UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
INSPECTOR GENERAL

July 6, 2015

TO: Mary Jo White, Chair
Jeffery Heslop, Chief Operating Officer

FROM: Carl W. Hoecker, Inspector General

SUBJECT: *Final Management Letter: Evaluation of the SEC's Use of the Reserve Fund*

The U.S. Securities and Exchange Commission (SEC or agency) Office of Inspector General (OIG) has completed an evaluation of the SEC's use of the Reserve Fund for fiscal years (FY) 2012, 2013, and 2014. This management letter summarizes the results of our evaluation.

Executive Summary

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111–203, 124 Stat. 1376) (Dodd-Frank or Act) established the "Securities and Exchange Commission Reserve Fund" (Reserve Fund or Fund)[1] to be used "as the [U.S. Securities and Exchange] Commission determines is necessary to carry out the functions of the Commission." Given this discretion, the SEC determined that for FYs 2012, 2013, and 2014 it would use the Reserve Fund for information technology (IT) modernization efforts and reported this decision to Congress. We determined that the SEC had the authority to make this decision and did not exceed its authority in making the decision. The SEC generally defines "IT modernization" to mean large-scale, enterprise-wide, multi-year efforts that are broad in scope. The agency chose eight IT modernization program areas to receive funding and we determined that it obligated the Reserve Fund to these program areas with increasing efficiency between FY 2012 and FY 2014.

We also found that the SEC established a process to request, grant, use, and track the money in the Reserve Fund. Specifically, between FY 2012 and FY 2014, the Office of Financial Management (OFM) loaded budget authority into the agency's financial system in accordance with the Chief Financial Officer's (CFO) authorization. Further, the SEC reported to Congress all Reserve Fund obligations, as required, and those reports were generally accurate, complete, and timely. Although the SEC did not concurrently report to the Office of Management and Budget (OMB) Reserve Fund obligations as required by agency policy, OFM took steps during our evaluation to ensure compliance with the policy in the future.

[1] Dodd-Frank amended Section 4 of the Securities Exchange Act of 1934 (15 U.S.C. 78d) by adding language establishing the "Securities and Exchange Commission Reserve Fund."

Furthermore, we determined that external and internal factors affect the availability of the Reserve Fund. Lastly, the availability of the Fund directly affects the agency's plans to modernize its IT, and the absence of the Fund would adversely impact the SEC's IT modernization efforts and the Office of Information Technology's (OIT) ability to provide ongoing IT operations and maintenance services to the agency. Although the SEC does not have, nor is it required to have, a formal plan for funding its IT modernization projects if the Reserve Fund is unavailable, the SEC routinely prioritizes such projects during the project planning process. The agency could use this process to decide which projects would be funded from the general fund, and at what level, if the Reserve Fund was unavailable.

Background

Section 991e(i) of Dodd-Frank gave the SEC authority to establish a Reserve Fund with the U.S. Department of the Treasury and deposit into the Fund up to $50 million per year from registration fees collected from SEC registrants, with a Fund balance limit of $100 million. This Fund is separate from the agency's annual appropriation, is considered "no-year" money, and, as discussed below, is subject to sequestration and can be affected by rescission.[2] Although the Act allows the SEC to determine how to use the Fund, Dodd-Frank requires the agency to notify Congress of the date, amount, and purpose of Reserve Fund obligations no later than 10 days after the date of each obligation.

In response to the establishment of the Reserve Fund, the SEC issued SEC Administrative Regulation (SECR) 14-2 (August 15, 2011), *Administrative Control of Reserve Fund*, which describes the policies and procedures for administrative control of the Reserve Fund. The SEC also added Chapter 06.05, *Budget Formulation and Execution: Reserve Fund Budgetary Procedures*, to the OFM Reference Guide, which established standard operating procedures for implementing the SECR. Consistent with Dodd-Frank, SEC policy does not restrict the agency's use of the Reserve Fund.

Through its regular annual appropriation, the SEC receives general funding to operate its OIT; however, this money is used to fund operations and maintenance needs such as help desk support, data center operations, and purchases for infrastructure and technology (e.g., computers and phones). Alternatively, SEC officials decided to use the Reserve Fund to fund large-scale, enterprise-wide, multi-year, mission-critical IT modernization efforts. Consistent with this decision, between FY 2012 and FY 2014, the former SEC Chairman and current SEC Chair regularly testified before and reported to Congress that the agency would use the Reserve Fund to modernize its IT systems.[3]

In FY 2013, the SEC introduced a multi-year technology modernization plan called Working Smarter. The goal of Working Smarter is to improve core operations and implement new

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[2] Dodd-Frank specified that the amounts collected in the Reserve Fund are not considered Government funds or appropriated monies, are not subject to apportionment, and "shall remain available until expended…." No-year funds are those available for obligation without fiscal year limitation.

