

Securities and Exchange Commission

Office of Inspector General

During the second half of fiscal year 2006, the Office of Inspector General assisted the Commission in its efforts to:

- Improve information technology security,
- Implement appropriate controls to prevent conflicts of interest in procurements,
- Enhance the integrity of the Commission and its staff by investigating allegations of misconduct,
- Improve the preliminary review process for disclosure filings,
- Develop a plan to ensure continuity of operations after a contingency (e.g., a natural or man-made disaster),
- Strengthen procedures for oversight of a large information technology contract,
- Improve the timeliness of the processing of exemptive applications,
- Enhance the oversight of the Public Company Accounting Oversight Board,
- Assure adequate security over official personnel files, and
- Appropriately screen candidates in the law student observer program.

Executive Summary

During this period (April 1, 2006 to September 30, 2006), the Office of Inspector General (Office) issued five audit reports, one inspection report, two special projects, and one investigative memoranda on management issues, and completed one survey.

These evaluations focused on preliminary reviews of disclosure filings; conflict of interest controls in procurement; the Commission's information technology contract with DynCorp/CSC; exemptive application processing; oversight of the Public Company Accounting Oversight Board; continuity of operations planning; personnel files; the law student observer program; the annual evaluation under the Federal Information Security Management Act; and a Privacy Act questionnaire. This work is described in more detail in the Audit Program section below.

Five investigations were closed during the period. One subject was referred to the Department of Justice, which declined prosecution. Three subjects were referred to Commission management. One of these subjects, a contract employee, was removed from the contract. One subject referred during the prior semiannual period was suspended for four days; another subject referred during the prior period was counseled and required to attend facilitation. Six subjects referred during this period and prior semi-annual periods are awaiting disposition. The Investigative Program section below describes the significant cases closed during the period.

Our Office previously reported Information technology (IT) management as a significant problem. During this period, the Commission further improved its IT management, especially IT security. We no longer consider IT security to be a significant weakness. We intend to maintain our audit focus in this important area.

An audit completed in a prior period found that Commission financial management controls for fiscal year 2002 were effective in all material respects except for controls over property accountability, accounting and control of disgorgements, information system and security program controls, and the Disgorgement and Penalties Tracking System. We reported these exceptions, taken together, as a significant problem.

The Government Accountability Office (GAO) identified similar weaknesses in its audits of the Commission's fiscal years 2004 and 2005 financial statements (except for property accountability - the value of the property account balance was below the materiality threshold). During its ongoing audit of the Commission's fiscal year 2006 financial statements, the GAO indicated that it no longer considers IT security to be a material weakness.

No management decisions were revised during the period. The Office of Inspector General agrees with all significant management decisions regarding audit recommendations.

Audit Program

During this period, the Office issued five audit reports, one inspection report, two special projects, and one investigative memorandum on management issues. The Office also completed a survey.

These evaluations are summarized below. Management generally concurred with our recommendations, and in many cases took corrective actions during the evaluations. A list of pending evaluations follows the summaries.

PRELIMINARY REVIEW OF DISCLOSURE FILINGS (NO. 401)

We reviewed the Division of Corporation Finance's preliminary review process for disclosure filings. We found that the Division has made several enhancements to the process. Further enhancements are planned, including additional focus on the quality of the filing company.

We made several recommendations to improve preliminary reviews, including enhancing consideration of company risk factors, maintaining surveillance of large companies, and continuing efforts to manage workloads better.

CONFLICT OF INTEREST CONTROLS IN PROCUREMENT (NO. 404)

We reviewed the controls used by the Commission to prevent and detect conflicts of interest during the procurement process. The audit was begun after an investigation by our office disclosed that an employee participated in a procurement while holding a disqualifying financial interest in a firm involved in the procurement.

We found that the conflict of interest controls were functioning, but that they could be improved. We recommended that the relevant regulation be updated to reflect current practices and to help ensure that required documentation is maintained. We also recommended that the Office of Administrative Services take steps to enhance related training and record-keeping.

