
ROI-505 - Failure to Timely Investigate Allegations of Financial Fraud	2/26/2010	Ensure as part of changes to complaint handling system that databases used to refer complaints are updated to accurately reflect status of investigations and identity of staff.
		Ensure as part of changes to complaint handling system that referrals are monitored to ensure they are being actively investigated and complainants are provided accurate information.
		Ensure as part of changes to case-closing system that cases that are not actively being investigated are closed promptly.
		Ensure as part of changes to case-closing system that Enforcement staff members have access to accurate information about the status of investigations and staff requests to close investigations.
		Ensure as part of changes to case-closing system that staff at all levels be appropriately trained in case-closing procedures.

<b>Audit/Inspection/ Evaluation or Investigation # and Title</b>	<b>Issue Date</b>	<b>Summary of Recommendation</b>
ROI-522 - Investigation of the Circumstances Surrounding the SEC's Proposed Settlements with Bank of America	9/30/2010	Create clear criteria for making Division of Corporation Finance waiver determinations.
		Disseminate the guidance for making Division of Corporation Finance waiver determinations.
		Articulate the rationale for a departure from stated waiver decision criteria in a written decision or order.
ROI-524 - Improper Use of Leave Without Pay (LWOP) to Receive Full-Time Benefits	7/23/2010	Disband the policy that allows employees to use LWOP to create a de facto part-time schedule and require offices to follow the Collective Bargaining Agreement.
		Conduct an audit of all SEC employees to determine whether employees regularly use LWOP to create a part-time schedule but have not had their benefits and leave reduced.
		Identify improvements needed in the manner in which the SEC manages and improves reduced work hours.

# Table 4

## Summary of Investigative Activity

<b>Cases</b>	<b>Number</b>
Cases Open as of 9/30/2010	16
Cases Opened during 10/01/2010 - 3/31/2011	15
Cases Closed during 10/01/2010 - 3/31/2011	20
Total Open Cases as of 3/31/2011	11
Referrals to the Department of Justice for Prosecution	3
Prosecutions	1
Convictions	0
Referrals to Agency for Disciplinary Action	21
<b>Preliminary Inquiries</b>	<b>Number</b>
Inquiries Open as of 9/30/2010	90
Inquiries Opened during 10/01/2010 - 3/31/2011	27
Inquiries Closed during 10/01/2010 - 3/31/2011	44
Total Open Inquiries as of 3/31/2011	73
Referrals to the Department of Justice for Prosecution	2
Referrals to Agency for Disciplinary Action	11
<b>Disciplinary Actions</b>	<b>Number</b>
Removals (Including Resignations and Retirements)	7
Demotions	0
Suspensions	2
Reprimands	3
Warnings/Other Actions	1





# Table 5

## Summary of Complaint Activity

Description	Number
Complaints Pending Disposition at Beginning of Period	11
Hotline Complaints Received	106
Other Complaints Received	266
Total Complaints Received	372
Complaints on which a Decision was Made	380
Complaints Awaiting Disposition at End of Period	3
<b>Disposition of Complaints During the Period</b>	
Complaints Resulting in Investigations	9
Complaints Resulting in Inquiries	27
Complaints Referred to OIG Office of Audits	12
Complaints Referred to Other Agency Components	150
Complaints Referred to Other Agencies	13
Complaints Included in Ongoing Investigations or Inquiries	20
Response Sent/Additional Information Requested	34
No Action Needed	120



# Table 6

## References to Reporting Requirements of the Inspector General Act

*The Inspector General Act of 1978, as amended, specifies reporting requirements for semiannual reports to Congress. The requirements are listed below and indexed to the applicable pages.*

<b>Section</b>	<b>Inspector General Act Reporting Requirement</b>	<b>Pages</b>
4(a)(2)	Review of Legislation and Regulations	77-78
5(a)(1)	Significant Problems, Abuses, and Deficiencies	24-42, 46-71
5(a)(2)	Recommendations for Corrective Action	24-42, 46-71
5(a)(3)	Prior Recommendations Not Yet Implemented	85-94
5(a)(4)	Matters Referred to Prosecutive Authorities	46-71, 95
5(a)(5)	Summary of Instances Where Information Was Unreasonably Refused or Not Provided	79
5(a)(6)	List of OIG Audit and Evaluation Reports Issued During the Period	81
5(a)(7)	Summary of Significant Reports Issued During the Period	24-42, 46-71
5(a)(8)	Statistical Table on Management Decisions with Respect to Questioned Costs	83
5(a)(9)	Statistical Table on Management Decisions on Recommendations That Funds Be Put To Better Use	83
5(a)(10)	Summary of Each Audit, Inspection or Evaluation Report Over Six Months Old for Which No Management Decision Has Been Made	79
5(a)(11)	Significant Revised Management Decisions	79
5(a)(12)	Significant Management Decisions with Which the Inspector General Disagreed	79
5(a)(14)	Appendix of Peer Reviews Conducted by Another OIG	101