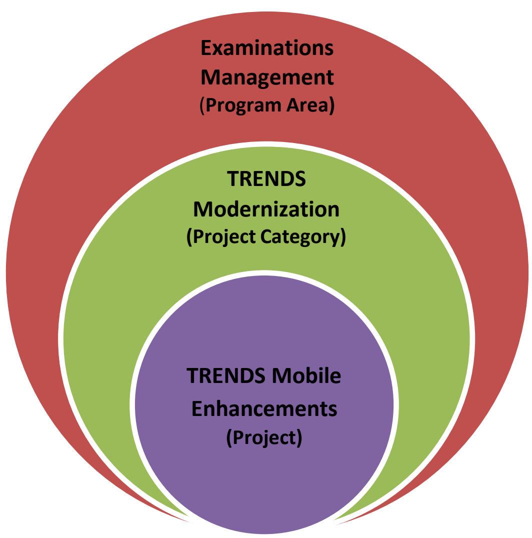
[3] For the purpose of this evaluation, we considered these communications criteria as they were public statements made to Congress regarding how the SEC intended to use the Reserve Fund.

responsibilities under Dodd-Frank. During the period evaluated, Working Smarter included the following eight IT program areas for which the SEC planned to use the Reserve Fund:

1. Business Process Automation and Improvement
2. Data Analytics
3. Electronic Data Gathering, Analysis, and Retrieval (EDGAR) System Modernization
4. Enforcement Investigation and Litigation
5. Enterprise Data Warehouse
6. Examinations Management
7. SEC.gov Modernization
8. Tips, Complaints, and Referrals System Modernization[4]

Each of these eight IT program areas contains multiple underlying project categories, which themselves contain one or more projects. For example, the Examinations Management program area comprises three project categories, including one called Tracking Reporting Examination National Documentation System (TRENDS) Modernization, which includes a project called TRENDS Mobile Enhancements.[5] Figure 1 shows the hierarchy from program area to project category to project. According to the SEC, as of February 11, 2015, the 8 IT program areas contained a total of 66 individual projects.

Figure 1. Example of a Program Area with Underlying Project Category and Project.



Source: OIG-generated.

[4] As of the date of this letter, the SEC had split the EDGAR System Modernization program area into EDGAR Enhancements and EDGAR Redesign. The agency had also implemented the Enterprise Data Warehouse and removed it from the Working Smarter plan.

[5] TRENDS provides an electronic examination platform to manage the National Examination Program processes of the Office of Compliance Inspections and Examinations.

To ensure it timely reports Reserve Fund obligations to Congress, the SEC established a process in the OFM Reference Guide. As shown in Figure 2, the general steps in the process are as follows:

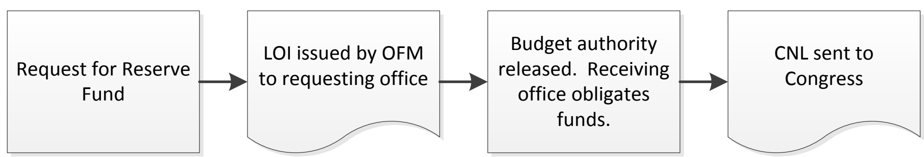
1. The division or office requesting to use the Reserve Fund asks OFM for budget allocation.

2. OFM grants the budget authority through a Letter of Instruction (LOI).

3. OFM loads the budget authority into the agency financial system, Delphi, for the requesting division or office to execute.[6]

4. The CFO notifies the SEC's U.S. House of Representatives and U.S. Senate appropriators and budget authorizers through a Congressional Notification Letter (CNL).

Figure 2. SEC Process for Authorizing, Tracking, and Communicating Reserve Fund Obligations to Congress.



Source: OIG-generated.

Objectives, Scope, and Methodology

The objective of our evaluation was to assess the SEC's use of the Reserve Fund for FYs 2012, 2013, and 2014. We reviewed applicable laws, policies, and procedures, and determined whether the SEC complied with Reserve Fund requirements. We also determined whether actual Reserve Fund expenditures agreed to the obligations reported to Congress. Finally, we assessed the SEC's plans for funding its large-scale, enterprise-wide, multi-year IT modernization efforts in an uncertain funding environment and in the event that the Reserve Fund is unavailable. We conducted this evaluation between January and June 2015 and in accordance with the Council of the Inspectors General on Integrity and Efficiency *Quality Standards for Inspection and Evaluation* (January 2012). Attachment I includes additional information on our scope and methodology.

