

DISGORGEMENT AND PENALTY PAYMENTS

EXECUTIVE SUMMARY

We reviewed 29 Enforcement actions that originated between 2003 and 2005, in which defendants or respondents (defendants)¹ were ordered to pay disgorgements, penalties and/or interest for violating securities laws. We found that the Division of Enforcement (Enforcement) generally followed up appropriately to ensure payments were made timely. Payment information recorded by the Office of Financial Management (OFM) contained required supporting documentation and the information was generally complete and accurate.

Payments ordered in the Enforcement actions we reviewed totaled \$732,377,621. Where possible, we selected actions where all payments owed had been made in order to better identify closed cases² and evaluate the overall accuracy and consistency of the data entered into the Case Activity Tracking System (CATS).

We are recommending that Enforcement and OFM continue to address inconsistencies and data limitations in CATS and continue developing a system to access case documentation electronically. Other recommendations relate to recording accurate payment due dates in CATS, making Enforcement's collections unit responsible for additional collections as resources permit, and encouraging wire payments or using a lockbox for payments received by check.

OBJECTIVES AND SCOPE

Our objectives were to evaluate Commission oversight of payments and the recording of payment information in the Commission's Case Activity Tracking System (CATS) by Enforcement and OFM.

We selected a judgmental sample of 29 civil or administrative actions³ that originated between 2003 and 2005, in which disgorgement, penalty and interest payments were ordered. Ordered payments totaled \$732,377,621. In the 29 actions

¹ A securities law violator is referred to as a defendant in a civil case and a respondent in an administrative proceeding.

² During our selection process, Enforcement was in the process of changing its criteria for what constituted a "closed case."

³ We selected our sample by obtaining information on all current Enforcement actions. Selection criteria included choosing four actions from headquarters and at least two from each field office.

reviewed, 45 defendants were ordered to make payments, as specified in final orders. As of September 30, 2005, the defendants had paid all but \$9,487,981 of the total owed, with \$9,412,481 (1.3%) past due. The majority of the past due balance resulted because the defendants claimed they were unable to pay.

Where possible, we selected actions where all payments owed had been made in order to better identify closed cases and evaluate the overall accuracy and consistency of the data entered into CATS. As a consequence, the collections rate of 98.7% is not necessarily indicative of the Commission's overall collections rate.

We reconciled financial information (money ordered and paid) in CATS with source documents, such as final orders, payment receipts from courts and receivers' reports. We also verified OFM's remittance of payments to Treasury. We interviewed Commission staff, reviewed Enforcement's paper copy files, OFM and CATS data, Enforcement's and OFM's written procedures, and other relevant documentation.

The audit was performed from April 2005 to September 2005 in accordance with generally accepted government auditing standards.

BACKGROUND

Disgorgements represent repayment of ill-gotten gains (or losses avoided) resulting from individuals or entities violating federal securities laws. The Commission seeks disgorgements to ensure that securities law violators do not profit from their illegal activity. Penalties represent fines levied on violators of federal securities laws. Disgorgements and penalties can be ordered in either administrative proceedings or civil actions, and the cases can be settled or litigated.

Enforcement and OFM work together to record case details and process payments from defendants. CATS is the Commission's electronic system for recording case information. Enforcement staff enter all case details into CATS, excluding financial information, which OFM enters into CATS. OFM enters financial information based on appropriate documentation showing ordered payments and payments made.

AUDIT RESULTS

In the 29 actions reviewed, we found that, overall, disgorgements and penalties ordered were paid timely, and the related supporting information in Enforcement's paper copy files was accurate. Enforcement staff were generally aware of past due payments and made efforts to collect such payments, where possible. OFM had required documentation for its financial entries in CATS and these entries were accurate. Payments that OFM remitted to Treasury were supported by required documentation directing such payments.

We are making several recommendations to improve effectiveness and efficiency and/or strengthen internal controls.

