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Office of Inspector General

Office of Audits

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# Program Improvements Needed Within the SEC's Division of Enforcement



September 29, 2009  
Report No. 467



OFFICE OF  
INSPECTOR GENERAL

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

## MEMORANDUM

September 29, 2009

**To:** Mary L. Schapiro, Chairman  
Robert Khuzami, Director, Division of Enforcement (Enforcement)

**From:** H. David Kotz, Inspector General, Office of Inspector General (OIG) *HDK*

**Subject:** *Program Improvements Needed Within the SEC's Division of Enforcement, Report No. 467*

This memorandum transmits the U.S. Securities and Exchange Commission, OIG's final report detailing the results of our review regarding program improvements needed within Enforcement. The review was conducted by the OIG as part of our continuous efforts to assess management of the Commission's programs and operations.

Enforcement concurred with the report's 21 recommendations. Within the next 45 days, please provide OIG with a written corrective action plan that is designed to address the agreed upon recommendations. The corrective action plan should include information such as the responsible official/point of contact, time frames for completing the required actions, milestone dates identifying how you will address the recommendations cited in this report, etc.

Should you have any questions regarding this report, please do not hesitate to contact me. We appreciate the courtesy and cooperation that you and your staff extended to our auditor.

### Attachment

cc: Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman  
Diego Ruiz, Executive Director, Office of the Executive Director  
Scott Friestad, Deputy Director, Division of Enforcement  
Joan McKown, Chief Counsel, Division of Enforcement

# Program Improvements Needed Within the SEC's Division of Enforcement

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## Executive Summary

**Background:** On December 11, 2008, the Securities and Exchange Commission (SEC) charged Bernard L. Madoff (Madoff) with securities fraud for a multi-billion dollar Ponzi scheme that he perpetrated on advisory clients of his firm. Subsequently, the Commission learned that credible and specific allegations regarding Madoff's financial wrongdoing, going back to at least 1999, were repeatedly brought to the attention of SEC staff but were never recommended to the Commission for action.

As a result, former Chairman Christopher Cox requested that the Office of Inspector General (OIG) conduct an investigation into the past allegations regarding Madoff and his firm and the reasons these allegations were not found to be credible by the Commission.

In June 2009, as a result of issues identified during this ongoing OIG investigation, the OIG launched a survey questionnaire to the Division of Enforcement (Enforcement) staff and management in headquarters as well as the regional offices. The questionnaire was designed to obtain feedback from Enforcement staff on topics such as allocation of resources, performance measurement, case management procedures, communication, adequacy of policies and procedures, employee morale, and management efficiency and effectiveness.

**Objective:** The objective of our review was to identify systemic issues that would prevent Enforcement from accomplishing its mission to enforce the securities laws and protect investors and determine from discussions with staff and supervisors which programmatic improvements are needed.

**Prior OIG Work:** This report contains information from the OIG's Report of Investigation, Report No. 509, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme*, dated August 31, 2009, which described in detail the factual circumstances surrounding the Madoff-related complaints received by the SEC and the SEC's examination and investigations of Madoff over the years.

**Results:** The review found that there are several program improvements needed within Enforcement with regard to complaint handling processes, fostering of relationships inside and outside the Division, verification of

information with industry experts outside the Commission, timely handling of administrative matters related to opening and closing investigations, effective supervision over investigations, communication of program priorities, and case handling processes.

Specifically, we found that Enforcement staff lacked adequate guidance on how to appropriately analyze complaints. As a result, Enforcement staff did not conduct a thorough review of a complaint brought to their attention in 2001 regarding Madoff. In addition, we found that Enforcement staff assigned to investigate Madoff were inexperienced and the investigation suffered from a lack of supervision which had consequences for the investigation. We also found that Enforcement staff did not always exercise due diligence in their handling of critical information regarding Madoff. As a result, we found that Enforcement staff did not sufficiently review a complaint that included approximately 30 red flags indicating that Madoff was operating a Ponzi scheme. Further, Enforcement staff investigating Madoff did not always seek assistance from other offices and divisions as needed during its investigation. As a result, Enforcement staff had difficulty understanding key aspects of Madoff's operations, including his purported trading overseas. Additionally, Enforcement staff working on the Madoff investigation failed to verify information provided by Madoff with independent third-party sources, a critical step in order to determine whether Madoff was actually engaged in trading. Furthermore, Enforcement staff did not adequately evaluate information received by the SEC while the Madoff investigation was inactive pending closure. Additionally, we found there were delays in completing administrative tasks related to opening a matter under inquiry on Madoff, as well as closing the investigation.

In addition, based on a June 2009 OIG survey of management effectiveness in Enforcement, we found that a large number of Enforcement staff have concerns regarding working relationships within Enforcement, communication of program priorities, and case handling processes. Additionally, staff expressed that they did not always know where to find information regarding impartiality in the performance of their duties.

### **Summary of Recommendations:**

To strengthen management controls, Enforcement should:

- (1) Establish formal guidance for evaluating various types of complaints (e.g., Ponzi schemes) and train appropriate staff on the use of the guidance. The guidance should address the necessary steps and key information required to be collected when conducting preliminary inquiries of various types of complaints, specify what information should be documented, and list whom should be consulted in other offices within the

SEC with relevant expertise in various subject matters and other pertinent data.

(2) Ensure the SEC's tip and complaint handling system provides for data capture of relevant information relating to the vetting process to document why a complaint was or was not acted upon and who made that determination.

(3) Require tips and complaints to be reviewed by at least two individuals experienced in the subject matter prior to deciding not to take further action.

(4) Establish guidance to require that all complaints that appear on the surface to be credible and compelling be probed further by in-depth interviews with the sources to assess the complaints validity and to determine what issues need to be investigated. Such guidance should also require that staff obtain all relevant documentation related to such complaints.

(5) Provide training to staff to ensure they are aware of the guidelines contained in Section 3.2.5 of the Enforcement Manual and Title 17 of the Code of Federal Regulations, Section 202.10 for obtaining information from media sources.

(6) Annually review and test the effectiveness of its policies and procedures with regard to its new tip and complaint handling system. Enforcement should also modify these policies and procedures, where needed, to ensure adherence and adequacy.

(7) Put in place procedures to ensure that investigations are assigned to teams where at least one individual on the team has specific and sufficient knowledge of the subject matter (e.g. Ponzi schemes) and the team has access to at least one additional individual who also has such expertise or knowledge.

(8) Train staff on what resources and information is available from the national specialized units and when and how assistance from these units should be requested.

(9) Make it mandatory that planning memoranda be prepared during an investigation and that the plan includes a section identifying what type of expertise or assistance is needed from others within and outside the Commission. The plan should also be reviewed and approved by senior Enforcement personnel.

(10) Require that after the planning memorandum is drafted, it is circulated to all team members assigned to the investigation, and all team members then should meet to discuss the investigation approach, methodology and any concerns team members wish to raise.

(11) Establish procedures so that junior-level Enforcement attorneys who are having difficulty with obtaining timely assistance from outside offices are able to escalate their concerns to senior-level management within Enforcement.

(12) Conduct periodic internal reviews of any newly implemented policies and procedures related to information sharing with Divisions and Offices outside of Enforcement to ensure they are operating efficiently and effectively and necessary changes are made.

(13) Require that the planning memorandum and associated scope, methodology and timeframes be routinely reviewed by an investigator's immediate supervisor to ensure investigations remain on track and determine whether adjustments in scope, etc. are necessary.

(14) Ensure that sufficient resources, both supervisory and support, are dedicated to investigations upfront to provide for adequate and thorough supervision of cases and effective handling of the investigations.

(15) Put in place policies and procedures or training mechanisms to ensure staff have an understanding of what types of information should be validated during investigations with independent parties such as the Financial Industry Regulatory Authority, Depository Trust Company, and Chicago Board Options Exchange.

(16) Include in its complaint handling guidance proper procedures for ensuring complaints received even if an investigation is pending closure, are properly vetted.

