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

M E M O R A N D U M

October 7, 2019

TO: Jay Clayton, Chairman

FROM: Carl W. Hoecker, Inspector General 

SUBJECT: *The Inspector General's Statement on the SEC's Management and Performance Challenges, October 2019*

The Reports Consolidation Act of 2000 requires the U.S. Securities and Exchange Commission's (SEC or agency) Office of Inspector General to identify and report annually on the most serious management and performance challenges facing the SEC.¹ In deciding whether to identify an issue as a challenge, we consider its significance in relation to the SEC's mission; its susceptibility to fraud, waste, and abuse; and the SEC's progress in addressing the challenge. We compiled the attached statement on the basis of our past and ongoing audit, evaluation, investigation, and review work; our knowledge of the SEC's programs and operations; and information from the U.S. Government Accountability Office and SEC management and staff. We reviewed the agency's response to the prior year's statement and efforts to address prior recommendations for improvement in areas of concern. We previously provided a draft of this statement to SEC officials and considered all comments received when finalizing the statement. As we begin fiscal year 2020, we have again identified the following as areas where the SEC faces management and performance challenges to varying degrees:

- Meeting Regulatory Oversight Responsibilities
- Protecting Systems and Data
- Improving Contract Management
- Ensuring Effective Human Capital Management

The challenges and corresponding audit, evaluation, investigation, or review work are discussed in the attachment. If you have any questions, please contact Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects.

Attachment

cc: Sean Memon, Chief of Staff, Office of Chairman Clayton
Bryan Wood, Deputy Chief of Staff, Office of Chairman Clayton

¹ Pub. L. No. 106-531, § 3a, 114 Stat. 2537-38 (2000).

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U.S. Securities and Exchange Commission
Office of Inspector General

The Inspector General's Statement on the SEC's Management and Performance Challenges



October 2019

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ABBREVIATIONS

COR	contracting officer’s representative
DERA	Division of Economic and Risk Analysis
EDGAR	Electronic Data Gathering, Analysis, and Retrieval
Enforcement	Division of Enforcement
FISMA	Federal Information Security Modernization Act of 2014
FY	fiscal year
GAO	U.S. Government Accountability Office
ISS	infrastructure support services
IT	information technology
OA	Office of Acquisitions
OCIE	Office of Compliance Inspections and Examinations
OHR	Office of Human Resources
OIG	Office of Inspector General
OIT	Office of Information Technology
OPM	Office of Personnel Management
SEC, agency, or Commission	U.S. Securities and Exchange Commission
T&M	time-and-materials

CHALLENGE: Meeting Regulatory Oversight Responsibilities

The U.S. Securities and Exchange Commission (SEC, agency, or Commission) is charged with overseeing more than 26,000 registered market participants, including investment advisers, mutual funds, exchange-traded funds, broker-dealers, municipal advisors, and transfer agents. The agency also oversees 22 national securities exchanges, 10 credit rating agencies, and 7 active registered clearing agencies, as well as the Public Company Accounting Oversight Board, the Financial Industry Regulatory Authority, the Municipal Securities Rulemaking Board, the Securities Investor Protection Corporation, and the Financial Accounting Standards Board. In addition, the SEC is responsible for selectively reviewing the disclosures and financial statements of almost 4,300 exchange-listed public companies.

As in previous years, agency management and the Office of Inspector General (OIG) recognize that, as the markets, products, and participants that the SEC oversees and regulates increase in size and complexity, the agency's ability to meet its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation becomes more challenging. The SEC's new Strategic Plan establishes goals and initiatives to ensure that, as the markets change rapidly and new technology, innovation, and global risks evolve, the SEC appropriately adapts its operational focus and remains an effective regulator.² We describe further below challenges to the SEC's ability to (1) keep pace with changing markets and innovations; (2) ensure sufficient examination coverage of registered investment advisers and timely enforcement investigations; and (3) leverage technology and analytics to meet mission requirements, while operating with limited resources.