SURVEY OF DYNACORP CONTRACT (NO. 407)

An OIG contractor performed a survey of a large Commission IT contract with DynCorp/CSC. The primary purpose of the survey was to identify areas for future detailed audit work.

At the end of the survey, we briefed the Office of Information Technology (OIT) on our results and made several preliminary suggestions to enhance contract oversight. The OIG contractor has started a detailed review of several areas identified during the survey.

IM EXEMPTIVE APPLICATION PROCESSING (NO. 408)

We reviewed the exemptive application process in the Division of Investment Management. Under the Investment Company Act of 1940, the Commission is authorized to grant exemptions from the Act's provisions when the exemption is in the public interest.

We found that the timeliness of the application process could be improved. Our recommendations included issuing exemptive rules, filing applications electronically, and restricting or eliminating the review of draft exemptive applications. We also recommended the return of poorly prepared applications, developing standard follow-up procedures, improving performance measures, and revising the applications database.

OVERSIGHT OF PCAOB (NO. 412)

Under the Sarbanes-Oxley Act of 2002, the Commission has oversight of the Public Company Accounting Oversight Board (which was created by the Act). Our review of the Commission's oversight identified several possible improvements.

Among other steps, we recommended that the Commission have the Board seek reports from its external auditor on its internal controls and compliance with laws and regulations; enhance oversight of the Board's human capital and disaster contingency plans; develop policies and procedures for certain Commission oversight responsibilities under the Act; and consider possible delegations of authority within the Commission regarding the Board.

CONTINUITY OF OPERATIONS PLANNING (NO. 413)

We reviewed the Commission's preparations for responding to contingencies that could affect the Commission's operations or securities markets (such as natural or man-made disasters). During the audit, Commission staff updated the draft Continuity of Operations (COOP) Plan and worked on several continuity-related initiatives.

We made several recommendations to assist the Commission's contingency planning, including designating a permanent COOP coordinator, ensuring adequate COOP staffing, making enhancements to the Market Watch rooms, testing backup generators, backing-up vital records, and training Commission essential staff.

PERSONNEL FILES (NO. 419)

As a follow-up to a prior audit, we performed an inspection of the security over personnel files maintained by the Office of Human Resources (OHR). We found that OHR had taken several steps to improve security over the files, including relocating the file room, installing a cipher lock, and limiting access to the file room.

We recommended several additional steps, including guidance on signing-out and safeguarding files in use, periodic inventories of files, and storing certain records electronically.

FISMA 2006 (NO. 425)

We hired a contractor to assist us in the annual evaluation of Commission IT security under the Federal Information Security Management Act (FISMA). The evaluation found that the Commission has continued to make progress in developing a mature information security program, and has addressed many security vulnerabilities identified in prior assessments. Overall, we no longer consider IT security to be a significant problem at the Commission.

We recommended improvements in developing the inventory of major systems, the certification and accreditation process, the tracking of security weaknesses, and the documentation of systems.

PRIVACY ACT QUESTIONNAIRE (NO. 426)

The FISMA contractor also helped us complete a data collection (DCI) instrument prepared by the Inspector General community (through the PCIE/ECIE). The DCI's purpose was to assess agency compliance with OMB requirements for securing sensitive data (i.e., personally identifiable information protected by the Privacy Act) described in OMB memorandum M-06-16, issued June 23, 2006. This memorandum responded to numerous incidents involving the compromise or loss of sensitive personal information by Federal agencies.

Based on our evaluation, we observed that the Commission has not yet fully implemented the OMB requirements. However, the Commission's Privacy Office and the Office of Information Technology are taking steps to comply by implementing additional controls and developing a policy on securing Privacy Act information.

