

**MANAGEMENT RESPONSE OF  
THE SECURITIES AND EXCHANGE COMMISSION  
ACCOMPANYING THE SEMIANNUAL REPORT OF THE INSPECTOR GENERAL  
FOR THE PERIOD OCTOBER 1, 1999 THROUGH MARCH 31, 2000**

**Introduction**

The Semiannual Report of the Inspector General (IG) of the Securities and Exchange Commission (SEC) was submitted to the Chairman on April 28, 2000 as required by the Inspector General Act of 1978, as amended. The report has been reviewed by the Chief of Staff, General Counsel, Executive Director, and Director of the Division of Enforcement. The management response is based on their views and consultation with the Chairman.

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

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

**A. Audit Program**

During the reporting period, the IG issued 10 audit reports. Management generally agreed with the findings and recommendations in the IG's reports.

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

**B. Response to Significant Problems**

No new significant problems were identified during this period.

**C. Response to Significant Problems Previously Identified**

The IG's semiannual report discusses three significant problems that were previously identified. An update on each problem follows.

*Sensitive Information.* Safeguarding sensitive information is a critical activity at the SEC, and aggressive steps are being taken to enhance our controls in this area. A task force of senior Commission staff is continuing efforts to enhance the effectiveness of the Commission's controls over sensitive information. As a result of the task force's efforts, a policy has been issued for safeguarding sensitive non-public information and new building access procedures have been implemented for visitors. In addition, a consultant has been hired to conduct a review of sensitive information security at the Commission. The consultant has completed the review and is preparing its recommendations.

*Collection of Filing Fees.* The IG's audit, released in February 1996, confirmed the Commission's previous assessment that the agency's fee and filing system (EFFS) was not materially in conformance with the Federal Managers' Financial Integrity Act. Since the audit was released, significant progress has been made in correcting the most serious weaknesses (*i.e.*, those related to separation of duties, access controls, audit trails, and financial information within the fee system). The separation of duties became even more effective with the transition to mandated electronic filing in May 1996 and the elimination of the user fees collected under the Independent Offices Appropriations Act of 1952 in October 1996.

Some corrective actions will not be fully implemented until the current fee collection system is redesigned. The fee system is being redesigned and implemented under the EDGAR modernization contract. A group of SEC managers and users is working with the contractors and developers to ensure that the new fee system contains adequate financial controls and meets the agency's and filers' requirements.

*Information Resources Management (IRM).* The SEC continues to make progress in correcting the weaknesses in the information technology (IT) area. Since the completion of the agency's Year 2000 conversion, the Office of Information Technology has devoted more attention to improving contract management, clarifying policies and procedures, and strengthening IT planning.

The office has taken a number of steps to improve contract management. It is consolidating a number of requirements and is matching these requirements to more appropriate contract vehicles. It is using a new financial database to improve management of contract data. It is taking steps to ensure that all program managers receive appropriate training in contract management. It is also incorporating recommendations from a recent independent review of its management of outsourced customer service operations.

The office has made significant progress clarifying IT policies and procedures to both internal and external stakeholders. Internally, an office-wide committee has begun following procedures for reviewing, formalizing and communicating all policies and procedures. Externally, the office has posted additional technical bulletins to its website, and has presented guidance to its user community in written memoranda and in interactive monthly conferences.

The Commission is also making progress in IT planning. Commission management has established a senior level information technology committee to address high level IT policy issues and to oversee three key areas of IT management: planning, control, and evaluation of IT investments. In the area of planning, the office has dedicated managerial resources to formulating specific goals, crafting business plans, and creating a useful balance scorecard. In the area of control, the office is continuing to improve IT security measures, and is redesigning its budget system to enhance fiscal discipline. In the area of evaluation, the office has assembled a performance measurement team to follow-up on recommendations from independent reviews

of Helpdesk management and contract management, and to conduct further assessments of organizational efficiency and effectiveness.

**D. IG Recommendations Concerning Use of Funds**

None.

**E. Reports with No Management Decisions**

Final management decisions have been made on all audits issued prior to the beginning of the reporting period (October 1, 1999).

**F. Revised Management Decisions**

No management decisions were revised during the reporting period.