Keeping Pace With Changing Markets and Innovations. According to the SEC's Fiscal Year (FY) 2020 Congressional Budget Justification, the securities markets continue to grow increasingly complex, with a proliferation of new and sophisticated products and services, tools, and trading strategies. Industry-based innovations include blockchain technology, automated investment advice, online marketplace lending, and crowdfunding. With such advancements, the SEC has reported that new risks have been introduced and, in some instances, existing risks have been magnified. For example, according to the agency, cybersecurity threats are continuing to grow in both frequency and sophistication. The FY 2020 Congressional Budget Justification states that, "These types of industry developments and financial innovation will continue to present challenges to the staff, requiring additional staff expertise, resources, and a program that is agile, responsive, and continuously improving."³

² U.S. Securities and Exchange Commission, *Strategic Plan Fiscal Years 2018-2022*; October 11, 2018.

³ U.S. Securities and Exchange Commission, *Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report*; March 18, 2019.

Although in FY 2019, the SEC received an appropriation of about \$1.675 billion—a \$23 million (or 1.4 percent) increase over the FY 2018 appropriation—for several years, the SEC’s annual appropriation was essentially flat, requiring a number of difficult operational choices, including cuts to contracts and a hiring freeze. The SEC implemented the hiring freeze in FY 2017, which resulted in a decrease of more than 400 positions over the last 2 FYs. In 2018 and 2019, divisions and offices reported specific challenges created by staffing levels that have fallen or have not kept pace with workload demands. For example, in its 2018 annual report, the Division of Enforcement (Enforcement) reported that the combined number of positions in the Division and the number of contractors supporting Enforcement’s investigation and litigation efforts fell by about 10 percent between FY 2016 and FY 2018. Although the Division continued to exhibit significant enforcement-related activity, Enforcement management reported that, with more resources, the SEC could focus more on individual accountability, and support two key Enforcement priorities: (1) protecting retail investors, and (2) combating cyber-related threats.⁴

The Office of the Investor Advocate also reported that, because of the hiring freeze, efforts to devote additional resources to the organization’s Ombudsman and research functions were hindered, which delayed the ability to build out these programs. Notably, in FY 2018, the Ombudsman—who, among other things, acts as a liaison in resolving problems that retail investors may have with the Commission or with self-regulatory organizations—received 449 new matters, which represented a 99-percent increase over the previous FY.⁵

In addition, in the SEC’s FY 2018 Annual Performance Report, the agency’s Office of International Affairs reported lower than expected numbers of non-U.S. regulators trained because of a temporary shortage of staff and resources. As a result, the Office held only two international institutes in 2018 and declined to participate in a number of foreign programs. Similarly, the Office of Investor Education and Advocacy reported a decrease in its ability to meet a performance goal of responding to investor contacts within 7 days as a likely result of staff attrition.⁶

FY 2019 funding allowed the SEC to begin lifting the hiring freeze and restoring positions to address critical priorities and enhance the agency’s expertise in key areas, including cybersecurity and market oversight. This remains a priority for FY 2020. According to the SEC Chairman’s May 8, 2019, congressional testimony, the SEC’s FY 2020 request of \$1.746 billion, a 4.2-percent increase over the FY 2019 enacted levels, will:

⁴ U.S. Securities and Exchange Commission, Division of Enforcement, *2018 Annual Report*; November 2, 2018.

⁵ U.S. Securities and Exchange Commission, Office of the Investor Advocate, *FY 2018 Report on Activities*; December 20, 2018.

⁶ U.S. Securities and Exchange Commission, *Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report*; March 18, 2019.

. . . support 4,694 positions, including 34 new positions. Along with the funding provided for 100 additional positions in FY 2019, the FY 2020 request will enable the SEC to fill approximately one-third of the approximately 400 positions lost due to the hiring freeze.⁷

We discuss the broader challenge of ensuring effective human capital management on page 15 of this document.

Coverage of Registered Investment Advisers and Timeliness of Investigations.