LAW STUDENT OBSERVER PROGRAM (G-444)

Unpaid interns who are not U.S. citizens work at the Commission through the Law Student Observer Program. During an investigation, we identified needed improvements in the selection process for these interns, and in determining what access they are given to Commission information and databases.

We recommended that the Office of the Executive Director (in consultation with affected offices) consider performing additional background and conflict of interest checks for these interns. We also recommended that the OED determine what access, if any, they should be given to non-public Commission information.

PENDING EVALUATIONS

The following evaluations were pending at the close of the semi-annual period (September 30, 2006):

No. 405 IT Management in Enforcement

- No. 416 Staff Interpretative Guidance
- No. 417 Systems Security Evaluation—Blue Sheet System
- No. 420 Office of Risk Assessment
- No. 421 Investment Company Filing Initiatives
- No. 422 FOIA Backlog
- No. 423 Enforcement Performance Management
- No. 424 Systems Security Evaluation—STARS
- No. 427 DynCorp Contract—Detailed Review

Investigative Program

Five investigations were closed during the period. One subject was referred to the Department of Justice, which declined prosecution. Three subjects were referred to Commission management. One of these subjects, a contract employee, was removed from the contract. One subject referred during the prior semi-annual period was suspended for four days; another subject referred during the prior period was counseled and required to attend facilitation. Six subjects referred during this period and prior semi-annual periods are awaiting disposition.

The most significant cases closed during the period are described below.

VIOLATION OF RULE REGARDING SECURITIES TRANSACTIONS

An Office investigation developed evidence that a staff member purchased securities in violation of the Commission's rule governing employee security transactions and failed to comply with the rule's reporting requirements. We also found evidence that some of the employee's securities purchases created an appearance of impropriety and that the employee did not consistently and accurately report financial assets on the Office of Government Ethics confidential financial disclosure form. The Department of Justice declined prosecution, and administrative action is pending.

BREACH OF CONFIDENTIALITY REQUIREMENT

An investigation found evidence that a Commission contract employee violated the terms of the contract by discussing in a public setting non-public information learned through the contractor's work at the Commission. The contract employee admitted and apologized for the disclosures. At the commencement of our investigation, the employee was removed from the contract. The employee will not be allowed to return to work at the Commission.

UNAUTHORIZED DISCLOSURE

The Office investigated concerns that an intern working at the Commission may have disclosed non-public Commission information to unauthorized persons. The investigation found insufficient evidence of improper disclosures of non-public information by the intern.

Significant Problems

No new significant problems were identified during the period.

Significant Problems Identified Previously

FINANCIAL MANAGEMENT SYSTEMS CONTROLS

An OIG contractor completed an audit of Commission financial management systems controls during a prior period (Audit No. 362). The audit found that Commission financial management controls for fiscal year 2002 were effective in all material respects, based on criteria established under the Federal Managers Financial Integrity Act, except for three material weaknesses and one material non-conformance.

The exceptions concerned property accountability, accounting and control of disgorgements, information system and security program controls, and the Disgorgement and Penalties Tracking System. We reported that, taken together, these financial management exceptions were a significant problem for the Commission. Management concurred with our recommendations to strengthen these financial controls, and promptly began to take actions to correct the weaknesses.

The Government Accountability Office (GAO) performed the audit of the Commission's financial statements for fiscal years 2004 and 2005. The audits found that the Commission has made significant progress in building a financial reporting structure for preparing financial statements for audit.

GAO also found that the SEC property account balance was below the threshold for materiality; as a consequence we removed property accountability as an element of this significant problem. However, GAO identified material internal control weaknesses in preparing financial statements and related disclosures, recording and reporting disgorgements and penalties, and information security, which became the basis for this significant problem.

During its ongoing audit of the Commission's fiscal year 2006 financial statements, GAO indicated that it no longer considers information security to be a material weakness, based on the corrective actions to date. It has not yet indicated whether the preparation of financial statements and recording and reporting of disgorgements and penalties still constitute material weaknesses.