SEC Management Response to  
Semiannual IG Report  
October 1, 1999 – March 31, 2000

SECTION II  
Disallowed Costs  
As of March 31, 2000

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

SEC Management Response to  
Semiannual IG Report  
April 1, 1999 - September 30, 1999

SECTION III  
Funds Put to Better Use  
As of March 31, 2000

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

SECTION IV  
Open Audit Reports Over One Year Old  
As of March 31, 2000

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
130	Management of the Data Center	11/18/89	\$0	\$0	Since the completion of the Y2K conversion, more attention has been devoted to improving the weaknesses in the information technology area. Efforts are continuing. (See "Response to Significant Problems Previously Identified" section above.)
143	Information Resources Management	3/27/91	\$0	\$0	Same as above.
159	Audit of Local Area Networks	2/16/93	\$0	\$0	The remaining pending recommendation concerns the implementation of prior audit and contractor recommendations. Each of the prior recommendations is being addressed under its original report.

SECTION IV  
Open Audit Reports Over One Year Old  
As of March 31, 2000

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
201	Controls Over Commercial Databases	6/10/94	\$0	\$0	See explanation for audit #130.
202	Investor Complaints and Inquiries	9/29/94	\$0	\$0	Efforts to update the CFR to reflect the current mission of the SEC's Office of Investor Education and Assistance have been delayed due to other priorities.
220	IRM Planning and Execution	3/26/96	\$0	\$0	See explanation for audit #130.
225	Collection of Filing Fees	2/8/96	\$0	\$0	The EFFS system is being redesigned and implemented under the three-year EDGAR modernization contract.

SECTION IV  
Open Audit Reports Over One Year Old  
As of March 31, 2000

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
220	IRM Planning and Execution	3/26/96	\$0	\$0	See explanation for audit #130.
225	Collection of Filing Fees	2/8/96	\$0	\$0	The EFFS system is being redesigned and implemented under the three-year EDGAR modernization contract.
226	Contingency Plans for PABX and Data Center	7/31/95	\$0	\$0	A contingency plan for the telephone system has been tested by real events. The plan is being properly documented for future reference.
238	International Telephone Service	8/27/96	\$0	\$0	The corrective action plan for the remaining pending recommendation is being re-examined as a result of the IG's recently issued report on telecommunications vulnerabilities.



SECTION IV  
Open Audit Reports Over One Year Old  
As of September 30, 1999

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
243	SECOA Local Area Network	3/21/97	\$0	\$0	See explanation for audit #130.
244	Office of Filings & Information Services	3/20/97	\$0	\$0	The EFFS redesign requirements have been included with the EDGAR modernization effort, which is expected to occur over a three-year period. Meanwhile, controls have been implemented to address the IG's concerns.
250	Enhancing Excellence-- Integrity Program	1/22/97	\$0	\$0	A substantial number of the recommendations have been implemented. Several policy documents are still being developed.

SECTION IV  
Open Audit Reports Over One Year Old  
As of March 31, 2000

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
253	Administrative Proceedings	11/7/97	\$0	\$0	An adjudicatory conference will be held once there is an experience factor to measure the overall results of the NASD's revised disciplinary procedures.
257	Client Server	9/9/97	\$0	\$0	See explanation for audit #130.
259	Review of Filings-- Comment Letter Process	2/2/98	\$0	\$0	Action on some of the recommendations is complete. Work on the remaining recommendations was delayed due to unusually heavy workload as a result of increased stock market activity.
260	Value Engineering Program	5/2/97	\$0	\$0	Guidance for the value engineering program will be published this month.

SECTION IV  
Open Audit Reports Over One Year Old  
As of March 31, 2000

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
262	Automation of Records Management	9/29/97	\$0	\$0	See explanation for audit #130.
269	Database Administration	1/5/98	\$0	\$0	See explanation for audit #130.
271	Property System	1/5/98	\$0	\$0	A task force has been established to address the recommendations in this audit. The task force's efforts are continuing.
272	Commission Review of SRO Rules	7/14/98	\$0	\$0	A new strategy is being formulated to store SRO rule filings on newly acquired equipment.
273	Review of Investment Company Filings	6/26/98	\$0	\$0	The EDGAR modernization efforts are expected to occur over a three-year period.