Since 2014, we have reported as a challenge the need for ensuring sufficient examination coverage of registered investment advisers by the Office of Compliance Inspections and Examinations (OCIE). OCIE conducts the SEC's National Examination Program, which seeks to protect investors, ensure market integrity, and support responsible capital formation through risk-focused strategies that: (1) improve compliance, (2) prevent fraud, (3) monitor risk, and (4) inform policy. The SEC uses the results of OCIE's examinations to inform rule-making initiatives, identify and monitor risks, improve industry practices, and pursue misconduct. According to the SEC's FY 2020 Congressional Budget Justification, in FY 2018, OCIE completed more examinations than at any point in the last decade; however, the organization "continues to face a number of challenges and issues that are having a significant impact on its limited resources." Namely, the agency reported that "the size of the SEC-regulated community continues to grow in volume and complexity, and significantly exceeds existing resource levels."⁸ In light of these challenges, it is imperative that management effectively use risk-based processes and—as discussed on page 5 of this document—leverage technology and analytics to address its regulatory responsibilities, including those of the examination program.

Additionally, Enforcement plays an essential role in carrying out the SEC's mission by investigating and bringing actions against those who violate Federal securities laws. The Commission's enforcement actions cover a broad range of subject areas, including investment management, securities offerings, issuer reporting and accounting, market manipulation, insider trading, broker-dealer activities, cyber-related conduct, and the Foreign Corrupt Practices Act, among others.

As we reported last year, the timeliness of Enforcement investigations remains a concern. Specifically, in FY 2018, the percentage of first enforcement actions filed within 2 years of the opening of the matter under inquiry or investigation was 49 percent. Once again, this did not meet the annual target of 65 percent. In addition, in FY 2018, the average number of months between opening a matter under inquiry or investigation and commencing an enforcement action was 25 months. This also did not meet the annual target of 20 months. To address the issue of timeliness in investigations, Enforcement has again reported "taking measures that include

⁷ Chairman Jay Clayton, *Testimony before the Financial Services and General Government Subcommittee of the U.S. Senate Committee on Appropriations*; May 8, 2019.

⁸ U.S. Securities and Exchange Commission, *Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report*; March 18, 2019.

emphasizing expediency in quarterly case reviews, promoting best practices regarding efficiencies in various phases of the investigative process, leveraging data analytics capabilities, and conducting training on tools that expedite investigations.”⁹

Leveraging Technology and Analytics to Meet Mission Requirements. As in previous years, agency management and the OIG recognize that technology and analytics are critical to the mission of the SEC and its ability to deliver information to the public, identify risks, uncover frauds, sift through large volumes of data, inform policy-making, and streamline operations. The SEC’s FY 2020 Congressional Budget Justification states:

Technology is also a crucial focus of the SEC’s Strategic Plan, and the FY 2020 request would enable the SEC to continue investments to strengthen the security of our systems and data; retire outdated legacy systems; and develop new [information technology (IT)] systems and analytic tools to help us become more efficient in our work.¹⁰

The agency established the following strategic technology priorities, which include a number of multi-year initiatives:

- continuing the development of a modernized, more secure Electronic Data Gathering, Analysis, and Retrieval (EDGAR) filing system;
- expanding the SEC’s use of secure cloud computing to deliver an expanded range of services at lower cost and in a more secure manner;
- deploying enhancements to critical analytic systems and upgrading the agency’s electronic discovery and document management tools;
- retiring legacy SEC systems and applications in favor of modernized, more secure replacements; and
- digitizing business processes to improve efficiency.

Finally, the SEC’s new Strategic Plan emphasizes the agency’s goal of enhancing and expanding its use of analytics.¹¹

⁹ The SEC’s FY 2018 Annual Performance Report (1) includes Performance Goal 2.3.2, *Percentage of first enforcement actions filed within two years of the opening of an investigation*, and Performance Goal 2.3.3, *Average months between opening a matter under inquiry or an investigation and commencing an enforcement action*; (2) compares the agency’s results from FY 2013 through FY 2018; and (3) describes plans for improving program performance, where necessary.