INFORMATION TECHNOLOGY MANAGEMENT

Since April 1996, we have reported information technology (IT) management as a significant problem based on weaknesses identified by several audits, investigations, and management studies. Significant IT weaknesses included information systems security; IT capital investment decision-making; administration of IT contracts; IT project management; enterprise architecture management; strategic management of IT human capital; and management of software licenses.

We no longer consider information systems security to be an element of this significant problem, based on our fiscal year 2006 FISMA evaluation and GAO's ongoing audit of the Commission's fiscal year 2006 financial statements. The Office of Information Technology (OIT) indicated that it has continued to strengthen the management of Commission IT during this reporting period. OIT expects that IT management will no longer be a significant problem by the end of fiscal year 2007.

Although OIT continues to take actions to correct the identified IT weaknesses, we still consider IT management to be a significant problem at this time. We intend to continue our oversight of this area.

Access to Information

The Office of Inspector General has received access to all information required to carry out its activities. No reports to the Chairman, concerning refusal of such information, were made during the period.

Other Matters

EXTERNAL COORDINATION

The Office actively participates in the activities of the Executive Council on Integrity and Efficiency (ECIE). The Inspector General attends ECIE meetings, is an active member of its Financial Institutions Regulatory Committee, and serves as the ECIE member on the Integrity Committee (established by Executive Order No. 12993).

The Deputy Inspector General is an active member of the Federal Audit Executive Council (FAEC). The FAEC considers audit issues relevant to the Inspector General community.

The Associate Inspector General for Investigations/Counsel to the Inspector General and the Associate Counsels are active members of the PCIE Council of Counsels. The Council considers legal issues relevant to the Inspector General community.

PEER REVIEW

The Office of Inspector General of the Corporation for Public Broadcasting completed a peer review of the Office's audit function during the period. The review found that the audit function complied with generally accepted government auditing standards. As a result of the review, we made several changes to our Audit and Inspection Manual to enhance our audit quality control system.

In the next semi-annual period (the first half of fiscal year 2007), the Office of Inspector General of the Equal Employment Opportunity Commission is scheduled to perform a peer review of the Office's investigative function.

REVIEW OF LEGISLATION AND REGULATIONS

The Office reviewed existing and proposed legislation and regulations relating to the programs and operations of the Commission, pursuant to the Inspector General Act of 1978, as amended. We tracked both legislation and regulations by researching relevant documents and databases, including lists prepared by the IG community and the Commission's Office of General Counsel. Our independent assessments focused on the impact on the economy and efficiency of, and the prevention and detection of fraud and abuse in, programs and operations administered by the Commission. In addition, statutes and regulations were reviewed within the context of audits and investigations (e.g., the impact of the Federal Information Security Management Act on Commission operations).

Among the legislation we assessed was the "Credit Rating Agency Reform Act of 2006" (S. 3850). This act streamlines the current process for designating credit rating firms and gives the Commission new power to inspect and to discipline rating firms. The Office did not provide any comments. We also had no comments on any of the proposed or final rules issued by the Commission.

We provided comments to the Government Accountability Office on proposed changes to the *Government Auditing Standards*. We also reviewed the Commission's network log-in banner and recommended that it be revised to comply with Department of Justice guidance. The Commission implemented our suggestions.

Questioned Costs

		DOLLAR VALUE (IN THOUSANDS)		
		<u>NUMBER</u>	<u>UNSUPPORTED COSTS</u>	<u>QUESTIONED COSTS</u>
A	For which no management decision has been made by the commencement of the reporting period	0	0	0
B	<i>Which were issued during the reporting period</i>	<u>0</u>	<u>0</u>	<u>0</u>
	Subtotals (A+B)	0	0	0
C	For which a management decision was made during the reporting period	0	0	0
	(i) Dollar value of disallowed costs	0	0	0
	(ii) Dollar value of costs not disallowed	0	0	0
D	For which no management decision has been made by the end of the period	0	0	0
	Reports for which no management decision was made within six months of issuance	0	0	0