(17) Conduct periodic internal reviews to ensure that MUIs are opened in accordance with any newly developed Commission guidance and examine ways to streamline the case closing process. Enforcement should also ensure staff have adequate time in which to complete these types of administrative tasks.

(18) Put in place a process to periodically remind staff of their responsibilities regarding impartiality in the performance of official duties and instruct staff where they can find additional information regarding impartiality.

(19) Establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over communication of program priorities and make recommended improvements to the Director of Enforcement.

(20) Establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns regarding case handling procedures within Enforcement and make recommended improvements to the Director of Enforcement.

(21) Establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over working relationships within Enforcement and make recommended improvements to the Director of Enforcement.

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# Background and Objective

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## Background

The primary mission of the Division of Enforcement (Enforcement) is to investigate and prosecute violations of the federal securities laws. These violations involve conduct ranging from fraudulent offering of securities, market manipulation, financial statement fraud and insider trading to violative activities of regulated entities such as exchanges, broker-dealers, investment companies, and investment advisers. This program currently is administered by approximately 1,200 enforcement staff members in the Commission's headquarters and eleven regional offices.

The Commission reported in its 2008 Performance and Accountability Report that, in enforcing the securities laws, the SEC focuses on early detection of potential problems or issues in the securities markets, preventing violations of securities laws and sanctioning violators. For FY 2008, the SEC reported that it focused more than half its resources toward achieving this goal, which totaled approximately 2,300 staff (including 1,169 Enforcement staff) and more than \$595 million in funding.

On December 11, 2008, the Securities and Exchange Commission (SEC) charged Bernard L. Madoff (Madoff) with securities fraud for a multi-billion dollar Ponzi scheme that he perpetrated on advisory clients of his firm. Subsequently, the Commission learned that credible and specific allegations regarding Madoff's financial wrongdoing, going back to at least 1999, were repeatedly brought to the attention of SEC staff but were never recommended to the Commission for action. As a result, former Chairman Christopher Cox requested that the Office of Inspector General (OIG) conduct an investigation into the past allegations regarding Madoff and his firm and the reasons these allegations were not found to be credible by the Commission. In June 2009, as a result of issues identified during this ongoing OIG investigation, the OIG launched a survey questionnaire to Enforcement staff and management in headquarters as well as the regional offices. The questionnaire was designed to obtain feedback from Enforcement staff on topics such as allocation of resources, performance measurement, case management procedures, communication, adequacy of policies and procedures, employee morale, and management efficiency and effectiveness.

## Objective

Based on the key issues identified in the OIG's Madoff investigation, together with feedback obtained from Enforcement staff regarding where improvements are needed in the Enforcement program, we identified potential systemic issues

that may prevent Enforcement from efficiently and effectively accomplishing its mission of enforcing the securities law and protect investors.

# Findings and Recommendations

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Based on a review of the SEC's handling of the Madoff investigation and a June 2009 OIG survey of management effectiveness in Enforcement, we identified several areas within Enforcement that are problematic with regard to complaint handling processes, fostering of relationships inside and outside the Division, verification of information with industry experts outside the Commission, resource issues, timely handling of administrative matters related to opening and closing investigations, effective supervision over investigations, communication of program priorities, and case handling processes. More specifically, we found that:

- 1) Enforcement staff lacked adequate guidance on how to appropriately analyze complaints;
- 2) Enforcement staff did not always exercise due diligence in its handling of critical information regarding Madoff;
- 3) Enforcement staff assigned to investigate the Madoff complaint were inexperienced in investigating Ponzi schemes;
- 4) Enforcement staff investigating Madoff did not always seek assistance from other offices and divisions as needed;
- 5) The Enforcement Madoff investigation suffered from a lack of supervision;
- 6) Enforcement staff failed to verify information provided by Madoff with independent sources;
- 7) Enforcement staff did not adequately evaluate additional information received by the SEC while the Enforcement Madoff investigation was active pending closure;
- 8) Enforcement staff did not timely open or close its Madoff investigation;
- 9) Program priorities have not always been clearly established and communicated to Enforcement staff;
- 10) Case handling processes can be improved;
- 11) Enforcement staff are not always aware of where to find information regarding impartiality and many have been in situations they felt lack impartiality; and
- 12) Enforcement staff expressed concern over working relationships within the Division.

This review recommends that Enforcement implement additional management controls to address the deficiencies identified to help ensure the Enforcement program efficiently and effectively fulfills its mission.

## **Finding 1: Enforcement Staff Lacked Adequate Guidance on How to Appropriately Analyze Complaints**

We found that Enforcement staff did not conduct a thorough review of a complaint brought to their attention regarding Madoff.

The OIG Madoff investigation found that in response to a 2001 complaint regarding Madoff from Harry Markopolos (Markopolos), an industry source, which was forwarded to the New York Regional Office (NERO) from the Boston District Office (BDO), NERO made an expedient decision not to investigate the complaint. NERO's Regional Director assigned the complaint to an Assistant Regional Director for initial inquiry. Despite the compelling circumstantial evidence in the complaint, the Assistant Regional Director e-mailed the Regional Director a day later, after having performed minimal follow-up and stated that she did not think NERO should pursue the matter further. Later, the Assistant Regional Director testified that she would have needed to consult with someone with greater options expertise to determine the full extent to which the complaint could be investigated. She also testified that she could not recall if she had consulted anyone, but had hoped she did.

This situation illustrates the need for guidance and training on appropriate complaint handling procedures. In particular, we found that no formal guidance exists within Enforcement to assist staff in determining what information is needed to adequately assess the legitimacy of a complaint, including for example, what specific information should be gathered related to a potential Ponzi scheme. Additionally, there was no readily available information regarding what procedures the Assistant Regional Director performed in reviewing the complaint and whom she may have consulted in making her decision not to pursue the matter further.

### **Recommendation 1:**

Enforcement should establish formal guidance for evaluating various types of complaints (e.g., Ponzi schemes) and train appropriate staff on the use of the guidance. The guidance should address the necessary steps and key information required to be collected when conducting preliminary inquiries of various types of complaints, specify what information should be documented, and list whom should be consulted in other offices within the SEC with relevant expertise in various subject matters and other pertinent data.

**Recommendation 2:**

Enforcement should ensure the SEC's tip and complaint handling system provides for data capture of relevant information relating to the vetting process to document why a complaint was or was not acted upon and who made that determination.

**Recommendation 3:**

Enforcement should require tips and complaints to be reviewed by at least two individuals experienced in the subject matter prior to deciding not to take further action.

## **Finding 2: Enforcement Staff Did Not Always Exercise Due Diligence in Their Handling of Critical Information Regarding Madoff**

We found that the Enforcement staff did not sufficiently review the evidence that Markopolos provided them. Further, Enforcement staff rebuffed Markopolos' offers of additional information related to his complaint.

The OIG Madoff investigation found in 2005, Markopolos provided the NERO Enforcement staff with a detailed complaint that included approximately 30 red flags indicating that Madoff was operating a Ponzi scheme, a scenario he described as "highly likely." We found that NERO Enforcement staff did not sufficiently review the evidence that Markopolos provided them and discounted much of the information in his complaint because Markopolos was not a Madoff employee or an investor. We also found that Enforcement staff questioned Markopolos' motives as being a competitor of Madoff's in the industry.

Additionally, we found that in December 2005, Markopolos e-mailed the Branch Chief assigned to the Madoff investigation stating that he was willing to meet with Enforcement staff and share his observations regarding Madoff's operations and provide them additional information and materials relevant to his complaint. He also made suggestions regarding sources within the media who would be willing to share information with the Enforcement staff as well. The Enforcement staff failed to adequately follow-up with Markopolos and obtain the information he was seeking to provide.

This situation demonstrates a lack of due diligence in the handling of critical information regarding Madoff and the need for additional policies, procedures and training in Enforcement to ensure these types of issues do not reoccur.