Results

The SEC Uses the Reserve Fund for IT Modernization. Neither Dodd-Frank nor SEC policy restricts the agency's use of the Reserve Fund; therefore, the SEC has wide discretion to determine how to use it. The SEC determined that it would use the Reserve Fund to

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[6] Between FY 2012 and FY 2014, OIT was the only SEC division or office that received authority to use the Reserve Fund.

modernize its IT systems and, between FY 2012 and FY 2014, informed Congress of its plans. In addition, the OFM Reference Guide established a process for reporting to Congress obligations made against the Reserve Fund, as required by Dodd-Frank. Additionally, we verified that the obligations reported to Congress were for IT modernization efforts and were consistent with actual expenditures made from the Reserve Fund.

The SEC Determined How to Use the Reserve Fund. Given the broad authority provided by Dodd-Frank, SEC officials – namely the Chief Operating Officer (COO), CFO, Executive Director, and staff of the former Chairman – determined that the agency would use the Reserve Fund for its IT modernization efforts.[7] We determined that the SEC had the authority to make this decision and did not exceed its authority in making the decision. In addition, we determined that the definition of "IT modernization" – large-scale, enterprise-wide, multi-year efforts that are broad in scope and do not include routine operations and maintenance – was consistent across the agency. Regarding the decision to use the Reserve Fund to modernize the SEC's IT systems, one official stated that there had been difficulty funding multi-year initiatives using only the agency's annual appropriation. Specifically, once the allocated portion was exhausted, the agency had to wait for the next annual appropriation to continue each project. Another official stated that the "newfound budget certainty" offered by the Reserve Fund allowed the SEC to initiate long-term IT modernization projects. However, SEC officials recognize that, because neither Dodd-Frank nor SEC policy requires or prohibits a specific use for the Fund, the agency could reassign it at any time.

The SEC Reported Its Decision in Congressional Testimony, Reports, and Correspondence. The Congressional testimony, reports, and correspondence of the former SEC Chairman and current SEC Chair memorialize the agency's decision to use the Reserve Fund for its IT modernization efforts. Specifically, at the beginning of FY 2012 (the first year of the Reserve Fund), the SEC sent a letter to Congress stating that it intended to use the Fund to modernize the EDGAR system and SEC.gov, the agency's public website. For each subsequent year, the former SEC Chairman and current SEC Chair consistently testified to the SEC's plans to fund multi-year IT efforts using the Reserve Fund. For example, on March 6, 2012, former Chairman Mary L. Schapiro testified that "the SEC…intends to use the Reserve Fund…to address important multi-year technology initiatives," specifying that, "[f]or FY 2013, the SEC plans to use $50 million from the Reserve Fund for continued modernization of EDGAR and SEC.gov, as well as additional IT projects."[8] Also, on May 7, 2013, SEC Chair Mary Jo White testified that "in FY 2014, the SEC plans to use $50 million from the SEC Reserve Fund…to fund large, multi-year, mission-critical technology projects."[9]

[7] While recollection of this decision was consistent, we found that discussions of how to use the Reserve Fund were not documented. Also, the functions of the Executive Director were transitioned to the Office of the COO in May 2011.

[8] Former SEC Chairman Mary L. Schapiro testimony before the Subcommittee on Financial Services and General Government, Committee on Appropriations, United States House of Representatives.

[9] SEC Chair Mary Jo White testimony before the Subcommittee on Financial Services and General Government, Committee on Appropriations, United States House of Representatives.

Also, for FYs 2013 and 2014, the SEC submitted Congressional budget justifications that consistently referred to the SEC's plans to fund multi-year IT efforts using the Reserve Fund. For example, the FY 2013 document was consistent with former Chairman Schapiro's 2012 testimony and stated that the agency would use the Reserve Fund for a number of other IT projects, including development of Market Oversight and Watch Systems; development of fraud analysis and fraud prediction analytical models; and deployment of search tools to assist fraud detection efforts. The FY 2014 document expanded on the FY 2013 projects, adding that, in addition to EDGAR system modernization, "the funds also will be used for the construction and enhancement of the Enterprise Data Warehouse" and to develop capabilities within the Consolidated Audit Trail Repository.

Reserve Fund Obligations Were for IT Modernization Efforts and Were Consistent with Actual Expenditures. As discussed above, the SEC established a process to request, grant, use, and track the money in the Reserve Fund. We found that, between FY 2012 and FY 2014, OFM issued all 27 LOIs to OIT, granting budget authority to use the Reserve Fund for the 8 IT modernization program areas. In addition, the agency's Reserve Fund obligations reported in all 51 CNLs between FY 2012 and FY 2014 related to the IT modernization program areas.