### PEER REVIEWS OF OIG OPERATIONS

#### Peer Review of the SEC OIG's Audit Operations

During the semiannual reporting period, the SEC OIG did not have an external peer review conducted of its audit operations. Peer reviews of OIG audit operations are required to be conducted every three years. The most recent peer review of the SEC OIG's audit operations was conducted by the Corporation for Public Broadcasting (CPB) OIG. The CPB OIG issued its report on the SEC OIG's audit operations in January 2010. This report concluded that the SEC OIG's system of quality for its audit function was designed to meet the requirements of the quality control standards established by the U.S. Comptroller General in all material respects. The report is available on our website at [http://www.sec-ig.gov/Reports/Other/CPB\\_PeerReviewSEC.pdf](http://www.sec-ig.gov/Reports/Other/CPB_PeerReviewSEC.pdf).

#### Peer Review of the SEC OIG's Investigative Operations

During the semiannual reporting period, the SEC OIG did not have an external peer review of its investigative operations. Peer reviews of Designated Federal Entity OIGs, such as the SEC OIG, are conducted on a voluntary basis. The most recent peer review of the SEC OIG's investigative operations was conducted by the U.S. Equal Employment Opportunity Commission (EEOC) OIG. The EEOC OIG issued its report on the SEC OIG's investigative operations in July 2007. This report concluded that the SEC OIG's system of quality for the investigative function conformed to the professional standards established by the President's Council on Integrity & Efficiency and the Executive Council on Integrity & Efficiency (now the Council of the Inspectors General on Integrity & Efficiency).



**Written Testimony of H. David Kotz  
Inspector General of the  
Securities and Exchange Commission**



**Before the Subcommittee on Financial Services and  
General Government, Committee on Appropriations,  
U.S. House of Representatives**

**Thursday, February 10, 2011  
10:00 a.m.**

## **Appendix B**

### **Introduction**

Thank you for the opportunity to testify before this Subcommittee with respect to the Securities and Exchange Commission (SEC or Commission). I appreciate the interest of the members of the Subcommittee in the SEC and the Office of Inspector General (OIG). In my testimony, I am representing the OIG, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

### **Role of the OIG**

I would like to begin my remarks by briefly discussing the role of my Office and the oversight efforts we have undertaken during the past few years. The OIG is an independent office within the SEC that conducts audits of programs and operations of the Commission and investigations into allegations of misconduct by agency staff or contractors. The OIG, in accordance with the Inspector General Act of 1978, as amended, does not make policy decisions for the SEC and/or substantive determinations regarding the Commission's program functions or budgetary process. Rather, the OIG's mission is to promote the integrity, efficiency and effectiveness of the programs and operations of the SEC and to report its findings and recommendations to the agency and to Congress. Since my appointment as Inspector General of the SEC in December 2007, the OIG's investigative and audit units have engaged in aggressive and vigorous oversight of the SEC.

### **SEC OIG Investigations**

The Office's investigations unit has conducted numerous comprehensive investigations into significant failures of the SEC in accomplishing its regulatory mission,



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as well as investigations into allegations of violations of statutes, rules and regulations, and other misconduct by Commission employees and contractors. Several of these investigations involved senior-level Commission officials and represent matters of great concern to the Commission, Congressional officials and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removal of employees from the Federal service, as well as recommendations for improvements in agency policies, procedures and practices.

Specifically, we have issued investigative reports regarding a myriad of allegations, including claims of failures by the Division of Enforcement (Enforcement) to pursue investigations vigorously or in a timely manner, improper securities trading by Commission employees, conflicts of interest by Commission staff, post-employment violations, unauthorized disclosure of non-public information, procurement violations, preferential treatment given to prominent persons, retaliatory termination, perjury and falsification of documents, failure of SEC attorneys to maintain active bar status, and the misuse of official position, government resources and official time.

In August 2009, we issued a 457-page report of investigation analyzing the reasons why the SEC failed to uncover Bernard Madoff's \$50 billion Ponzi scheme. This report was issued after a nine-month investigation in which we conducted 140 interviews and reviewed approximately 3.7 million e-mails. In March 2010, we issued a thorough and comprehensive report of investigation regarding the history of the SEC's examinations and investigations of Robert Allen Stanford's alleged \$8 billion Ponzi scheme. More recently, we issued reports on the circumstances surrounding the SEC's proposed settlements with Bank of America, which included an analysis of the impact of

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Bank of America's status as a Troubled Asset Relief Program (TARP) recipient on the SEC's Enforcement action and settlement, and allegations of improper coordination between the SEC and other governmental entities concerning the SEC's Enforcement action against Goldman Sachs & Co.