¹⁰ U.S. Securities and Exchange Commission, *Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report*; March 18, 2019.

¹¹ U.S. Securities and Exchange Commission, *Strategic Plan Fiscal Years 2018-2022*; October 11, 2018.

In support of these efforts, the SEC requested an additional \$20 million in FY 2020 to ensure its systems remain relevant to changing needs. This request relies on continued access to the Reserve Fund, created by the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹² We note that the President's Budget for FY 2020 again proposes to eliminate the Reserve Fund beginning in 2021.¹³

To assess the SEC's progress in these areas, in FY 2019, we completed assessments of (1) the SEC's efforts to redesign the EDGAR system, (2) the Division of Economic and Risk Analysis' (DERA) analytical support of other divisions and offices, and (3) the SEC's planning and management of its FY 2018 IT investments. The results of OIG work in each of these areas are further described below. We discuss the broader challenge of protecting SEC systems and data on page 8 of this document.

EDGAR Redesign. On May 23, 2019, we issued the management letter titled *Final Management Letter: Update on the SEC's Progress Toward Redesigning the Electronic Data Gathering, Analysis, and Retrieval System*, which stated that, since 2014, the SEC has taken several steps to develop a new electronic disclosure system, including spending about \$10.6 million on related contracts. However, the agency's approach to redesigning the EDGAR system was unclear; EDGAR Redesign program cost and schedule estimates presented to agency decision makers and senior officials were not based on best practices; and the EDGAR Business Office created a Grand Functional Requirements Document for the redesigned EDGAR system but did not include sufficient detail about the system's security requirements.

To help us determine whether further action by the OIG is warranted, we requested—and management provided—additional information in June 2019. As the SEC continues to modernize the EDGAR system and improve the system's security, functionality, and maintainability, we will assess the value of follow-on reviews.

DERA Analytics. Analytics provided by DERA support exam planning and other SEC oversight programs related to issuers, broker-dealers, investment advisers, exchanges, and other trading platforms. In our report titled *Although Highly Valued by End Users, DERA Could Improve Its Analytics Support by Formally Measuring Impact, Where Possible* (Report No. 553, issued April 29, 2019), we concluded that, although other SEC divisions and offices highly valued DERA's analytics support and believed such analytics were indispensable for risk scoping, investor protection, detecting illegal conduct, allocating resources more efficiently, and helping the SEC achieve its mission, DERA management generally did not formally measure the quantitative or qualitative impact of its analytics support. By not measuring, where possible, the impact of analytics support, DERA risks limiting its ability to assess its organizational performance, increase awareness of its analytics capabilities (including through outreach efforts), and fully integrate analytics into the work of the SEC in accordance with the agency's strategic goals and objectives.

¹² Pub. L. No. 111-203, § 991e, 124 Stat. 1376, 1954-55 (2010).

¹³ Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2020*.

To address these topics, we made three recommendations for corrective action. Management concurred with the recommendations, which will be closed upon completion and verification of corrective action.

FY 2018 IT Investments. In FY 2019, we completed an audit of the SEC's management of its FY 2018 IT investments, which represented about 18 percent of all funding available to the SEC that year. In our report titled *The SEC Has Processes To Manage Information Technology Investments But Improvements Are Needed* (Report No. 555, issued September 19, 2019), we stated that the SEC's management of steady state investments (investments to maintain and operate IT assets in a production environment) needs improvement. The SEC's spending on steady state investments has gradually increased in recent years, and in FY 2018, steady state investments represented 71 percent of the agency's total IT investment expenditures (that is, \$217 million of the \$307 million spent that year). Improving agency management of steady state investments could promote more effective decision-making and provide greater assurance that such investments (1) deliver value, (2) do not unnecessarily duplicate or overlap with other investments, and (3) continue to meet the SEC's needs.

We also reported that the SEC can better manage and document deviations from approved plans for investments to develop, modernize, and enhance IT assets; and, that the Office of Information Technology (OIT) needs to improve the documentation of hardware assets investment planning and to demonstrate investment outcomes. Finally, we identified contract management concerns that we further discuss on page 14 of this document.