The SEC has recently taken steps to improve its ability to handle tips and complaints. In February 2009, the SEC retained the Center for Enterprise Modernization to begin work on a comprehensive review of internal procedures to evaluate tips, complaints, and referrals. The OIG has learned that the project is intended to be significant in scope and has not yet been completed. On August 5, 2009, Enforcement announced the creation of an Office of Market Intelligence. The Office of Market Intelligence will be Enforcement's liaison to the Agency's Tip, Complaint and Referral (TCR) process and system which is responsible for the collection, analysis, risk-weighting, triage, referral and monitoring of the hundreds of thousands of tips, complaints and referrals that the Commission receives each year. By analyzing each tip according to internally-developed risk criteria and making connections between and among tips from different sources, Enforcement hopes to be able to better focus its resources on those tips with the greatest potential for uncovering wrongdoing. The Office of Market Intelligence will also utilize the expertise of the Agency's other Divisions and newly created specialized units within Enforcement to help analyze the tips and identify wrongdoing.

While the SEC has begun the process of developing policies and procedures to improve the manner in which they evaluate tips and complaints, these procedures, when finalized, need to be tested to ensure they operate effectively.

**Recommendation 4:**

Enforcement should establish guidance to require that all complaints that appear on the surface to be credible and compelling be probed further by in-depth interviews with the sources to assess the complaints validity and to determine what issues need to be investigated. Such guidance should also require that staff obtain all relevant documentation related to such complaints.

**Recommendation 5:**

Enforcement should provide training to staff to ensure they are aware of the guidelines contained in Section 3.2.5 of the Enforcement Manual and Title 17 of the Code of Federal Regulations, Section 202.10 for obtaining information from media sources.

### **Recommendation 6:**

Enforcement should annually review and test the effectiveness of its policies and procedures with regard to its new tip and complaint handling system. Enforcement should also modify these policies and procedures, where needed, to ensure adherence and adequacy.

## **Finding 3: Enforcement Staff Assigned to Investigate the Madoff Complaint Were Inexperienced in Investigating Ponzi Schemes**

We found that the Enforcement staff assigned to the Madoff investigation team were inexperienced in investigating Ponzi schemes.

As a result of information from Markopolos received by NERO in 2005, Enforcement initiated an investigation into Madoff. The investigation was assigned by an Associate Director for Enforcement to a team of individuals (Assistant Director for Enforcement, Branch Chief, and Staff Attorney) that had virtually no experience in investigating Ponzi schemes.

The Staff Attorney, who had established a reputation for being smart and hard-working, had not been the lead Staff Attorney on any investigation and had been involved in very few investigations overall. Additionally, she had no experience investigating Ponzi schemes. Also, her supervisors, the Assistant Director and Branch Chief, testified that they also had no, or limited experience investigating a Ponzi scheme. There were also questions about the level of planning that was conducted by the Enforcement team for the Madoff investigation. This lack of experience and planning had consequences for the investigation they conducted of Madoff.

This situation illustrates the need for Enforcement to ensure that investigations are assigned to a team where at least one individual on the team has specific and sufficient knowledge of the subject matter and the team has access to at least one additional individual who also has such expertise or knowledge. Additionally, Enforcement should require planning memoranda to be prepared and approved by management during investigations which outline the steps to be taken to complete the investigation, identify other offices and or particular individuals with requisite expertise that should be consulted during the investigation, and identify staffing resources needed and estimated timeframes to complete the work.

In response to a June 2009 OIG survey of management effectiveness in Enforcement, many Enforcement staff expressed that they would like to see the idea of specialization introduced and one respondent commented that he is usually halfway through a new investigation before he has a clue about “what he should be doing or looking for.” Another proponent of specialization commented that “...we need to be able to focus our efforts more strategically...” Still others expressed that they thought specialization was a bad idea as many times until you get into an investigation you do not know what statute has been violated or if more than one statute has been violated. Others pointed out that it would make their positions redundant and boring.

Enforcement advised the OIG that they plan to introduce the creation of national specialized units dedicated to particular highly specialized and complex areas of securities laws. An intended outcome of these units is to allow staff to “get smart” about certain products, markets, regulatory regimes, practices and transactions. Additionally, it will allow investigators to be more efficient and less likely to be misled by those who use complexity to conceal their misconduct. Initially, there will be five specialized units including: Asset Management, Market Abuse, Structured and New Products, Foreign Corrupt Practices Act, and Municipal Securities and Public Pension Unit. Each specialized unit will be headed by a Unit Chief, and will be staffed across the nation by people in the Division who already have expertise in the topics, or have a desire to learn. They will receive specialized and advanced training. Additionally, individuals with practical market experience and other expertise, whether from private industry, other SEC Divisions, or elsewhere, will be hired into these units.

Once Enforcement introduces these specialized units, they need to ensure that they train staff on what resources and information is available and when and how assistance from these units should be requested. Enforcement should also periodically evaluate the operations of these units to ensure their efficiency and effectiveness.

**Recommendation 7:**

Enforcement should put in place procedures to ensure that investigations are assigned to teams where at least one individual on the team has specific and sufficient knowledge of the subject matter (e.g. Ponzi schemes) and the team has access to at least one additional individual who also has such expertise or knowledge.

**Recommendation 8:**

Enforcement should train staff on what resources and information is available from the national specialized units and when and how assistance from these units should be requested.

**Recommendation 9:**

Enforcement should make it mandatory that planning memoranda be prepared during an investigation and that the plan includes a section identifying what type of expertise or assistance is needed from others within and outside the Commission. The plan should also be reviewed and approved by senior Enforcement personnel.

**Recommendation 10:**

Enforcement should require that after the planning memorandum is drafted, it is circulated to all team members assigned to the investigation, and all team members then should meet to discuss the investigation approach, methodology and any concerns team members wish to raise.

## **Finding 4: Enforcement Staff Investigating Madoff Did Not Always Seek Assistance from Other Offices and Divisions As Needed**

We found that Enforcement staff did not always seek assistance from other divisions and offices as needed during its investigation of Madoff.

Although the Enforcement staff had difficulty understanding some aspects of Madoff's operations, including his purported trading overseas, they did not sufficiently consult with other divisions and offices within the SEC. Specifically, Enforcement did not consult with the SEC's Division of Trading and Markets for assistance in understanding issues relating to broker-dealer operations. Similarly, upon learning of Madoff's purported trading with European counterparties, the staff did not seek assistance from the Office of International Affairs (OIA) for help in investigating this aspect of Madoff's operations. The Enforcement staff expressed concern that external offices were often slow in providing assistance to them.

A June 2009 OIG survey regarding management effectiveness within Enforcement indicates that a certain percentage of the Enforcement staff did not feel they were receiving adequate support from offices and divisions outside of Enforcement. Our survey polled Enforcement staff on whether they felt they received adequate support from external offices and divisions when requested. Out of 759 respondents to this question, 66 percent agreed that they received adequate support. However, 24 percent (180 respondents) disagreed that they received adequate support. The remainder said that the question was not applicable to their jobs. Of those respondents that disagreed, many provided

written comments expressing their concerns over the difficulty in getting timely guidance or information from other divisions and offices. We selected a representative sample of those comments and have provided them below:

External offices and divisions should be able to advise in their respective areas of expertise. They generally do cooperate and provide helpful and useful responses, albeit through a cumbersome and time consuming process. The current memo circulation process effectively gives these offices and divisions a veto power over our work, which I think is both inappropriate and inconsistent with our mission of investor protection. If these offices and divisions were given an opportunity to comment, in a much shorter time frame, without the authority to withhold an unneeded approval, our mission, and investors generally would be better served.

Other Divisions typically take far too long to respond to our requests for guidance or information. For example, I sought guidance from an office within Market Reg over 3 months ago and did not get a response until two weeks ago and that only came after leaving numerous phone messages, e-mails and even standing outside of the relevant person's office. Some Divisions are better than others. It depends on the group and the people involved but overall it is too slow and Enforcement management typically does not want to make decisions without the relevant responses from the other offices so it slows the entire process down and frustrates the process.

Historically - no. During Chairman Cox's tenure, the other divisions were not supportive of the Division of Enforcement. Throughout his tenure, the other divisions took on an adversarial role towards Enforcement and used the comment process on memoranda to slow down recommendations and prevent them from reaching the Commission for decision. I had one high-profile matter that was 18 months in the comment process with repeated rounds of comments from two external divisions. The case was not allowed to go to the Commission for that time and aged badly.