### **SEC OIG Audits**

The Office's audit unit has also issued numerous reports involving matters critical to SEC programs and operations and the investing public. These have included an examination of the Commission's oversight of Bear Stearns and the factors that led to its collapse, an audit of Enforcement's practices related to naked short selling complaints and referrals, a review of the SEC's bounty program for whistleblowers, an analysis of the SEC's oversight of credit rating agencies, an audit of the SEC's real property and leasing procurement process and an audit of the FedTraveler travel service. In addition, following the investigative report related to the Madoff Ponzi scheme described above, we performed three comprehensive reviews providing the SEC with 69 specific and concrete recommendations to improve the operations of both Enforcement and the SEC's Office of Compliance Inspections and Examinations (OCIE.)

### **SEC OIG's Identification of Waste of Government Funds**

Over the past three years, many of our efforts have been directed at identifying waste or misuse of government funds by the SEC. We have issued numerous reports in which we identified waste and inefficiencies, as well as inadequate oversight on the part of various SEC components. By reviewing our audit and investigative reports issued over the past three years, we found that the two largest areas in which we have identified

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significant waste and inefficiencies have been procurement and contracting and costs relating to real property leasing and office moves.

In the procurement and contracting area, we have identified numerous deficiencies in the management and oversight of contracts into which the SEC has entered, a lack of written internal policies and procedures for administering contracts and other agreements, a failure to maintain accurate records and data regarding contracts and agreements, and improprieties in the selection of vendors and the awarding of contracts. These failures have led to the cancellation of contracts and the expenditure of funds to re-procure required services.

In addition, numerous OIG investigations, audits and reviews have revealed significant excessive costs and inefficiencies in connection with the SEC's leasing of real property and the relocation of staff offices. We found numerous situations in which the SEC made excessive payments that could have been avoided if appropriate policies and procedures had existed and been followed. We also found that SEC management approved a project to re-configure internal office staff space at a significant monetary cost without performing any cost-benefit analysis of the project prior to its undertaking. An OIG survey to the Commission staff affected by the moves revealed that they were satisfied with their workplace locations prior to the project and generally felt the project was a waste of time and money.

### **SEC OIG's Follow-up on its Recommendations**

In the instances that I described in which our Office found wasteful expenditures and inefficiencies, we have provided SEC management with detailed descriptions of our findings, as well as concrete and specific recommendations to alleviate the problems and

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concerns we identified. We have also followed up to ensure that these recommendations have been agreed to and are fully implemented. We are pleased to report that the overwhelming majority of our recommendations have been implemented and, accordingly, we are confident that the situations we identified have been ameliorated and will not recur.

### **Funding Necessary to Implement OIG Recommendations**

We have also made recommendations designed to increase the SEC's oversight capability and its internal controls. In certain instances, it has been and will be necessary for the SEC to incur additional expenses in order to implement our recommendations. For example, after our investigative report found that the SEC failed to respond appropriately to credible tips and complaints about Bernard Madoff's operations by conducting competent examinations and investigations, we made numerous recommendations designed to reform the SEC's system for handling tips and complaint system. The SEC has implemented these recommendations and instituted a new Tip, Complaint and Referral (TCR) system in order to ensure that complaints received are acted upon in a timely and appropriate manner at a total cost of approximately \$21 million. Additional funding will be required to ensure that the SEC has sufficient resources to implement many of the recommendations that have arisen, and will arise, out of our audits, reviews and investigations.

### **Identification of Efficiencies Within SEC Operations and Functions**

We are also pleased to report that senior SEC officials, particularly those within the Office of Information Technology (OIT), have informed us that they are analyzing the SEC's operations and functions to identify efficiencies and areas in which costs can be

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reduced. The SEC's new Chief Information Officer has recently indicated that he plans to cancel a \$2 million information technology contract that he found not to be cost-effective. We support and applaud these efforts and will continue to encourage this type of approach in the future.

### **Conclusion**

I believe that the SEC's mission of protecting of investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, is more important than ever. As our nation's securities exchanges mature into global for-profit competitors, there is even greater need for sound market regulation. At the same time, the SEC has a responsibility to utilize government funds in an efficient and effective manner. The OIG intends to remain vigilant to ensure that scarce government resources are utilized wisely and cost-effectively and instances of waste and abuse are eliminated.

I appreciate the interest of the Subcommittee in the SEC and my Office. I believe that the Subcommittee's and Congress's continued involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. Thank you.



Help ensure the integrity of SEC operations by reporting to the OIG suspected fraud, waste or abuse in SEC programs or operations, and SEC staff or contractor misconduct by contacting the OIG.

**Call:**

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Main Office (202) 551-6061

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**Write:**

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U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

**Email:**

[oig@sec.gov](mailto:oig@sec.gov)

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**U.S. Securities  
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