To improve the SEC's management of IT investments, we made four recommendations for corrective action. Management concurred with the recommendations, which will be closed upon completion and verification of corrective action.

In FY 2020, we will continue assessing how well the SEC achieves its regulatory oversight responsibilities and, in doing so, leverages technology and analytics. Specifically, we will complete ongoing evaluations of (1) the efficiency and effectiveness of the Division of Trading and Markets' Office of Broker-Dealer Finances, and (2) the SEC's processes for identifying, tracking, and notifying delinquent filers and issuing related revocation orders and/or trading suspensions. We are also planning to follow up on prior OIG assessments of the Office of Investor Education and Advocacy's efficiency in addressing investor inquiries and processing investor complaints, and OCIE's investment adviser/investment company examination processes. Finally, we plan to evaluate the SEC's Tips, Complaints and Referrals Program, and the newly formed Office of the Advocate for Small Business Capital Formation.

CHALLENGE: Protecting Systems and Data

Strategic initiative 3.4 in the SEC’s new Strategic Plan addresses the importance of “developing a robust and resilient program for dealing with threats to the security, integrity, and availability of the SEC’s systems and sensitive data.”¹⁴ Among other actions, the SEC has taken steps to reduce the amount of sensitive information contained in agency systems, test its security posture, and improve related security controls and practices. However, as we further describe below, opportunities remain to strengthen the SEC’s cybersecurity posture and mature its information security program.

Strengthening the SEC’s Cybersecurity Posture. Cybersecurity and minimizing cyber risks at the SEC continue to be top priorities and management challenges. As noted in the SEC Chairman’s May 2019 congressional testimony, “The SEC and other agencies are frequent targets of attempts by threat actors who seek to penetrate our systems, and some of those actors may be backed by substantial resources.”^{15, 16} Nonetheless, in its FY 2018 Agency Financial Report, the SEC again recognized a material weakness in its internal controls related to cybersecurity risks. As the agency reported in 2017, this material weakness was caused by deficiencies that hindered its ability to timely detect and mitigate a vulnerability in the EDGAR system’s source code, which was exploited in 2016, resulting in unauthorized access to non-public information.¹⁷ Under Performance Goal 4.3.2, *Assurance statement on internal control over operations*, the SEC’s FY 2018 Annual Performance Report states that the agency is working to mitigate the deficiencies that caused the material weakness, including taking steps to improve communication and escalation protocols and enhance the information security of the EDGAR system.¹⁸ Moreover, in its FY 2020 Congressional Budget Justification, the SEC reported that it has already undertaken efforts to uplift its cybersecurity risk profile by:

- deploying new security capabilities;
- engaging with outside experts to actively test its security posture;

¹⁴ U.S. Securities and Exchange Commission, *Strategic Plan Fiscal Years 2018-2022*; October 11, 2018.

¹⁵ Chairman Jay Clayton, *Testimony before the Financial Services and General Government Subcommittee of the U.S. Senate Committee on Appropriations*; May 8, 2019.

¹⁶ In July 2019, the Council of Inspectors General on Financial Oversight reported “Managing and Securing Information Technology at Regulatory Organizations” as a cross-cutting challenge facing multiple financial-sector regulatory organizations. [Council of the Inspectors General on Financial Oversight, *Top Management and Performance Challenges Facing Financial-Sector Regulatory Organizations* (Approved July 2019)].

¹⁷ U.S. Securities and Exchange Commission, *Fiscal Year 2018 Agency Financial Report*; November 15, 2018.

¹⁸ U.S. Securities and Exchange Commission, *Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report*; March 18, 2019.

- improving its enterprise security controls and practices;
- reducing the amount of sensitive information contained in SEC systems; and
- taking better advantage of the cybersecurity tools and services provided by the Department of Homeland Security.