Recommendations That Funds Be Put To Better Use

		<u>NUMBER</u>	<u>DOLLAR VALUE (IN THOUSANDS)</u>
A	For which no management decision has been made by the commencement of the reporting period	0	0
B	Which were issued during the reporting period	<u>0</u>	<u>0</u>
	-		
	Subtotals (A+B)	0	0
C	For which a management decision was made during the period	0	0
	(i) Dollar value of recommendations that were agreed to by management	0	0
	- Based on proposed management action	0	0
	- Based on proposed legislative action	0	0
	(ii) Dollar value of recommendations that were not agreed to by management	0	0
D	For which no management decision has been made by the end of the reporting period	0	0
	Reports for which no management decision was made within six months of issuance	0	0

Reports with No Management Decisions

Management decisions have been made on all audit reports issued before the beginning of this reporting period (April 1, 2006).

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.

**MANAGEMENT RESPONSE OF
THE SECURITIES AND EXCHANGE COMMISSION
ACCOMPANYING THE SEMIANNUAL REPORT OF THE INSPECTOR GENERAL
FOR THE PERIOD APRIL 1, 2006 THROUGH SEPTEMBER 30, 2006**

Introduction

The Semiannual Report of the Inspector General (IG) of the Securities and Exchange Commission (SEC) was submitted to the Chairman on October 31, 2006 as required by the Inspector General Act of 1978, as amended. The report has been reviewed by a member of the Executive Staff, as well as the Executive Director, General Counsel, and Director of the Division of Enforcement. The Management Response is based on their views and consultation with the Chairman.

The Management Response is divided into four sections to reflect the specific requirements listed in Section 5(b) of the Inspector General Act of 1978, as amended.

**Section I
Comments Keyed to Significant Sections of the IG Report**

A. Audit Program

During the reporting period, the IG issued five audit reports, one inspection report, two special project reports, and one investigative memorandum on management issues. The IG also completed one survey. Management generally concurred with the findings and recommendations in the IG's reports.

In addition to audits performed by the agency's IG, the Government Accountability Office (GAO) actively reviewed program and administrative functions of the SEC. A complete listing of all GAO audit activity involving the SEC is attached as Appendix A.

B. Response to Significant Problems

No new significant problems were identified by the IG during this reporting period.

C. Response to Significant Problems Previously Identified

Financial Management System Controls

As in prior years, the Inspector General's report provides a description of the financial management system control weaknesses identified during an OIG contractor's audit and subsequent GAO audits. During the 2006 financial statement audit, GAO reviewed the corrective actions taken by the SEC to resolve the material weaknesses in this area and determined that financial management system controls are no longer a material weakness. The following is a description of corrective actions taken to improve controls in this area.

- *Financial Statement Preparation Process.* In 2006, the SEC made substantial progress in improving its financial management system controls. Among other initiatives, the agency's Office of Financial Management completed documentation of key policies and procedures for financial reporting; improved documentation of the audit trail between general ledger accounts and the financial statements, prepared interim financial statement notes, and added key staff. In addition, the office formalized the membership, procedures, and responsibilities of the Financial Management Oversight Committee.
- *Recording and Reporting of Disgorgement and Penalties.* The SEC took a number of important steps to ensure the integrity of enforcement-related disgorgement and penalty data: the Enforcement Division completed a comprehensive Delinquent Debt Project, the agency introduced new controls over the recording of enforcement receivables, and the agency completed the design of a new financial management system for tracking disgorgement and penalties that will replace the financial portion of the Division's existing case tracking system.

Information Resources Management

During this reporting period, the Office of Information Technology (OIT) significantly improved the underlying management controls and overarching policies and procedures governing the management of information technology. OIT satisfied a total of 87 audit recommendations in fiscal 2006, addressing the need to establish and implement a body of management controls, policies and procedures related to IT capital investment decision-making, administration of IT contracts, IT project management, enterprise architecture management, strategic management of IT human capital, and management of software licenses.