Despite an individual's personal perception of whether seeking out assistance from other offices would be helpful or take too long, Enforcement staff should

work on establishing more effective relationships with other divisions and offices and ensure they are consulted on matters within their areas of expertise.

In a August 5, 2009 Memorandum to all Enforcement staff regarding the recent approval of delegated authority for formal orders, Enforcement management emphasized the importance of consulting with other applicable Divisions/Offices at the onset of an investigation and at appropriate times thereafter to ensure that Enforcement does not miss significant legal or policy issues. During the piloting of this new delegated authority, Enforcement will need to show that they can successfully tap into the expertise of other Commission Divisions and Offices without these parties having a formal role in reviewing many formal order requests.

Enforcement has also included in its newly drafted streamlining guidance for action memos a requirement that all action memos be circulated to other Divisions no later than eight weeks following completion of the initial draft of the action memo by the assigned staff member, with more routine or non-controversial matters being circulated within four weeks after the initial draft is prepared. In basic cases, an action memo will be required to be circulated within two weeks. Like the formal order process, the action memo process will rely on Enforcement staff to reach out to appropriate Divisions and Offices at the onset of the investigation (and at key decision making points thereafter) so that important issues are not identified for the first time when the action memo circulates. Relatedly, the draft streamlining guidance states that Enforcement contemplates that staff in other Divisions and Offices will escalate questions raised during an investigation to senior officers with decision-making authority so that Enforcement can rely on Division guidance in shaping the investigation and the subsequent recommendations in the action memo.

As effective information sharing is critical to the Enforcement Staff being able to adequately perform their functions, Enforcement will need to evaluate adherence to newly drafted policies and procedures on a periodic basis to ensure they are operating as intended. This would include assessing whether Enforcement is obtaining adequate and timely assistance and support from outside offices and ensuring that junior-level attorneys are supported in their efforts to obtain such assistance. To help identify potential problems in this area, Enforcement should implement procedures that require junior-level attorneys to report problems involving obtaining assistance from outside offices to senior-level management.

#### **Recommendation 11:**

Enforcement should establish procedures so that junior-level Enforcement attorneys who are having difficulty with obtaining timely assistance from outside offices are able to escalate their concerns to senior-level management within Enforcement.

## **Recommendation 12:**

Enforcement should conduct periodic internal reviews of any newly implemented policies and procedures related to information sharing with Divisions and Offices outside of Enforcement to ensure they are operating efficiently and effectively and necessary changes are made.

## **Finding 5: The Madoff Investigation Suffered From a Lack of Supervision**

We found that in addition to a lack of experience with investigating Ponzi schemes, the Madoff investigation suffered from a lack of supervision.

The OIG found that there were questions about the level of supervision provided to the staff attorney on the Madoff Enforcement investigation with regard to providing guidance in how to conduct the investigation. There were also concerns expressed about the lack of resources available to the Enforcement staff in connection with its Madoff investigation.

When reflecting on the SEC's failure to uncover Madoff's Ponzi scheme, the Assistant Director commented that one problem was the administrative burdens that occupied much of the Branch Chief's time. The Assistant Director explained:

. . . she [the Branch Chief] had inherited a branch where everybody had left and left these old cases in shambles, and you had to go back to the court records, pulling all these court files, and recreating files to close them...Then you had to have six month memos on cases, whether or not you should keep them open, memos to write. The joke that we had in the office was that you had to write a memo to get permission to write a memo. You know, a lot of this was to make the performance measurable, which is great, and it should be measurable, but you have to provide people the resources to do it.

We also found in response to the June 2009 OIG Enforcement survey that Enforcement staff had concerns about lack of resources and the resulting administrative burdens they had to perform. More specifically, we surveyed Enforcement staff regarding their thoughts on resources by asking "Do you have adequate resources to successfully perform your job?" Out of 776 respondents to this question, 54 percent stated they did not have adequate resources to successfully perform their job. Many of the Enforcement staff cited the lack of

support resources (e.g., secretaries, paralegals and document clerks) as a major problem with investigations. Many stated that they spend a considerable amount of time copying, scanning files, faxing documents, and preparing cases for closing instead of reviewing and analyzing evidence, and paying attention to whether cases further the division's mission in the best ways.

Enforcement has recently taken actions to begin to address concerns related to routine monitoring of Enforcement cases and the hiring of additional support staff. Enforcement provided the OIG a memorandum drafted by its newly created Management Advisory Group to show that they intend to implement a requirement that management conduct quarterly case reviews using data from Enforcement's case management system (HUB). The reviews would target certain types of investigations (e.g. aged and inactive investigations, Top Ten, etc.) with the objective of moving the investigations toward resolution. The case reviews will be at the Associate/Office Head level. Also, to the extent the periodic case reviews identify critical action items for specific cases, the action items will be required to be documented in writing for effective follow-up.

While quarterly case reviews will help ensure periodic involvement by upper levels of management, they do not replace the need for effective continuous monitoring of cases by an investigator's immediate supervisor.

With regard to adding additional support staff resources, the Director of Enforcement recently stated in a speech before the New York City Bar that Enforcement has committed to more than triple the current number of full-time paralegals and support personnel in the Division. Additionally, Enforcement has taken the necessary steps to identify and justify in its recent budget request the number and type of support staff positions needed.

**Recommendation 13:**

Enforcement should require that the planning memorandum and associated scope, methodology and timeframes be routinely reviewed by an investigator's immediate supervisor to ensure investigations remain on track and determine whether adjustments in scope, etc. are necessary.

**Recommendation 14:**

Enforcement should ensure that sufficient resources, both supervisory and support, are dedicated to investigations upfront to provide for adequate and thorough supervision of cases and effective handling of the investigations.

## **Finding 6: Enforcement Staff Failed to Verify Information Provided By Madoff with Independent Sources**

We found that the Enforcement staff working on the Madoff investigation failed to verify information provided by Madoff through the use of independent third-party sources.

In conducting an investigation of the allegation that Madoff was operating a Ponzi scheme, it would have been critical to verify Madoff's purported trading with independent third-parties such as the Financial Industry Regulatory Authority (FINRA), Chicago Board Options Exchange (CBOE), and/or the Depository Trust Company (DTC). Yet, we found that the Enforcement staff conducting the Madoff investigation failed to sufficiently and adequately follow up with independent third-parties in order to verify whether Madoff actually engaged in trading.

Particularly in an investigation of fraud, it is very important to verify representations made by the individual or firm being investigated. In an investigation of a possible Ponzi scheme, independent third-party verification is a critical component of conducting a thorough and comprehensive investigation

### **Recommendation 15:**

Enforcement should put in place policies and procedures or training mechanisms to ensure staff have an understanding of what types of information should be validated during investigations with independent parties such as the Financial Industry Regulatory Authority, Depository Trust Company, and Chicago Board Options Exchange.

## **Finding 7: Enforcement Staff Did Not Adequately Evaluate Additional Information Received by the SEC While the Madoff Investigation Was Inactive Pending Official Closure**

We found that Enforcement failed to adequately evaluate additional troubling information received by the SEC after Madoff agreed to register as an investment advisor in August

2006, but before the case was officially closed in January 2008.

In June 2007, Markopolos e-mailed the Branch Chief on the Enforcement Madoff investigation stating that he had attached some very troubling documents that showed the Madoff fraud scheme was getting even more brazen. Additionally, the e-mail stated that Madoff could not possibly be managing the billions in his strategy that he claimed.

Despite the additional information, we found no documentation to show that any analysis was done or contact was made with Markopolos by the Enforcement staff to follow up on the e-mail or attached documents. The Branch Chief testified that she did not recall whether the e-mail attachments were given significant analysis. Further, the Staff Attorney opined that she did not believe the e-mail provided any new information.

Similarly, the Enforcement staff received a letter regarding Madoff from an anonymous source including allegations about Madoff's investment firm. We found that the Enforcement staff failed to appropriately analyze this letter complaint as well.