Although Dodd-Frank requires that the SEC notify Congress of Reserve Fund obligations, the Act does not require the agency to report expenditures made against those obligations. However, we reviewed actual expenditures in Delphi and determined that they appear to align with the IT modernization obligations the SEC reported to Congress in the CNLs.

Obligations Reported to Congress Generally Met Requirements. As described above, the SEC uses LOIs to grant budget authority from the Reserve Fund and uses CNLs to report to Congress Reserve Fund obligations. Additionally, SECR 14-2 requires the SEC to notify OMB "concurrently with notification to the Congress by sending a copy of the Congressional notification to the [Resource Management Officer]…." We found that OFM accurately loaded budget authority into Delphi in accordance with authorization given in the LOIs. Also, obligations reported to Congress in the CNLs were generally accurate, complete, and timely. However, the SEC did not notify OMB of Reserve Fund obligations, as required.

OFM Accurately Loaded Budget Authority into Delphi in Accordance with Authorization. As noted above, the CFO signed 27 LOIs between FY 2012 and FY 2014 and they all provided OIT budget authorization to use the Reserve Fund for the SEC's IT modernization efforts. We further validated that OFM correctly loaded budget authority for those years into Delphi accordance with the LOIs.[10] Specifically, all of the budget authority transactions in Delphi for the period reviewed had a corresponding LOI, and all Reserve Fund authorizations in LOIs were reflected in Delphi. For example, we found that an LOI dated December 28, 2012,

[10] We noted that in FY 2014, the dollar amounts in the LOIs were rounded to the nearest $100,000. OFM stated that it used a more specific OIT request in the Budget and Program Performance Analysis System to grant budget authority in Delphi to the dollar. Therefore, the LOIs did not exactly match the budget allocated in Delphi. We found that in FY 2014, the cumulative stated budget authority in the LOIs was approximately $200,000 greater than the actual budget allocation given in Delphi.

authorized $9.3 million to procure hardware, software, and labor needed to modernize the EDGAR system. On the same date, the same dollar amount was allotted to OIT in Delphi.

Obligations Reported to Congress Were Generally Accurate, Complete, and Timely. As discussed above, Dodd-Frank requires the SEC to notify Congress of the date, amount, and purpose of all Reserve Fund obligations no later than 10 days after the date of the obligation. We reviewed the 51 CNLs from FYs 2012, 2013, and 2014 and all obligation transactions in Delphi for the same period and determined that the SEC generally appears to have accurately and completely reported to Congress all Reserve Fund obligations during those years. In addition, the dollar amounts of the obligations in Delphi matched those reported on the CNLs, with one immaterial exception.[11] Further, we identified no Reserve Fund obligations in Delphi that were not reported on a CNL.

Although the SEC generally submitted the CNLs timely, we found that 3 of the 51 CNLs were submitted more than 10 days from the date of the obligation. One was submitted 99 days after the obligation and adjusted a prior year's obligation by less than $90. Two were submitted 11 days after the obligation. In response, OFM consulted the SEC's Office of the General Counsel, which stated that, if the 10th day falls on a weekend or holiday, OFM may submit the CNL to Congress on the next business day. One of the two CNLs submitted on the 11th day meets this criterion.

We also determined that the obligation date in Delphi did not always match the obligation date reported in the CNL, and that OFM had not defined in policy the date on which it would start to count the 10 days. OFM officials stated that the obligation date in Delphi may differ by one day from the date of the actual obligation (e.g., the signing of a contract for IT modernization services) due to the timing of system batch processing. In response, on April 3, 2015, OFM's Assistant Director for its Planning and Budget Office sent an email to responsible staff stating that, effective immediately, OFM would use the actual contract obligation date as the starting date for the 10-day reporting period.

In addition, in FY 2014 Congress required the SEC to include in its written notifications to Congress certain additional information regarding available balances and total costs.[12] We found that for FY 2014, the SEC appended two tables to the CNLs in response to these additional reporting requirements.

The SEC Did Not Notify OMB as Required by Agency Policy. Although required by SECR 14-2, the SEC had not sent to OMB copies of the Reserve Fund CNLs. After we brought this to OFM's attention, OFM sent OMB copies of all FY 2015 CNLs. OFM also informed the OMB Resource Management Officer that the SEC will provide CNLs with each Reserve Fund obligation in the future.

