

**Written Testimony of H. David Kotz  
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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.**

## **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,

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

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

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

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

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.