This situation illustrates the need for Enforcement staff to thoroughly evaluate complaints and tips and encourage additional information from complainants even if an investigative matter is pending closure.

**Recommendation 16:**

Enforcement should include in its complaint handling guidance proper procedures for ensuring complaints received even if an investigation is pending closure, are properly vetted.

## **Finding 8: Enforcement Staff Did Not Timely Complete Administrative Tasks Associated with Opening and Closing the Madoff Investigation**

We found that there were delays in completing administrative tasks related to opening a matter under inquiry (MUI) on Madoff, as well as closing the investigation.

In the OIG Madoff investigation, we found that there were delays in the Enforcement staff opening a MUI in its Madoff investigation. According to the

SEC's Enforcement Manual, the process of opening a MUI helps to ensure efficient allocation of resources to investigations. The Assistant Director acknowledged that one of the reasons why one should open a MUI immediately is to ensure that if a complaint regarding the same entity or matter comes in to another office within the SEC, that person can determine if there is already an open investigation by searching the appropriate SEC database and can forward the relevant information to that office.

We found that due to the delay in opening the MUI, the Enforcement staff conducting the Madoff investigation never received an e-mail complaint regarding Madoff, which would have been useful in connection with their investigation.

Similarly, we found that although the Madoff investigation was effectively completed in August 2006, after Madoff agreed to register as an investment advisor, the matter was not officially closed until January 2008 which was almost 18 months later. Enforcement staff commented that the substantial lag is not uncommon due to the paperwork burden involved with closing cases.

Enforcement has begun to streamline processes related to the MUI process by drafting an initiative to discontinue Deputy-level review when opening a routine MUI. Instead when opening a MUI in Enforcement's case activity tracking system (CATS), staff will include a short narrative in the comments field indicating the nature of the case and the geographic or other nexus to the investigating office. The data is then pulled into the HUB system and the headquarters Enforcement office will generate weekly reports to be provided to Senior Officers showing MUI openings.

Similarly, Enforcement should also examine ways to streamline the case closing process and devote adequate resources to do so.

**Recommendation 17:**

Enforcement should conduct periodic internal reviews to ensure that MUIs are opened in accordance with any newly developed Commission guidance and examine ways to streamline the case closing process. Enforcement should also ensure staff have adequate time in which to complete these types of administrative tasks.

## **Finding 9: Other Opportunities for Programmatic Improvements within Enforcement**

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While not directly related to the Madoff investigation, we identified through a June 2009 OIG survey of management effectiveness in Enforcement, other areas where opportunities exist for making programmatic improvements within Enforcement, including: (1) ensuring staff are periodically reminded of their responsibilities regarding impartiality in the performance of their duties, (2) enhancing case handling processes, (3) encouraging groups within Enforcement to work more cohesively with one another, and (4) clearly establishing and communicating program priorities. In our survey results relating to these particular matters, we received a large amount of detailed comments by Enforcement staff expressing concern in response to these survey questions. We believe that the considerable number and detailed nature of comments on these and other issues demonstrates the significance of these matters to survey respondents within Enforcement. Addressing these areas of concern will help Enforcement to more effectively achieve its program goals.

### **Finding 9A: Enforcement Staff Are Not Always Aware of Where to Find Information Regarding Impartiality and a Troubling Number Have Been In Situations They Felt Lacked Impartiality**

While the majority of Enforcement staff stated that they have not known of or been involved in a situation where they felt there was a lack of impartiality, a troubling number of Enforcement staff stated that they felt they had been in a situation where there was a lack of impartiality. Additionally, a large percentage of Enforcement staff stated that they did not know where to find information regarding impartiality in the performance of official duties (e.g., improper preferential treatment and external influences).

Our survey polled respondents on three questions regarding impartiality in order to determine if staff knew where to find information on impartiality in the performance of their official duties, whether staff had ever been in a situation where they felt there was a lack of impartiality, and whether staff believed that management promptly and sufficiently addressed situations involving lack of

impartiality. The questions and response percentages for each answer are depicted below:

Q1). Do you know where to find information regarding impartiality in the performance of official duties?

<b>Yes</b>	<b>No</b>	<b>Total Respondents</b>
447	302	749
59.7%	40.3%	

Q2). Do you know of or have you ever been involved in a situation where you felt there was lack of impartiality or the appearance of lack of impartiality in performance of your official duties? For example, preferential treatment toward the opposing lawyer who once worked at the Commission, improper external influences, etc.

<b>Yes</b>	<b>No</b>	<b>Total Respondents</b>
99	653	752
13.2%	86.8%	

Q3). Do you believe that the Division of Enforcement's management promptly and sufficiently addresses situations involving the lack of impartiality or improper influence?

<b>Yes</b>	<b>No</b>	<b>Don't Know</b>	<b>Total Respondents</b>
191	60	508	759
25.2%	7.9%	66.9%	

The survey found that while 60 percent of respondents (447) indicated they knew where to find information regarding impartiality, 40 percent of respondents (302) do not know where to find such information. Also, while it is a positive sign that only 13 percent of respondents (100) have been or felt that they had been in a situation involving the lack of impartiality, any situation where there may have been a lack of impartiality is a cause for concern.

The survey also found that while 67 percent of respondents did not know if management promptly and sufficiently addressed situations involving the lack of impartiality, 25 percent of respondents thought that management did adequately address these situations.

### **Recommendation 18:**

Enforcement should put in place a process to periodically remind staff of their responsibilities regarding impartiality in the performance of official duties and instruct staff where they can find additional information regarding impartiality.

## **Finding 9B: Program Priorities Are Not Always Clearly Established and Communicated to Enforcement Staff**

While the majority of Enforcement staff believes that program priorities are clearly established and communicated, a large percentage expressed concern over workload priorities.

Our survey polled respondents on five questions regarding communication of workload priorities and alignment of priorities with the performance goals and measures in the SEC's Performance and Accountability Report (PAR) and Enforcement's mission to protect investors and the markets by investigating potential federal securities law violations and litigating the SEC's enforcement actions. The goal was to determine if management had clearly established and communicated program priorities and that those priorities aligned with Enforcement's mission and strategic goals.

The survey found that out of 795 respondents, 59 percent agreed that Enforcement clearly communicated its workload priorities while 41 percent disagreed. Additionally, out of 780 respondents, 57 percent agreed that management provides staff adequate guidance on how to achieve program priorities, while 43 percent disagreed that staff was provided adequate guidance. Further, more than 50 percent of respondents (420) were not familiar with the performance goals and measures in the SEC's performance and accountability report.

There was a widespread feeling among the respondents (81 percent) that Enforcement's workload priorities aligned with its mission to protect investors and the markets by investigating potential federal securities law violations and litigating the SEC's enforcement actions.

While 59 percent of respondents agreed that Enforcement program priorities were clearly communicated, 18 percent of respondents strongly disagreed that Enforcement workload priorities were clearly communicated to staff and many provided detailed and specific comments explaining their concerns. We selected

a sample of those comments to illustrate common concerns and have provided them below:

Overall I find that workload priorities are not communicated to the staff in a clear and concise manner. Moreover, such priorities are overall not communicated to the staff in a cohesive, unified fashion. Rather, priorities are communicated in a haphazard fashion by various managers at various times. Moreover, in my view the branch chief will often not have an understanding or knowledge of the priorities of his or her manager.

Managers are extremely reluctant to set priorities because they're afraid they will focus on the wrong thing and be caught unprepared if someone senior to them asks about a case they haven't identified as a priority. As a result, staff are told to make every case a priority and it's extremely inefficient and unproductive.

While management's workload priorities are laid out, they are subject to constant change from day to day. Staff Attorneys are not allowed to prioritize and manage their investigations as they see fit. Attorneys are constantly being pulled from one task to another at the whim of their manager. It makes the Staff Attorney's job exceedingly difficult. Part of the problem is that the Staff Attorney is supervised by multiple layers of management, all of whom have different priorities at different times and none of whom coordinate amongst themselves in order to set out an overall vision of how the attorney should proceed with all of their cases as a whole.