[11] An obligation dated August 18, 2014, was over-reported by $251.14 on a CNL dated August 22, 2014.

[12] Explanatory Statement to the Consolidated Appropriations Act of 2014, Pub. L. No. 113-76.

The Availability of the Reserve Fund Affects the SEC's IT Modernization Efforts and Could Adversely Impact OIT's Ability to Provide Services. External and internal factors affect the availability of the Reserve Fund. Such factors include statutory limits, rescission, the agency's carryover of prior year balances, sequestration, and the state of the agency's IT infrastructure and IT modernization project lifecycles. In addition, the availability of the Fund directly affects the SEC's plans to modernize its IT systems and could adversely impact OIT's ability to provide ongoing operations and maintenance services to the agency. Finally, although the SEC does not have, nor is it required to have, a formal plan for funding its IT modernization projects in the event that the Reserve Fund is unavailable, the SEC routinely prioritizes such projects during the project planning process. SEC officials told us that they could use this process to determine which projects would be funded (and how) if the Reserve Fund was unavailable.

External and Internal Factors Affect the Availability of the Reserve Fund. Several factors affect annual Reserve Fund balances available for obligations, including statutory limits, rescission, prior year carryover balances, and sequestration. In addition, the SEC's ability to use the Fund depends heavily on the state of its IT infrastructure and IT modernization project lifecycles.

First, Dodd-Frank established three statutory limits for the Fund: (1) the SEC may only deposit $50 million into the Fund annually; (2) the Fund balance may not exceed $100 million at any point in time; and (3) the SEC may only obligate up to $100 million from the Fund in any one fiscal year (referred to as budget authority). We reviewed the Reserve Fund deposits, balances, and obligations for FYs 2012 to 2014 and found that the SEC did not exceed any of the statutory limits.

Second, in FYs 2012 and 2014, Congress rescinded $25 million "from the unobligated balances available." The rescissions did not change the Fund's cash deposit or balance, but rather the SEC's budget authority for those years.[13] Because the rescissions were part of the annual appropriations bills, they expired at the end of the fiscal year and the rescinded funds were made available in the following year. Although the Reserve Fund is permanently authorized by Dodd-Frank, OFM and OIT do not budget for the use of the Fund or approve Reserve Fund money for individual IT modernization projects until Congress passes the annual appropriations bill in case the appropriations bill rescinds all or part of the Fund.

Third, the SEC carries over unobligated balances from one fiscal year to the next. The prior year carryover plus the current year's cash deposit of $50 million must not exceed the statutory limit of $100 million. We found that the SEC carried over amounts after each of the three fiscal years reviewed.

Finally, Federal sequestration in FYs 2013 and 2014 impacted the Reserve Fund by 5.1 percent (approximately $2.5 million) and 7.2 percent (approximately $5.4 million), respectively. Like rescission, sequestration reduced the SEC's authority to obligate the Fund's

[13] For example, in year one, if the SEC deposited $50 million into the Fund, it could only obligate $25 million in that year given a $25 million rescission.

existing cash balance and the sequestered amounts were made available at the beginning of the next fiscal year.

As shown in the table below, the effects of rescission, carryover, and sequestration are realized in each fiscal year's "Net Available Balance" amount, which is the amount available for obligation that fiscal year. The amounts obligated are the total amounts of the Reserve Fund Net Available Balance that were obligated in each of the three years reviewed. Cash expenditures are the amounts of actual payments made against existing obligations.

Table. Flow of Reserve Fund Balances

	FY 2012	FY 2013	FY 2014
Statutorily-Established Annual Deposit Limit	$50,000,000	$50,000,000	$50,000,000
Current Year Rescission by Appropriation	($25,000,000)	N/A	($25,000,000)
Prior Year Rescission Released	N/A	$25,000,000	N/A
Prior Year Unobligated Balance Carried Over	$0	$12,642,370	$43,749,596
Current Year Budget Authority Withheld by Sequestration	$0	($2,550,000)	($5,400,000)
Prior Year Sequestration Released	N/A	N/A	$2,550,000
Net Available Balance	**$25,000,000**	**$85,092,370**	**$65,899,596**
Amount Obligated	($12,357,630)	($41,342,774)	($65,604,766)
Unobligated Balance - Carry Over	$12,642,370	$43,749,596	$294,830
Cash Expenditures	$0	$24,654,000	$34,825,000

Source: OIG-generated based on Dodd-Frank, OMB FY 2013 and 2014 sequestration reports, Delphi financial data for FYs 2012 to 2014, and the SEC's Annual Financial Reports for FYs 2012 to 2014.