The SEC is also assessing ways to further reduce its “attack surface” and plans additional actions in FY 2020 to further strengthen its cybersecurity posture based on the recommendations from its assessment. For FY 2020, the agency seeks resources to hire three additional staff positions in OIT to “deepen OIT’s expertise in new technologies such as cloud computing, and to expand [its] proactive monitoring of network and systems for malicious activity by cyber threat actors.”¹⁹

In response to the 2016 intrusion of the EDGAR system and a request from the SEC Chairman that the OIG review related matters, on September 21, 2018, we issued a report titled *Evaluation of the EDGAR System’s Governance and Incident Handling Processes* (Report No. 550). The report (1) presented the OIG’s findings and recommendations from our assessment of the information security practices applicable to the EDGAR system between FY 2015 and FY 2017, and (2) included 14 recommendations to improve the SEC’s EDGAR system governance, security practices, and incident handling processes. To date, the SEC has taken corrective action sufficient to close 12 of the 14 recommendations. We commend agency management for corrective action taken to date, and encourage management to fully implement all agreed-to corrective actions to help address the material weakness and underlying deficiencies identified in this area.

In addition, in April 2019, the U.S. Government Accountability Office (GAO) notified the SEC that a priority recommendation related to cybersecurity remained open.²⁰ The recommendation, from a July 2017 GAO report, addressed the need to maintain up-to-date network diagrams and asset inventories in key system security plans.²¹ GAO also noted that, in the March 2019 update to its High-Risk Series, GAO recognized “Ensuring the Cybersecurity of the Nation” as a government-wide high-risk area, and urged management’s attention to such government-wide high-risk issues as they relate to the

¹⁹ U.S. Securities and Exchange Commission, *Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report*; March 18, 2019.

²⁰ According to GAO, priority recommendations are those that GAO believes warrant priority attention from heads of key departments or agencies. Priority recommendations are highlighted because, upon implementation, they may significantly improve Government operation, for example, by realizing large dollar savings; eliminating mismanagement, fraud, and abuse; or making progress toward addressing a high-risk or duplication issue.

²¹ U.S. Government Accountability Office, *Information Security: SEC Improved Control of Financial Systems but Needs to Take Additional Actions* (GAO-17-469; July 27, 2017).

SEC.^{22, 23} According to the SEC, corrective actions necessary to address the open priority recommendation are complete and a closure request is pending.

Maturing the SEC’s Information Security Program. Effective information security controls are essential to protecting the SEC’s information systems and the information they contain. To help the SEC establish and maintain effective information security controls and to comply with the Federal Information Security Modernization Act of 2014 (FISMA), annually, the OIG evaluates the SEC’s implementation of FISMA information security requirements and the effectiveness of the agency’s information security program on a maturity model scale.²⁴ The OIG contracted with Kearney and Company, P.C., to conduct the FY 2018 independent evaluation and subsequently issued the report titled *Fiscal Year 2018 Independent Evaluation of SEC’s Implementation of the Federal Information Security Modernization Act of 2014* (Report No. 552, issued December 17, 2018). The FY 2019 FISMA evaluation is ongoing and will be completed in the first quarter of FY 2020.

As stated in Report No. 552, since FY 2017, OIT improved aspects of the SEC’s information security program. Among other actions taken, OIT made progress by:

- enhancing information security policies and procedures to address security risks at the organizational and information system levels;
- strengthening authentication mechanisms;
- reducing the number of critical vulnerabilities;
- enhancing its security awareness and training processes; and
- continuing its efforts to enhance its continuous monitoring program.

Although OIT took steps to strengthen the SEC’s information security program, Kearney and Company, P.C., determined for FY 2018 that, as in prior years, the SEC’s information security program did not meet annual Inspector General FISMA reporting metrics’ definition of “effective.”²⁵ As stated in Report No. 552, the SEC’s maturity level for the five Cybersecurity Framework security functions (“identify,” “protect,” “detect,” “respond,” and “recover”) was either Level 2 (“Defined”) or Level 3 (“Consistently Implemented”). None of the functions reached Level 4 (“Managed and Measurable”),

²² U.S. Government Accountability Office, *Priority Open Recommendations: Securities and Exchange Commission* (GAO-19-379SP; April 3, 2019).