Priorities change like the flavor of the day. Whatever's "hot in the news" becomes our priority. Often it feels like we're the dog chasing its own tail.

Priorities of the enforcement division appear to change over time and that change does not seem to be rapidly communicated down the chain to line attorneys. At the current time, I do not have 100% confidence I could accurately identify with any specificity--i.e., beyond a general statement of a desire to see cases related to the financial meltdown--the types of cases enforcement management would like to see brought.

There appears to be no prioritization of cases or workload. In addition, I have no idea who is required to review my work product or even which work product must be reviewed. Certain branch chiefs completely micromanage and do not allow any communication by Staff Attorneys with anyone external to the office (including even AUSA's) while others do not even want to see document requests before they go out. The same is true of assistants and associates. Management appears to get no direction or instruction on what their duties are as a supervisor. I have never even been in the same room as my associate - I'm not sure I would be recognized by sight. Considering the fact that I am the person most knowledgeable about my cases, it seems incredibly ill-advised that communication with individuals up the chain does not include the Staff Attorney. Sometimes I have an idea about how to proceed or difficulties that I believe we will encounter with our case. I provide the idea to my branch chief and I hear nothing back. I assume that whatever ideas or suggestions I make are completely ignored but I have no way of knowing one way or the other because I'm not included in conversations between the branch chief/assistant/associate.

As an agency, priorities have been continuously ambiguous and ever-changing depending on the shifting winds in Washington politics and/or the make-up of the Commission.

I'm not sure exactly what you mean by "workload priorities" but I can tell you that I don't know quite what is expected of me. Because there are no quantifiable metrics used to evaluate my effectiveness in my role, it is virtually impossible to communicate to me what is expected of me. Only vague generalizations can be expressed. What I do is, admittedly, very complicated, but measurements can be made. Even a simple directive such as, "you are expected to bring two insider trading cases and one market manipulation case to successful conclusion each year" would be an improvement.

These comments show that some Enforcement staff are concerned about communication of information up and down the chain of command, constantly changing workload priorities, and lack of clear expectations.

**Recommendation 19:**

Enforcement should establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over communication of program priorities and make recommended improvements to the Director of Enforcement.

**Finding 9C: Case Handling Processes Could Be Improved**

While the majority of the feedback received from Enforcement staff with regard to its case handling processes was positive, a considerable number of staff expressed concerns in this area.

Our survey polled respondents on the following seven questions related to Enforcement’s case selection process, assigning resources to cases and rewarding employees for their work on cases to determine their satisfaction with current processes. The relevant questions and answers are provided below.

Q1). Do you believe that Enforcement management has an effective process in place for selecting cases such as determining the number of high profile cases it will take on, versus cases that are less significant (i.e. balancing the workload)?

<b>Strongly Disagree</b>	<b>Somewhat Disagree</b>	<b>Somewhat Agree</b>	<b>Strongly Agree</b>	<b>N/A to my job</b>	<b>Total Respondents</b>
107	202	188	45	196	738
14.5%	27.4%	25.5%	6.1%	26.6%	

Q2). Do you believe the Division of Enforcement selects cases based on appropriate risk factors?

<b>Strongly Disagree</b>	<b>Somewhat Disagree</b>	<b>Somewhat Agree</b>	<b>Strongly Agree</b>	<b>N/A to my job</b>	<b>Total Respondents</b>
41	142	271	67	204	725
5.7%	19.6%	37.4%	9.2%	28.1%	

Q3). Do you believe that Enforcement staff are improperly influenced or directed by Division management or supervisors to take on certain or specific types of cases?

Strongly Disagree	Somewhat Disagree	Somewhat Agree	Strongly Agree	N/A to my job	Total Respondents
255	162	127	50	158	752
33.9%	21.5%	16.9%	6.6%	21.0%	

Q4). Do you believe that Enforcement management assigns cases fairly among staff such as high visibility cases?

Strongly Disagree	Somewhat Disagree	Somewhat Agree	Strongly Agree	N/A to my job	Total Respondents
114	128	220	123	158	743
15.3%	17.2%	29.6%	16.6%	21.3%	

Q5). Do you believe that Enforcement assigns cases to staff based on an individual's skills and experience?

Strongly Disagree	Somewhat Disagree	Somewhat Agree	Strongly Agree	N/A to my job	Total Respondents
68	118	283	144	130	743
9.2%	15.9%	38.1%	19.4%	17.5%	

Q6). Do you believe that the Division of Enforcement's management allocates resources primarily with the goal of maximizing investor protection?

Strongly Disagree	Somewhat Disagree	Somewhat Agree	Strongly Agree	Total Respondents
65	139	357	165	726
9.0%	19.1%	49.2%	22.7%	

Q7). Do you believe there is a culture within Enforcement's management that rewards the "quantity" of cases versus the "quality" of cases that its staff undertakes? For example staff that complete work on several smaller, simple cases (quantity), are recognized or rewarded more often than staff who work on larger cases that are complex and lengthy (quality).

Strongly Disagree	Somewhat Disagree	Somewhat Agree	Strongly Agree	N/A to my job	Total Respondents
138	182	191	119	119	749
18.4%	24.3%	25.5%	15.9%	15.9%	

The survey found that a troubling number of Enforcement staff dislike the current case selection processes. Specifically, 42 percent of respondents (309) do not

believe that Enforcement has an effective process in place for selecting cases, 25 percent of respondents (183) do not believe that Enforcement selects cases based on appropriate risk factors, and 24 percent of respondents (177) felt that cases were improperly influenced or directed by Enforcement management. To better illustrate concerns expressed by staff related to case selection processing, the OIG selected a sample of the written comments provided by Enforcement staff and have provided them below.

Everyone is afraid of making a mistake, so they take on every case, then make every case a priority and, a year later, when the dust settles, they have to close the cases they never looked at on the grounds that they don't have sufficient resources. No real decision-making is done at the outset.

There is no process for anything. And there is no review to make sure that the staff's workload is balanced. There are staff attorneys who are completely swamped (who are in a busy line) while there are other staff attorneys that are completely slow (who are in a slow line). Staff attorneys are not shared across reporting lines, for no apparent reason. I suspect it has something to do with "points" that individual members of management are accruing for their own review purposes.

. . . . we are not "looking" at risk factors and selecting cases based upon them (to my knowledge). I think we should. Where are the top three areas the SEC sees the next big fraud coming from? I have no idea, but I should. Someone in enforcement should be thinking about this and instructing the staff accordingly.

There is no process. Often years of investigation go down the tube because a litigator doesn't like the case. Why couldn't we know that a few YEARS earlier.

We did find that 46 percent of respondents (343) believe that management assigns cases fairly among staff, such as high visibility cases. In addition, 58 percent of respondents (427) believe that cases are assigned based on an individual's skills and experience. Further, 72 percent of respondents (522) believe that Enforcement management allocates resources primarily with the goal of maximizing investor protection.

With respect to rewarding employees for their work on cases, 41 percent of respondents (310) of Enforcement staff believe that management rewards

employees for the “quantity” of cases they perform versus the “quality” of cases that staff undertakes.

**Recommendation 20:**

Enforcement should establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns regarding case handling procedures within Enforcement and make recommended improvements to the Director of Enforcement.

## **Finding 9D: Enforcement Staff Expressed Concern Over Working Relationships within the Division**

In addition to concerns over obtaining assistance from outside divisions and offices, Enforcement staff does not always believe that different groups within the Division work together effectively.

The survey asked Enforcement staff whether they believed that different groups worked effectively with one another within the Division. The survey found that out of 736 respondents to this question, 61 percent of respondents (452) agreed that groups work effectively with each other and 39 percent of respondents (284) disagreed with the statement. Several members of Enforcement staff that disagreed, provided comments explaining their concerns. We selected a sample of those comments to illustrate common concerns and have provided them below.