With respect to IT security, the SEC improved this area to the point where the IG no longer considers it a component of this significant problem. The SEC implemented a wide variety of new policies and procedures governing the assessment and management of information security risk. These procedures include comprehensive approaches for identifying security risk; configuring, testing, and monitoring information systems; incident response; remedial action tracking; and many other areas. The SEC also completed the certification and accreditation of its major systems, and conducted awareness training for 99 percent of SEC staff. The SEC also established and tested its disaster recovery and business continuity plans in accordance with recommendations from previous years.

Although some additional work remains to be completed to adequately address some aspects of the IG's continuing concerns, OIT is currently working with the Inspector General to jointly assess the remaining elements of the significant problem.

Given the continuous attention, progress and improvements made by OIT to establish, implement, and enforce effective IT management policies and controls, the SEC's Chief Information Officer anticipates resolving this significant problem in fiscal 2007.

D. IG Recommendations Concerning Use of Funds

None.

E. Reports with No Management Decisions

Management decisions have been made on all audits issued prior to the beginning of the reporting period (April 1, 2006).

F. Revised Management Decisions

No management decisions were revised during the reporting period.

SEC Management Response to
Semiannual IG Report
April 1, 2006 – September 30, 2006

SECTION II
Disallowed Costs
As of September 30, 2006

	<u>Number</u>	<u>Dollar Value (in thousands)</u>
A. For which final action has not been taken by the commencement of the reporting period	0	\$0
B. On which management decisions were made during the reporting period	<u>0</u>	<u>\$0</u>
(Subtotal A+B)	0	\$0
C. For which final action was taken during the reporting period	0	\$0
(i) Recovered by management	0	\$0
(ii) Disallowed by management	0	\$0
D. For which no final action has been taken by the end of the reporting period	0	\$0

SEC Management Response to
Semiannual IG Report
April 1, 2006 – September 30, 2006

SECTION III
Funds Put to Better Use
As of April 1, 2006

	<u>Number</u>	<u>Dollar Value (in thousands)</u>
A. For which final action has not been taken by the commencement of the reporting period	0	\$0
B. On which management decisions were made during the reporting period	0	\$0
C. For which final action was taken during the reporting period:		
(i) Dollar value of recommendations that were agreed to by management	0	\$0
(ii) Dollar value of recommendations that management has subsequently concluded should/could not be implemented or completed	0	\$0
D. For which no final action has been taken by the end of the reporting period	0	\$0

SECTION IV
Open Audit Reports Over One Year Old
As of September 30, 2006

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
220	IRM Planning and Execution	3/26/1996	\$0	\$0	An overarching policy framework has been implemented, which addresses all aspects of IT management. A major initiative is underway to publish all remaining IT-related policies in 2007.
320	General Computer Controls	12/26/2000	\$0	\$0	The recommendations are being addressed as part of the remediation efforts underway as a result of the audits of SEC's financial statements.
337	IT Project Management	1/24/2002	\$0	\$0	See explanation for audit #220.

SECTION IV
Open Audit Reports Over One Year Old
As of September 30, 2006

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
353	Regional Telecommuni- cations Security	8/20/2002	\$0	\$0	An inventory of voice and circuit data is ongoing and expected to be completed in the first quarter of fiscal 2007.
365	IT Capital Investment Decision-making Followup	3/29/2004	\$0	\$0	The draft IT Capital Planning Committee Charter is being revised due to a shift in its mission.
371	Small Business Reg D Exemption Process	3/31/2004	\$0	\$0	The two remaining recommendations are being addressed as part of a rule-making initiative. A process has been worked out to coordinate development of the rule proposals with state securities regulators.