In addition, OIT officials stated that the SEC's ability to obligate the Reserve Fund between FY 2012 and FY 2014 depended heavily on the state of its IT infrastructure and IT modernization project lifecycles. According to officials, the initial stage of requirements-gathering may take 12 to 18 months and is reflected by minor spending, and in FY 2012, the Reserve Fund was used for requirements-gathering for the EDGAR system and SEC.gov modernization efforts.[14] OIT officials told us that additional requirements-gathering was performed in FY 2013, and we noted that Reserve Fund obligations expanded to include the following IT program areas: Business Process Automation and Improvement; Examinations Management; Data Analytics; Enterprise Data Warehouse; and Tips, Complaints, and Referrals System Modernization. According to OIT, by FY 2014, needed IT infrastructure was in place, the SEC had established the eight IT modernization program areas in its Working Smarter plan, projects were past the requirements-gathering stage, and OIT began to meet targeted spending. We noted that, in FY 2014, the SEC was able to obligate more than the $50 million it deposited into the Reserve

[14] We validated that for FY 2012, all Reserve Fund obligations related to modernization of the EDGAR system and SEC.gov website.

Fund that year, due in part to the amount carried over from FY 2013, and that obligations expanded to include the Enforcement Investigation and Litigation program area.

The Absence of a Reserve Fund Would Adversely Impact the SEC's IT Modernization Efforts and OIT's Ability to Provide Services. Availability of the Reserve Fund directly affects the SEC's IT modernization efforts, and the absence of the Fund would adversely impact those efforts and OIT's ability to provide ongoing IT operations and maintenance services to the agency. For example, for FY 2014, OIT created an "impact statement" of what could happen if the Reserve Fund was rescinded by $25 million, as it was in FY 2012. According to the impact statement, a $25 million rescission could:

- delay implementation of planned EDGAR system enhancements;
- negatively impact content migration, search optimization, and user support for the SEC.gov website; and
- impact smaller projects, including postponing (1) a series of projects to modernize and automate the Division of Enforcement's litigation processes, and (2) supplements to the Office of Compliance Inspections and Examinations' ability to analyze high-frequency trading activities.

OIT officials stated that a complete rescission of the Reserve Fund would have a major impact on the SEC's various IT modernization projects because the Fund enables OIT to undertake projects that would either be impossible or more difficult without it. According to OIT officials, before 2010, the SEC's IT systems were failing and antiquated and, without the Reserve Fund, the agency's IT development would probably still be inadequate. In addition, the SEC would not have the capability to ingest, mine, and use large data sets to meet its oversight mission.

In Congressional testimony, the former SEC Chairman and current SEC Chair expressed a similar view of how the reduction or elimination of the Reserve Fund would likely impact the SEC's IT capabilities and IT modernization initiatives. For example, on December 6, 2011, former SEC Chairman Mary L. Schapiro testified that if the Reserve Fund was eliminated, important IT projects such as modernizing the SEC's EDGAR system and SEC.gov website would be significantly impacted. Likewise, the SEC's ability to resolve inadequacies in its IT systems to benefit investors "would be significantly hindered."[15] Similarly, on May 14, 2014, current SEC Chair Mary Jo White testified that, while the agency had made "significant progress" in modernizing its IT systems in recent years, this progress was "set back" by the level of funding received in FY 2014[16] – the same fiscal year that Congress rescinded $25 million from the Reserve Fund for the second time in three years.

In addition, we were told that, in the event of a complete rescission of the Reserve Fund, all funding for ongoing IT modernization projects would come from the OIT general fund. The OIT

[15] Former SEC Chairman Mary L. Schapiro testimony before the United States Senate Committee on Banking, Housing, and Urban Affairs.

[16] SEC Chair Mary Jo White testimony before the Subcommittee on Financial Services and General Government Committee on Appropriations, United States Senate.

general fund provides agency-wide operations and maintenance services such as help desk support, data center operations, and technology and infrastructure purchases. To fund IT modernization projects using the general fund, OIT would be placed on an "austerity budget" and would have to cut operations and maintenance activities such as laptop and server refreshes.