Management does not understand the work of the examination groups in the office and rarely acknowledge the benefit to the program that could be obtained by working more closely with those groups, particularly on more timely market and other issues pertaining to regulated entities. They appear to arrogantly dismiss the greater expertise of the examination groups in certain critical market and regulatory issues that could be tapped to prevent serious market issues if there were a coordinated effort between the two sides of the office. Instead they compete with the exam staff to find leads on past violations and then ignore the ability of the exam staff to obtain information in a timely manner in order to keep the cases and, I guess the "rewards" to themselves. Moreover, the Enf Associates ignore the referrals of the examination program. As a result,

the Enf program is almost entirely reactive to problems that may arise, when the whole program could take a proactive approach by relying on and supporting its proactive divisions on the examination side of the office.

There should be better coordination with the accounting and market surveillance staffs and the investigative and litigation staff. These different sections do not always work together well.

Our current severely hierarchical structure tends to create fiefdoms -- managers tend to want to control everything on their turf, including outside contacts and consultations. Veteran staffers cross lines to consult when necessary, but do so quietly.

At least in OIE, I feel that we are segregated out from the rest of Enforcement. We don't often work with other groups in Enforcement. However, I think we should, especially given that we currently investigate all types of cases, cases that require a certain level of knowledge and experience not readily available to us within the group.

Turf battles between regional office and Home Office. Previously, senior leadership in the Division routinely favored staff in the Home Office and did not effectively manage such conflicts.

We could do a lot more to put accountants and attorneys on equal footing in order to allow the expertise of the staff to be put to full use. The kind of specialized knowledge we have been lacking on some high-profile failures of ours can be obtained through empowering our accounting and market surveillance staff to take a greater role in investigations and deciding their course.

The trial unit has always had problems working with the investigative side. Some attorneys get better than others but still there are tensions between groups. Management has made no effort to correct this.

I believe that different branches are totally separate entities and the Division of Enforcement does almost nothing to foster teamwork between different groups.

There is almost no cross-group interaction, but again, this should change with the new specialization program. Right now it's very unusual for the staff of one AD group to know that a different AD group has a similar case, or has faced a similar issue, let alone knowing that someone in a different region has done so. Once we have a national program of specialized groups, sharing information and working together should come much more regularly and naturally.

Dealing with other enforcement groups is often a hassle, because every office is primarily motivated to guard their own territory and make sure the other office isn't trying to poach the good cases. That said, informal, relationship based contacts with staff in other offices about particular matters is frequently helpful and rewarding.

Sometimes I am discouraged from working with other groups because it is viewed as relinquishing control of "our case."

The survey results and comments demonstrate that Enforcement can do more to foster coordination and cooperation among the different working groups within the Division.

**Recommendation 21:**

Enforcement should establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over working relationships within Enforcement and make recommended improvements to the Director of Enforcement.

## Acronyms

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BDO	Boston District Office
CATS	Case Activity Tracking System
CBOE	Chicago Board Options Exchange
DTC	Depository Trust Company
Enforcement	Division of Enforcement
FINRA	Financial Industry Regulator Authority
HUB	Case Management System
Madoff	Bernard L. Madoff
MUI	Matter Under Inquiry
NERO	New York Regional Office
PAR	Performance and Accountability Report
OIA	Office of International Affairs
OIG	Office of Inspector General
SEC or Commission	U.S. Securities and Exchange Commission

## Scope and Methodology

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This review was not conducted in accordance with the government auditing standards.

**Scope.** We examined Enforcement program activities covering the period Fiscal Year 2000-2009. This included reviewing information and documentation related to an OIG investigation of Madoff and his firm and the reasons allegations were not found to be credible by the Commission and the results of a survey questionnaire launched by the OIG in June 2009 that was sent to the Division of Enforcement staff and management to obtain information regarding management effectiveness.

**Methodology.** In order address the audit objective, we analyzed information from OIG Investigative Report No. 509, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme*, to identify systemic issues that would prevent the Division of Enforcement from accomplishing its mission to enforce the securities law and protect investors.

We also developed a 50 question survey consisting of 42 multiple choice questions and 8 open-ended questions to which respondents could write a response. The questionnaire was designed to obtain feedback from Enforcement staff on topics such as allocation of resources, performance measurement, case management procedures, communication, adequacy of policies and procedures, employee morale, and management efficiency and effectiveness. The survey was launched in June 2009 to Enforcement staff in headquarters and the Commission's eleven regional offices. Of the 1,242 staff that were emailed questionnaires, 838 respondents (67%) completed some portion of the survey and 750 respondents (60%) completed the entire survey. The survey results were summarized in different formats including spreadsheets and a database format to show the response rate for all questions in the survey. We also conducted phone interviews with Enforcement staff that asked to be contacted regarding their survey responses.

**Prior OIG Coverage.** The OIG previously conducted an investigation into Madoff and his firm and the reasons allegations were not found to be credible by the Commission and issued OIG Investigative Report No. 509, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme*.

## List of Recommendations

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### **Recommendation 1:**

Enforcement should establish formal guidance for evaluating various types of complaints (e.g., Ponzi schemes) and train appropriate staff on the use of the guidance. The guidance should address the necessary steps and key information required to be collected when conducting preliminary inquiries of various types of complaints, specify what information should be documented, and list whom should be consulted in other offices within the SEC with relevant expertise in various subject matters and other pertinent data.

### **Recommendation 2:**

Enforcement should ensure the SEC's tip and complaint handling system provides for data capture of relevant information relating to the vetting process to document why a complaint was or was not acted upon and who made that determination.

### **Recommendation 3:**

Enforcement should require tips and complaints to be reviewed by at least two individuals experienced in the subject matter prior to deciding not to take further action.

### **Recommendation 4:**

Enforcement should establish guidance to require that all complaints that appear on the surface to be credible and compelling be probed further by in-depth interviews with the sources to assess the complaints validity and to determine what issues need to be investigated. Such guidance should also require that staff obtain all relevant documentation related to such complaints.

### **Recommendation 5:**

Enforcement should provide training to staff to ensure they are aware of the guidelines contained in Section 3.2.5 of the Enforcement Manual and Title 17 of the Code of Federal Regulations, Section 202.10 for obtaining information from media sources.

**Recommendation 6:**

Enforcement should annually review and test the effectiveness of its policies and procedures with regard to its new tip and complaint handling system. Enforcement should also modify these policies and procedures, where needed, to ensure adherence and adequacy.

**Recommendation 7:**

Enforcement should put in place procedures to ensure that investigations are assigned to teams where at least one individual on the team has specific and sufficient knowledge of the subject matter (e.g. Ponzi schemes) and the team has access to at least one additional individual who also has such expertise or knowledge.

**Recommendation 8:**

Enforcement should train staff on what resources and information is available from the national specialized units and when and how assistance from these units should be requested.

**Recommendation 9:**

Enforcement should make it mandatory that planning memoranda be prepared during an investigation and that the plan includes a section identifying what type of expertise or assistance is needed from others within and outside the Commission. The plan should also be reviewed and approved by senior Enforcement personnel.

**Recommendation 10:**

Enforcement should require that after the planning memorandum is drafted, it is circulated to all team members assigned to the investigation, and all team members then should meet to discuss the investigation approach, methodology and any concerns team members wish to raise.

**Recommendation 11:**

Enforcement should establish procedures so that junior-level Enforcement attorneys who are having difficulty with obtaining timely assistance from outside offices are able to escalate their concerns to senior-level management within Enforcement.

**Recommendation 12:**

Enforcement should conduct periodic internal reviews of any newly implemented policies and procedures related to information sharing with Divisions and Offices outside of Enforcement to ensure they are operating efficiently and effectively and necessary changes are made.

**Recommendation 13:**

Enforcement should require that the planning memorandum and associated scope, methodology and timeframes be routinely reviewed by an investigator's immediate supervisor to ensure investigations remain on track and determine whether adjustments in scope, etc. are necessary.

**Recommendation 14:**

Enforcement should ensure that sufficient resources, both supervisory and support are dedicated to investigations upfront to provide for adequate and thorough supervision of cases and effective handling of the investigations.