SECTION IV
Open Audit Reports Over One Year Old
As of September 30, 2006

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
376	Telephone Card Program	11/17/2003	\$0	\$0	See explanation for audit #220.
377	Lost and Stolen Securities Program	3/31/2004	\$0	\$0	Several Commission releases are expected to be revised. In addition, a process is being created for managing non-SEC developed applications.
380	IT Contractor Billings	1/10/2005	\$0	\$0	Some policies are being changed in conjunction with the automated procurement system currently being implemented.
383	Targeting IA/IC Compliance Examinations	9/29/2004	\$0	\$0	Most of the recommendations have been implemented. Various options are being explored to meet the spirit and intent of the remaining open recommendations.

SECTION IV
Open Audit Reports Over One Year Old
As of September 30, 2006

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
393	Software Management		\$0	\$0	Policies and procedures are expected to be published in 2007. In addition, work is underway to identify performance metrics for monitoring and follow-up on software licensing information.
394	Targeting B/D Compliance Examinations	9/22/2005	\$0	\$0	Efforts are underway to enhance the broker-dealer targeting process and to develop a risk rating system.
395	Integrity Program— Inspection of Field Offices	5/31/2005	\$0	\$0	The draft employee handbook is being reviewed.

SECTION IV
Open Audit Reports Over One Year Old
As of September 30, 2006

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
402	Office of the Secretary	9/20/2005	\$0	\$0	Policies have been drafted and will be issued in 2007.
406	Federal Information Security Management Act—2005	9/28/2005	\$0	\$0	E-authentication risk assessments are being conducted for systems remotely authenticating users over the network. The expected completion date is March 2007.
409	Certification and Accreditation of ACTS+		\$0	\$0	The system's security and disaster recovery plans are being updated. The expected completion date is March 2007.

SECTION IV
 Open Audit Reports Over One Year Old
 As of September 30, 2006

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
411	Security Certification and Accreditation Process	9/30/2005	\$0	\$0	The general support system certification and accreditation is being updated. The updated certification and accreditation will be used to reassess the security test and evaluations of the SEC's 12 major applications already accredited. The expected completion date is March 2007.

APPENDIX A

Government Accountability Office Audit Activity Involving the Securities and Exchange Commission

Reports Issued During the Reporting Period

1. *Internal Control: Improvements Needed in SEC's Accounting and Financial Reporting Procedures* (GAO-06-459R, Mar. 2006)
2. *Sarbanes-Oxley Act: Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies* (GAO-06-361, Apr. 2006)
3. *Personnel Practices: Conversion of Employees from Noncareer to Career Positions May 2001-April 2005* (GAO-06-381, May 2006)
4. *Personal Information: Key Federal Privacy Laws Do Not Require Information Resellers to Safeguard All Sensitive Data* (GAO-06-674, June 2006)
5. *Financial Restatements: Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Activities* (GAO-06-678, June 2006)

Projects Active as of September 30, 2006

1. Hedge Funds and Related Federal Regulatory Oversight (250313). A review of the risks and regulatory framework of hedge funds. Issues to be addressed include the evolution of the hedge fund industry in terms of growth, investment strategies and fee structures; SEC oversight of hedge funds and financial regulators' oversight of counterparties; disclosure requirements; potential implications of ERISA amendments related to hedge funds; and the applicability of legislative reforms suggested by the President's Working Group after Long Term Capital Management. In addition to the SEC, GAO will be conducting the audit work at the Department of Labor, Commodity Futures Trading Commission, Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision.
2. SEC Oversight of Corporate Governance Ratings (250312). A review of the SEC's oversight of firms that provide proxy advisory services and corporate governance ratings. GAO will focus on (1) the structure and operations of these firms, particularly with respect to the potential for conflicts of interest; (2) the extent to which the methodologies used by these firms to issue ratings and proxy recommendations are transparent; (3) the extent to which competition exists in the industry; (4) the impact these firms have, if any, on proxy voting; and (5) the extent of any other related SEC actions involving these firms.