The SEC's Plans for Funding IT Modernization Projects In An Uncertain Environment. Because Congress rescinded $25 million from the Reserve Fund twice in the first three years of the Fund, we assessed the SEC's plans for funding its large-scale, enterprise-wide, multi-year IT modernization efforts in an uncertain funding environment and in the event that the Reserve Fund is unavailable. In the event of a complete rescission, multi-year IT modernization projects would stall, smaller projects would not be completed, and it would be difficult for the SEC to implement important technological upgrades. Further, according to the Chief Information Officer (CIO), complete rescission of the Fund may result in a reduction in IT services across the SEC, which could potentially impact the agency's ability to effectively meet its mission.[17]

At the time of our evaluation, SEC officials had not formalized – nor were they required to formalize[18] – contingency plans in the event of a complete rescission of the Reserve Fund. They stated that, even with the rescissions that have already occurred, the agency has been able to allocate at least some Reserve Fund money to each of its IT modernization program areas each year. In addition, the SEC has a process for categorizing and prioritizing IT projects.[19] Officials told us that, if the Reserve Fund was unavailable, they could use this process to decide which projects would be funded from its general funds and at what level. The priority projects would likely be those (1) in the two highest-priority categories (Mandatory and Lights On), (2) that have an immediate impact on investors and registrants, and (3) that are ongoing, depending on relative lifecycles and other information such as the amount of work remaining and projected future cost to complete each project. Further, SEC officials would consider where the biggest impacts could be made with the funding available.

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[17] For FY 2015, Congress again rescinded $25 million from the Reserve Fund. Also, on June 17, 2015, the U.S. House of Representatives Committee on Appropriations approved the FY 2016 Financial Services and General Government Appropriations bill. The Committee's recommended funding level for SEC IT initiatives "increases the overall funding level by $50 million specifically to support IT funding priorities" while "prohibiting funds from the Reserve Fund from being used by the [U.S. Securities and Exchange] Commission."

[18] Although we did not identify a requirement to formalize contingency plans in the event that the Reserve Fund is unavailable, an April 4, 2013, OMB memorandum regarding sequestration addressed executive branch agencies with reserve funds. The memorandum stated, "Similarly, while agencies with carryover balances or reserve funds should consider appropriate use of these funds to maintain core mission functions in the short term, it is important not to use these funds in a manner that would leave the agency vulnerable to future risks due to a potential lack of available funds in future years."

[19] The SEC categorizes its IT projects on the following scale: (1) Mandatory (must be completed to be compliant with either regulations or audits); (2) Lights On (essential to keeping systems operational); (3) Well Managed (initiatives to move towards a well-managed state relative to quality, efficiency, and budget); (4) Non-Mandatory Important (strategically important); and (5) Nice to Have (not essential). Officials suggested that these categories could be used to help the SEC prioritize IT modernization projects for funding if the Reserve Fund is unavailable.

On June 19, 2015, we provided SEC management with a draft of our management letter for review and comment. In its June 29, 2015, response, management noted steps it has taken to ensure that the SEC's use of the Reserve Fund continues to comply with the Act and the SEC policies. Management's comments are included as an attachment to this final management letter.

We appreciate management's cooperation. If you have questions, please contact Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects.

Attachments

cc: Andrew J. Donohue, Chief of Staff, Office of the Chair
Erica Y. Williams, Deputy Chief of Staff, Office of the Chair
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Objectives, Scope, and Methodology

Objectives. The evaluation covered the period of FY 2012 through FY 2014, and the overall objective was to evaluate the SEC's use of the Reserve Fund during that period. Specifically, we reviewed applicable laws, policies, and procedures, and determined whether (1) the SEC complied with Reserve Fund requirements, and (2) actual Reserve Fund expenditures agreed to the obligations reported to Congress. We also assessed the SEC's plans for funding its large-scale, enterprise-wide, multi-year IT modernization efforts in an uncertain funding environment.

Scope and Methodology. We conducted this evaluation from January through June 2015 and in accordance with the Council of the Inspectors General on Integrity and Efficiency *Quality Standards for Inspection and Evaluation (January 2012)*.

During the evaluation, we conducted fieldwork at the SEC's Headquarters in Washington, D.C. To gain an understanding of the policies, procedures, and controls surrounding the SEC's use of the Reserve Fund, we interviewed the CIO, CFO, COO, and other SEC employees from OIT, OFM, and the Office of the Chair. We reviewed relevant policies and compared them to Dodd-Frank. We also reviewed relevant SEC Congressional testimony and budget justifications, as they established how the SEC intended to use the Reserve Fund. Finally, we tested key financial information and internal and external communications to determine whether (1) budgetary allocations were properly approved, (2) expenditures agreed to obligations, and (3) the SEC accurately, completely, and timely reported to Congress Reserve Fund obligations during the period reviewed.

Although we identified the SEC's rationale for using the Reserve Fund for multi-year IT modernization efforts, including eight specific program areas, we do not opine on these decisions. In addition, although we reviewed Reserve Fund obligations and expenditures, we neither reviewed, nor do we opine on, the validity of specific Reserve Fund expenditures under the eight IT modernization program areas. Further, we neither evaluated, nor do we opine on, the benefits gained by the SEC from Reserve Fund expenditures.