²³ U.S. Government Accountability Office, *HIGH-RISK SERIES Substantial Efforts Needed to Achieve Greater Progress on High-Risk Areas* (GAO-19-157SP; March 6, 2019).

²⁴ Pub. L. No. 113-283, § 3555, 128 Stat. 3073 (2014).

²⁵ *FY 2018 Inspector General Federal Information Security Modernization Act of 2014 (FISMA) Reporting Metrics*, Version 1.0.1; May 24, 2018.

which the annual Inspector General FISMA reporting metrics consider an effective information security program.

Report No. 552 included 11 recommendations to strengthen the SEC's information security program, and highlighted opportunities to improve in all 8 FISMA metric areas. To date, the SEC has taken corrective action sufficient to close two of these recommendations and, in September 2019, OIT submitted to the OIG a request to close an additional recommendation. Notably, 12 of the 20 recommendations from our FY 2017 FISMA report, issued in March 2018, also remain open, although in August 2019 OIT requested closure of 2 of these recommendations.²⁶ Again, we commend agency management for corrective action taken to date, and encourage management to promptly act on all opportunities for improvement identified in the last two FISMA reports to help minimize the risk of unauthorized disclosure, modification, use, and disruption of the SEC's sensitive, non-public information, and to assist the agency's information security program reach the next maturity level.

In FY 2020, we will continue to assess the SEC's efforts to secure its systems and data. Specifically, we will complete an ongoing audit of the SEC's management of the planning, implementation, and security of its cloud computing services. We also plan to assess the SEC's mobile device program and controls for protecting information stored and/or processed on such devices, as well as the agency's firewall security.

CHALLENGE: Improving Contract Management

To accomplish its mission, the SEC relies on contractor support in a variety of programs and operations. Contractors assist Enforcement investigators and litigators by providing trial, mock jury, paralegal, and administrative support, among other services. Contractors also support the SEC's examination staff and the agency's business management operations, quantitative and risk analysis activities, and human resources program. Moreover, OIT relies heavily on contractors to provide services and expertise, including application management, business solutions delivery, IT infrastructure and operations management, information security, IT governance, data management, and telecommunication and equipment maintenance. To fund these and other contract requirements, the SEC's FY 2020 budget request included about \$509 million for contractual services and supplies, which represents about 29 percent of the total requested amount for agency operations (\$1.746 billion).²⁷

²⁶ U.S. Securities and Exchange Commission, Office of Inspector General, *Audit of the SEC's Compliance With the Federal Information Security Modernization Act for Fiscal Year 2017* (Report No. 546; March 30, 2018).

²⁷ According to *usaspending.gov*, the contractual services and supplies object class covers purchases in object classes 210 through 260 (Travel and transportation of persons; Transportation of things; Rent, Communications, and Utilities; Printing and reproduction; Other contractual services; and Supplies and materials).

In 2018, we again identified contract management as an SEC management and performance challenge.²⁸ In response, management reported that the Office of Acquisitions (OA) plans to work on a variety of fronts to further promote effective contract management. Such actions include improving communications between contracting officers and contracting officer's representatives (CORs), ensuring CORs received proper training and enforced their use of the Electronic Contract File system, conducting annual reviews of contract files to make sure files contain all appropriate documents, and improving reporting.

In addition, OA plans to continue the Contract Management Excellence initiative, which the SEC developed in FY 2018 to drive improvements in contract management. The SEC's FY 2020 Congressional Budget Justification also states that the agency will continue the COR Improvement Initiative "to create a more comprehensive COR Program that will provide efficient and functional control, transparency, and management of the COR Program across the SEC."²⁹

In recent years, OIG audits and evaluations primarily identified concerns in the post-award phase of the contracting life cycle (as the following figure shows), with concerns largely relating to contractor oversight performed by contracting officers and CORs.³⁰ However, we have also reported concerns in the pre-award phase related to requirements definition.³¹ As further described below, in FY 2019, we again identified concerns in the pre- and post-award life cycle phases, as well as in the award phase related to competition and pricing.