3. Credit Derivatives (250310). A review of the use of information technology systems in the credit derivatives markets. GAO will determine: (1) the extent to which major dealers are using IT systems to manage their operational risk in connection with their credit derivative transactions, (2) the extent to which financial regulators are overseeing the operational risk faced by major dealers in connection with their credit derivatives transactions, and (3) actions that industry associations and clearing organizations are taking to improve IT systems to reduce operations risk.
4. Pay and Performance Systems (450460/450492). A review of pay and performance systems at the SEC and other federal financial regulatory agencies. For each of these agencies, GAO will examine the extent to which their pay and performance management systems are aligned with key practices important for effective performance management.
5. NCUA Corporate Governance (250302). A review of the National Credit Union Administration's policies and procedures regarding the composition and professional background of NCUA's Board members and senior staff as it relates to independence and objectivity issues. GAO intends to talk with SEC about the Commission and its senior staff, to identify best practices regarding policies and procedures related to independence and objectivity.
6. EBSA's ERISA Enforcement (130532). A study to assess the capability of the Labor Department's Employee Benefits Security Administration to enforce pension laws. Among other things, GAO will examine what promising enforcement practices and strategies agencies such as SEC and the IRS use that may be applicable to EBSA's enforcement efforts.
7. Pension Plan Asset Management (130554). A study of the potential conflicts that may exist involving investment managers and the effects these conflicts may have had on recent problems in plan underfunding.
8. Basel II Capital Accord (250291). A review of the potential impact of the implementation of Basel II on the U.S. financial system and the proposed revisions to current reserve requirement regulations for non-Basel II banks.
9. Consolidated Supervision (250258). A study of the policies and procedures of the various agencies engaged in consolidated supervisory responsibilities for financial institutions to determine how and why they differ, the effectiveness of consolidated supervision and the extent to which agencies seek to improve its effectiveness by identifying and adopting "best practices", and the implications of any duplication of resources caused by having various regulatory bodies engaged in overseeing similar activities.

10. Financial Markets Preparation Follow-on (250285). A review of the progress made by U.S. financial regulators and market participants to increase their security and resiliency against attacks or other disasters, as well as to follow-up on issues and recommendations made from GAO's prior reports.
11. Financial Literacy (250276). A review of the Financial Literacy and Education Commission's (1) national strategy and (2) activities to promote financial literacy and coordinate federal efforts in this area.
12. FY 2006 SEC Financial Statement Audit (194571). An audit of the SEC's 2006 financial statements. GAO will (1) express an opinion on whether the SEC's fiscal year 2006 financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles, (2) express an opinion on whether SEC's internal controls provided reasonable assurance that losses, noncompliance or misstatements material in relation to the statements would be prevented or detected on a timely basis, and (3) report on SEC compliance with selected provisions of laws and regulations.
13. PUHCA (360719). A study of FERC's efforts to assume responsibilities for protecting consumers and investors previously under the jurisdiction of the SEC. GAO plans to describe differences in state's authority to regulate utility affiliates. GAO plans to meet with SEC to discuss any transition issues and concerns.
14. CFTC Oversight (250256) and Natural Gas Prices (360659). The first assignment is a review of the CFTC's oversight of futures trading in energy. The second assignment is a review of the factors that affect natural gas price volatility—particularly those driving today's higher prices—and the federal government role in ensuring that prices are determined in a competitive market. Although SEC is not the focus of these studies, GAO will meet with SEC to discuss: (1) the SEC's equities market surveillance, and (2) SEC's staff report entitled, "Implications of the Growth of Hedge Funds in September 2003," and how the role played by hedge funds in the financial markets has changed.
15. World Peak Oil Production (360601). A review of the available data and estimates of world oil reserves, oil production and oil consumption, as well as government and private studies predicting the date of world peak oil production. GAO's contact with SEC focuses on SEC guidelines and definitions for accurate disclosures of proved oil reserves in SEC filings.