The Federal laws and guidance, SEC policies and procedures, and SEC Congressional testimony and budget justifications we reviewed included:

- Dodd-Frank Wall Street Reform and Consumer Protection Act (PL 111-203), January 5, 2010.
- Consolidated Appropriations Act, 2012, (PL 112-74), December 23, 2011.
- Consolidated and Further Continuing Appropriations Act, 2013, (PL 113-6), March 26, 2013.
- Consolidated Appropriations Act, 2014, (PL 113-76), January 17, 2014.
- Explanatory Statement to the Consolidated Appropriations Act, 2014, January 15, 2014.
- SEC Administrative Regulation 14-2, *Administrative Control of Reserve Fund*, August 15, 2011.

- Office of Financial Management Reference Guide, Chapter 06.05, *Budget Formulation and Execution: Reserve Fund Budgetary Procedures*, September 24, 2011.
- Congressional testimony of former SEC Chairman (Mary L. Schapiro) and current SEC Chair (Mary Jo White) between March 15, 2011, and May 14, 2014.
- U.S. Securities and Exchange Commission Fiscal Year 2012 Congressional Budget Justification (February 2011), Fiscal Year 2013 Congressional Budget Justification (February 2012), and Fiscal Year 2014 Congressional Budget Justification (Undated).

Internal Controls. We gained an understanding of the administrative controls over the use of the Reserve Fund. While we did not test the design or operational effectiveness of those internal controls, we noted that management did not identify any controls specific to the Reserve Fund in its risk control matrices.

Computer-processed Data. The Government Accountability Office's *Assessing the Reliability of Computer-Processed Data* (GAO-09-680G, July 2009) states that "data reliability refers to the accuracy and completeness of computer-processed data, given the uses they are intended for. Computer-processed data may be data (1) entered into a computer system or (2) resulting from computer processing." We determined that the various Delphi reports provided by OFM were computer-processed data that would have a material impact on our evaluation's findings and conclusions.

To assess the reliability of this data, we reviewed the Government Accountability Office's audits of the SEC's financial statements for FYs 2012 to 2014. The audits used Delphi as a source of information and the auditors opined for FYs 2012 to 2014 that the SEC's financial statements were not materially misstated. In addition, we found that, in 2014, the Department of Transportation, which owns Delphi, contracted a third party to review the system in accordance with Standards for Attestation Engagements (SSAE) No. 16, *Reporting on Controls at a Service Organization*. In addition, in 2014, the Department of Transportation OIG conducted a quality control review of the third party auditor's work on the SSAE No. 16 report and found no instances in which the auditor did not comply, in all material respects, with generally accepted government auditing standards. Therefore, for the purposes of this evaluation, we deemed the Delphi data to be reliable.

Prior Coverage. Neither the SEC OIG nor the Government Accountability Office has conducted prior audit or evaluation work regarding the SEC's Reserve Fund.

Major Contributors to the Management Letter.

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Elizabeth Palmer Gontarek, Auditor

David Witherspoon, Senior Counsel

Attachment II

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
CHIEF OPERATING OFFICER

MEMORANDUM

June 29, 2015

TO: Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects, Office of Inspector General

FROM: Jeffery Heslop, Chief Operating Officer, Office of the Chief Operating Officer

SUBJECT: Response to SEC Inspector General's, *Evaluation of the SEC's Use of the Reserve Fund* Draft Management Letter

Thank you for the opportunity to review and comment on the Office of the Inspector General's (OIG) draft management letter on the *Evaluation of the SEC's Use of the Reserve Fund*.

We are pleased to note that the OIG staff found that the SEC's use of the Reserve Fund was in compliance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) (DFA) for fiscal years 2012, 2013, 2014.

As noted in your draft letter, the SEC has already taken steps to ensure that our use of the Reserve Fund continues to be in compliance with the DFA and the SEC's own policies.

For example, we have revised SEC Administrative Regulation (SECR) 14-2 to more precisely describe the process by which requests to use the Reserve Fund will be reviewed and authorized by the Chief Operating Officer (COO) and the Chair's office. The revised version of SECR14-2 also provides additional guidance to ensure that the required notification of obligations to Congress are in compliance with the statute's requirements and consistent with the Commission's Rules of Practice.

Furthermore, since the requirement to report obligations to the Office of Management and Budget (OMB) is not included in the DFA, we have removed this requirement from SECR 14-2. However, we will continue to provide these notifications to OMB as a courtesy.