SECTION IV  
Open Audit Reports Over One Year Old  
As of March 31, 2000

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
276	Enforcement Action Memo Process	3/18/99	\$0	\$0	A document addressing the remaining recommendations is under review. It will be completed by the end of June.
284	International Technical Assistance	10/27/98	\$0	\$0	The SEC website is being revamped.
287	Boston District Office	10/23/98	\$0	\$0	Most of the recommendations have been implemented. A regulation that addresses the recommendations concerning telephone reimbursements is expected to be issued in June.

SECTION IV  
Open Audit Reports Over One Year Old  
As of March 31, 2000

<u>Audit #</u>	<u>Audit Title</u>	<u>Issued</u>	<u>Funds Put to Better Use (in thousands)</u>	<u>Questioned Costs (in thousands)</u>	<u>Reason Final Action Not Taken</u>
M5	Screening Prospective Employees	1/19/96	\$0	\$0	The formal policy for screening employees is being reviewed internally.
M9	Food Service at the Ops Center & Annex	9/22/98	\$0	\$0	A meeting has been scheduled with the Blind Association to discuss issues associated with the vending machines.
M11	Part-time Employment Program	10/21/98	\$0	\$0	A policy document is being developed.
M12	Control of Computer Equipment	12/29/98	\$0	\$0	See explanation for #130.
M14	Contingency Testing	3/15/99	\$0	\$0	See explanation for #130.

## APPENDIX A

### General Accounting Office Audit Activity Involving the Securities and Exchange Commission

#### Reports Issued October 1, 1999 – March 31, 2000

1. Long-Term Capital Management: Regulators Need to Focus Greater Attention on Systemic Risk, GGD-00-3 (October 1999)
2. Year 2000: Insurance Regulators Have Accelerated Oversight, But Some Gaps Remain, GGD-00-42 (December 1999)
3. Financial Regulatory Coordination: The Role and Functioning of the President's Working Group, GGD-00-46 (January 2000)
4. Responses to Questions Concerning Long-Term Capital Management and Related Events, GGD-00-67R (February 2000)
10. Securities Exchange Act: Review of Reporting Under Section 10A, AIMD-00-54R (February 2000)
6. The Euro: Implications for the United States—Answers to Key Questions, GGD/NSIAD-00-105 (March 2000)
10. Securities Pricing: Progress and Challenges in Converting to Decimals, T-GGD-00-96 (March 2000)

#### Audits In Progress as of March 31, 2000

1. SEC Oversight of SBA Section 7(a) Loans (233543): A review of the secondary market for SBA Section 7(a) loans.
2. Securities Arbitration (233590): A review of the arbitration process in the securities industry.
3. Mutual Fund Fees and Expenses (233592): A study of mutual fund fees and expenses, including a determination of how fees are set, whether these costs are reasonable, whether they are adequately disclosed to investors and understood by them, the impact of fees and other charges on performance and net return, and whether mutual funds are being run for the benefit of their shareholders.

4. Year 2000 Costs and Future Funding (511725): A government-wide review of year 2000 costs and funding requirements.
5. Small Business Access to Equity Capital (233620). A study comparing small business access to equity capital and the cost of that capital relative to medium or large businesses.
6. Security Protection for Officials (240357). A review of the security protection for government officials.
7. CFTC Shad-Johnson Accord (233618). A study of the Commodity Exchange Act's prohibition on the trading of futures contracts on individual securities and narrowly based security indexes.
8. On-line Trading Firms (233613). A review of on-line trading.
9. Day Trading (233611). A review involving day trading.
10. Regulatory Information Sharing and Oversight Issues within the Insurance Industry (233631). A review of regulatory information sharing and oversight issues within the insurance industry in light of the alleged fraudulent investment activities perpetrated among several insurance companies and masterminded by Martin Frankel.
11. Disclosure and Reporting Requirements of Foreign Government-Controlled Entities (711479). A review to identify U.S. government sources of data on these foreign government-controlled entities of concern and assess the feasibility of determining if any of these entities have connections with the U.S. equity markets.
12. Foreign Investments in U.S. Companies Reported to CFIUS. A review of the implementation of the Defense Production Act for voluntary notifications of foreign investments in U.S. companies to the Committee on Foreign Investments in the United States (CFIUS).