**Recommendation 15:**

Enforcement should put in place policies and procedures or training mechanisms to ensure staff have an understanding of what types of information should be validated during investigations with independent parties such as the Financial Industry Regulatory Authority, Depository Trust Company, and Chicago Board Options Exchange.

**Recommendation 16:**

Enforcement should include in its complaint handling guidance proper procedures for ensuring complaints received even if an investigation is pending closure, are properly vetted.

**Recommendation 17:**

Enforcement should conduct periodic internal reviews to ensure that MUIs are opened in accordance with any newly developed Commission guidance and examine ways to streamline the case closing process. Enforcement should also ensure staff have adequate time in which to complete these types of administrative tasks.

**Recommendation 18:**

Enforcement should put in place a process to periodically remind staff of their responsibilities regarding impartiality in the performance of official duties and instruct staff where they can find additional information regarding impartiality.

**Recommendation 19:**

Enforcement should establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over communication of program priorities and make recommended improvements to the Director of Enforcement.

**Recommendation 20:**

Enforcement should establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns regarding case handling procedures within Enforcement and make recommended improvements to the Director of Enforcement.

**Recommendation 21:**

Enforcement should establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over working relationships within Enforcement and make recommended improvements to the Director of Enforcement.

## Management Comments

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### MEMORANDUM

**TO:** H. David Kotz, Inspector General, Office of Inspector General

**FROM:** Robert Khuzami, Director of Enforcement *RSU*

**RE:** Enforcement's Response to the Office of Inspector General's Report, *Program Improvements Needed Within the SEC's Division of Enforcement, Report No. 467*

**DATE:** September 25, 2009

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This memorandum is in response to the Office of Inspector General's Draft Report No. 467 entitled *Program Improvements Needed Within the SEC's Division of Enforcement*. Thank you for the opportunity to review and respond to this report. We concur in all of the recommendations in the Report. In fact, Enforcement has already taken significant steps toward creating a better organized and more effective Division.

In the past several months, the Division of Enforcement has engaged in a far reaching self assessment which has resulted in Enforcement being restructured to a more specialized model that included the establishment of national enforcement units organized along product, market or regulatory lines. This specialization model will permit the Division to conduct investigations in a more strategic manner by enhancing the agency's ability to quickly meet the challenges in today's complex and quickly evolving markets. Enforcement is also providing its staff with increased opportunities for training, engaging in practices that will streamline Enforcement's current investigation process, and is in the process of creating a new centralized office to handle all tips, complaints and referrals;

**Recommendations 1, 2, 3, 4, 6 and 16** each relate to guidance regarding the handling of tips, complaints and referrals by Enforcement. Enforcement concurs in these recommendations. Each of these recommendations will be implemented through the agency-wide restructuring of the tips, complaints and referrals process ("TCR process") to a more centralized process. The Commission hired the MITRE Corporation to assist with a project to completely revamp and centralize the agency's processes for intake, triage and analysis of all tips, complaints and referrals. Enforcement has been working closely with the Chairman's office on this initiative. Further, Enforcement has created a new office, the Office of Market Intelligence ("OMI"), that will consolidate, under the full time supervision of a Senior Officer, the handling of all TCRs. The principal functions of the OMI will include the coordination, consolidation and management of all processes within the Division for the proper handling of tips, complaints and referrals that come to the attention of the Division from any internal or external source.

**Recommendations 5, 8, 15, and 18** each relate to the training of Enforcement staff. Enforcement concurs in these recommendations. As part of Enforcement's restructuring, we will be significantly enhancing our training program and the items outlined in these four recommendations will be included in our enhanced program.

**Recommendation 7** states that Enforcement should ensure that case staffing includes at least one individual with knowledge of the subject matter of the investigation and that the investigative team has access to expertise. We concur in this recommendation. Expertise is important to an investigation and Enforcement has undertaken a wide range of initiatives to achieve this goal, including the creation

of specialized units, enhanced training, hiring of specialists, creation of a skill survey, and better access to expertise in other Divisions. Enforcement notes that often an investigative team is comprised of an Assistant Director and a staff attorney.

**Recommendations 9, 10, and 13** each relate to the role of the planning memorandum in the investigation process. Enforcement concurs with these recommendations. During the investigation, staff should prepare a planning memorandum that will be reviewed by the assistant director on the investigation. The assistant director will also meet with the staff assigned to the matter to review the plan. In addition, as part of our new processes there will be regular quarterly reviews of investigations to encompass Recommendation 13. Investigative plans will be discussed during these reviews. The recommendations do not require a particular format for the plans. We will develop a format that provides the necessary flexibility for the nature and scope of the particular investigation.

**Recommendations 11 and 12** each relate to productively working with different divisions within the Commission. Enforcement concurs with these recommendations. Enforcement agrees that our own ability to work effectively with other divisions and their willingness to share their expertise with us is important to the proper functioning of the investigative program.

**Recommendation 14** relates to ensuring that Enforcement has sufficient resources for its investigations. Enforcement concurs with this recommendation. Enforcement agrees that having sufficient resources for its investigations is critical to the efficient operation of the division and, through the budget process, we have asked for funds for additional staffing and much-needed technology.

**Recommendation 17** relates to the opening of MUIs and the case closing process. Enforcement concurs with this recommendation. Enforcement will conduct reviews to ensure that MUIs are opened pursuant to guidance. Additionally, Enforcement currently has a working group focusing on the efficient operation of the case closing process and will continue to streamline this process for greater efficiency.

**Recommendations 19, 20, and 21** recommend that Enforcement analyze the OIG survey results relating to staff views on communication of program priorities, case handling procedures and working relationships within Enforcement. We concur in these recommendations and plan to utilize one of Enforcement's existing working groups to analyze these survey results.

The implementation of these recommendations will be part of our continuing efforts to have the most effective enforcement program possible. Developing a more effective program is the central focus of our current restructuring, the most significant in the Division's history. As the restructuring is fully implemented, the Division periodically will reevaluate the changes made, including those reflected in these recommendations, to make certain that they continue to promote our ability to achieve the Commission's enforcement goals in the most effective manner possible and are the most efficient use of the Commission's resources.

## OIG Response to Management's Comments

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The Office of Inspector General (OIG) is pleased that the Division of Enforcement (Enforcement) concurred with all 21 recommendations in this report. We believe that these recommendations are crucial to ensuring that Enforcement is able to conduct thorough and effective investigations in the future. As the OIG Report entitled "Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme" dated August 31, 2009 detailed, Enforcement received three versions of a very specific complaint entitled "The World's Largest Hedge Fund is a Fraud" detailing approximately 30 red flags indicating that Bernard L. Madoff (Madoff) was operating a Ponzi scheme. Moreover, on the first two occasions this complaint was brought to Enforcement's attention, no efforts were made to conduct an investigation. While an investigation was eventually conducted, Enforcement never really investigated the possibility of a Ponzi scheme.

We believe that the immediate implementation of these recommendations should be Enforcement's top priority. We are encouraged that Enforcement is acknowledging that significant changes are necessary in its operations and that it intends to implement all of our recommendations.

The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. Crucial to the SEC's effectiveness in all areas is its enforcement authority. The public needs to be able to rely upon the SEC to conduct thorough and comprehensive investigations where it is provided detailed complaints outlining a potential fraud.

We believe that these recommendations would ensure a basic level of competence in Enforcement investigations and can be fully implemented in short order. The OIG plans to follow-up to ensure that all 21 recommendations are implemented in full and report back to the Congress on the status of these efforts. We also plan to conduct a follow-up audit to determine if the changes to Enforcement's operations are having the desired and appropriate effect.

# Audit Requests and Ideas

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The Office of Inspector General welcomes your input. If you would like to request an audit in the future or have an audit idea, please contact us at:

U.S. Securities and Exchange Commission  
Office of Inspector General  
Attn: Assistant Inspector General, Audits (Audit Requests/Ideas)  
100 F Street, N.E.  
Washington D.C. 20549-2736

Tel. # 202-551-6061 Freedom of Information Act (FOIA)  
Fax # 202-772-9265  
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