OVERDUE BALANCES

Nearly all payments in our sample were received on or before their due dates. Payments relating to three actions, totaling \$27,752,001, were paid up to 11 days after their due dates, according to CATS records. Payments relating to four actions, totaling \$9,412,482, were past due and still unpaid as of December 19, 2005. In three of these actions, the defendants had an inability to pay, according to Enforcement.

Enforcement staff were aware of the past due balances. Enforcement initiated a referral process to the Department of Treasury in three of the four past due cases by sending the defendants a Treasury Offset Program (TOP) letter.⁴ One action could not be referred because the defendant was in prison.⁵

Enforcement sent the TOP letters to the debtors approximately two to four months after the debts became delinquent. According to statute, the debt should be sent to Treasury after it has been delinquent for 180 days. The TOP notification letter must be sent to the debtor 60 days prior to this referral to Treasury. Enforcement would like its staff to send the TOP letter at the beginning of the delinquency, within 10 to 30 days. Ideally, therefore, these letters should have been sent out between 10 and 30 days after the due date, according to Enforcement's policy.

However, this timeframe does not apply in all circumstances because there may be reasons why Enforcement should not send a TOP letter between 10 and 30 days after a debt becomes delinquent. Delays may be caused by appeals, settlement discussions, alternate payment arrangements, or other case circumstances.

During the audit, Enforcement changed some of its policies regarding the issuance of TOP letters. Enforcement changed its requirement to obtain a final order before sending out a TOP letter and informed its staff of the new guideline. This requirement is expected to reduce delays in sending out TOP letters, because the amount of time it took to obtain a certified final order varied, depending on the court. During the audit, Enforcement also implemented procedures to monitor the timing when TOP letters are sent out. These procedures include entering information on TOP letters into CATS in 2006, when additional CATS screens will make this possible.

Recommendation A

Where appropriate, Enforcement should ensure that TOP letters are sent to debtors between 10 and 30 days after a debt becomes delinquent.

CATS DATA

Missing Information

⁴ A TOP letter is a demand letter informing a debtor of his obligations to pay an overdue debt, his options, and the Commission's intent to seek collection of the debt through the TOP. If the debt is still unpaid 60 days after the debtor receives the TOP letter, the Commission may refer the debt to the Department of Treasury for collection.

⁵ The Department of Treasury will not accept a debt if the defendant is in prison.

In one action, money was apparently paid pursuant to an order, but not reflected in the “Money Paid” screen of CATS, as of December 14, 2005. The money paid was reflected in a different screen of CATS, as shown below. Only money reflected in the “Money Paid” screen is reflected in the Commission’s audited financial statements.

Money Ordered (per CATS and Court Order)	Money Paid (per CATS “Money Paid” screen)	Money Paid (per CATS “Money Comments” field)*
\$165,918	\$0	\$165,918
\$100,000	\$10,000	\$20,000

* *This field appears in the “Money Ordered” screen of CATS.*

Enforcement said it would work with OFM to properly record the payments in CATS.

Recommendation B

Enforcement and OFM should work together to ensure that information pertaining to the action described above is entered into CATS.

In another action, ordered payments of \$89,019 were not entered into CATS timely. After we notified OFM and Enforcement, Enforcement apparently sent OFM the required documentation more than once, but OFM said it had not received it until Enforcement sent it again in late September. The amount was specified in an order dated March 31, 2005 and we first notified OFM and Enforcement of the missing information in July 2005. OFM entered the information in CATS in late September 2005, upon receiving required documentation from Enforcement.

CATS Limitations

Identical fields that appear in more than one screen in CATS did not consistently contain the same values. The fields included those related to FAIR funds and whether money ordered in a case might be distributed to harmed investors. The “judgment date” field, which appears on three CATs screens was also inconsistent. Enforcement and OFM officials were aware of these issues and working to address them during the audit. Some of the inconsistencies resulted from computer glitches, according to Enforcement.

CATS also has other limitations. It cannot produce ad hoc reports, or systematically produce or update financial information. Its search capability is also limited. The Commission has undertaken a multi-year effort to upgrade CATS to address these and other concerns.

Enforcement recently conducted a comprehensive review of all open actions to ensure its files were complete and CATS information was accurate. This review helped identify and address CATS limitations.

Recommendation C

Enforcement and OFM should continue to address issues related to the consistency and accuracy of CATS data and the system's limitations.

Calculating Due Dates

We reviewed OFM's accuracy in calculating due dates for payments ordered. OFM's calculations were slightly off 17 times out of 71.⁶ These inconsistencies occurred for the following reasons:

- OFM did not exclude holidays when calculating due dates;
- OFM recorded due dates that fell on a weekend or a holiday (in these instances, the due date should be moved to the next business day);
- OFM did not receive from Enforcement the version of the final order containing the date it was docketed with the court and erroneously used the date the order was signed to calculate the due date. Due dates should be calculated based on the date the order is docketed with the court.
- When payments were due in installments, OFM did not update CATS to reflect the next payment due date, upon receipt of the prior payment;⁷ and
- OFM used the wrong criteria (*e.g.*, calendar days instead of business days or vice versa) to calculate due dates.

Although the miscalculations usually resulted in due dates being off by only a few days, the due dates are used to determine which payments are paid late or are past due. OFM has rules for calculating due dates, but staff did not consistently follow the rules.

Enforcement is in the process of imaging court orders and other case information from which due dates are calculated, onto a shared drive with OFM. Thus, it will be continuously available for review.

Recommendation D

OFM should remind its staff of the rules for calculating due dates and develop procedures to ensure that due dates in CATS are accurate. When necessary, OFM should ask Enforcement to provide final orders containing the date they were docketed with the courts.

ELECTRONIC DOCUMENTS

Currently, Enforcement staff in Washington, DC and the field offices around the country send paper copies of final orders and other financial information to OFM,

⁶ Each action typically contained several due dates pertaining to different defendants and/or separate disgorgements or penalties.

⁷ Currently, this date needs to be manually updated. When CATS is replaced with new software, the new system is expected to allow for automatic payment information updates.

which is located in Alexandria, Virginia. This procedure has caused delays and the loss of documentation.

Enforcement has begun to implement a document imaging system, which will make case documents available electronically. Eventually, Enforcement plans to make financial information from its case files available to OFM electronically. Use of electronic documents would help prevent lost documents and other delays caused by inter-office mail.

Recommendation E

Enforcement, in consultation with OFM and OIT, should continue to implement its plan to allow OFM electronic access to case information.

COLLECTIONS

Based on our review and an informal survey of Enforcement attorneys, we believe that it is often inefficient for Enforcement attorneys to pursue collections, especially when cases are litigated or collections are time-consuming. In addition, Enforcement attorneys are not generally trained in the collections process and are not typically rewarded for monitoring and ensuring timely payment of money owed.

Enforcement's Collections Unit provides Commission-wide assistance and guidance on the collections process and the staff have expertise in collections. The Unit consists of three attorneys, four paralegals and a shared support staff. The unit plans to hire two additional attorneys.

If staff resources permit, Enforcement would like this office to be responsible for more collections Commission-wide. Currently, the Collections Unit has collections responsibility for headquarters and the Boston District Office.

Enforcement informed us that the Collections Unit staffs (including the addition of two new attorneys) are needed for current workloads and additional expansion of the collections unit is not possible at this time due to budgetary constraints.

Recommendation F

If resources become available, Enforcement should make the Collections Unit responsible for additional collections throughout the Commission.

MAIL ROOM OPERATIONS

Administrative proceeding orders typically require defendants to mail a check to OFM to satisfy disgorgement and penalty payments. In our sample of 29 actions, OFM processed payments totaling \$576,746,216 by check.

One mail room staff person sorts and delivers the mail at the Operations Center. Two OFM staff open the mail together and log all money received.

As checks can be lost or stolen, receipt of payment by wire transfer is preferable.

Recommendation G

Enforcement should encourage defendants to make payments by wire. If this is not feasible, OFM should consider a lockbox for payments made by check.