²⁸ In July 2019, the Council of Inspectors General on Financial Oversight reported "Improving Contract and Grant Management" as a cross-cutting challenge facing multiple financial-sector regulatory organizations. [Council of the Inspectors General on Financial Oversight, *Top Management and Performance Challenges Facing Financial-Sector Regulatory Organizations* (Approved July 2019)].

²⁹ U.S. Securities and Exchange Commission, *Fiscal Year 2020 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2018 Annual Performance Report*; March 18, 2019.

³⁰ Examples include: (1) U.S. Securities and Exchange Commission, Office of Inspector General, *Audit of the SEC's Contracting Officers' Representative Program* (Report No. 530; September 18, 2015); (2) U.S. Securities and Exchange Commission, Office of Inspector General, *Management of the SEC's Protective Security Force Contract Needs Improvement* (Report No. 536; June 22, 2016); (3) U.S. Securities and Exchange Commission, Office of Inspector General, *Audit of the SEC's Progress in Enhancing and Redesigning the Electronic Data Gathering, Analysis, and Retrieval System* (Report No. 544; September 28, 2017); and (4) U.S. Securities and Exchange Commission, Office of Inspector General, *Audit of the SEC's Internal Controls for Retaining External Experts and Foreign Counsel for the Division of Enforcement* (Report No. 547; June 15, 2018).

³¹ Examples include: (1) U.S. Securities and Exchange Commission, Office of Inspector General, *Audit of the SEC's Information Technology Requirements-Gathering Process* (Report No. 538, September 30, 2016); (2) U.S. Securities and Exchange Commission, Office of Inspector General, *Final Management Letter: Progress on the SEC's Tips, Complaints, and Referrals Intake and Resolution System Redesign and Vulnerability Remediation Efforts* (May 31, 2017); (3) U.S. Securities and Exchange Commission, Office of Inspector General, *Audit of the SEC's Management of Its Data Centers* (Report No. 543; September 29, 2017); and (4) U.S. Securities and Exchange Commission, Office of Inspector General, *TCP Established Method To Effectively Oversee Entity Compliance With Regulation SCI But Could Improve Aspects of Program Management* (Report No. 551; September 24, 2018).

Figure. Contracting Life Cycle

Source: Adapted from U.S. Government Accountability Office, *FEDERAL ACQUISITIONS: Congress and the Executive Branch Have Taken Steps to Address Key Issues, but Challenges Endure* (GAO-18-627; September 12, 2018).

Pre-Award Phase Concerns. As previously discussed, to maintain visibility into the SEC's IT acquisitions and operations, in FY 2019 we continued to monitor the agency's progress toward redesigning the EDGAR system. On May 23, 2019, we issued the management letter titled *Final Management Letter: Update on the SEC's Progress Toward Redesigning the Electronic Data Gathering, Analysis, and Retrieval System*, which stated that, among other things, the agency's approach to redesigning the EDGAR system was unclear; EDGAR Redesign program cost and schedule estimates presented to agency decision makers and senior officials were not based on best practices; and the EDGAR Business Office created a Grand Functional Requirements Document for the redesigned EDGAR system but did not include sufficient detail about the system's security requirements. Because the SEC is relying on contractor support to redesign the EDGAR system, these issues are relevant to discussions about IT acquisitions and operations.

We also completed an audit in FY 2019 that assessed the SEC's management of funds obligated to and spent on the agency's infrastructure support services (ISS) contract—the agency's largest active contract—which comprises key aspects of the SEC's IT program. We sought to (1) determine whether the SEC obtained and properly reviewed plans for converting any contract task area(s) from time-and-materials (T&M) to other pricing structures, (2) evaluate the SEC's decision to waive the requirement for using the agency's Contractor Time Management System, and (3) assess the agency's management of contractor time and approval of contractor invoices.

In our report titled *The SEC Can Better Manage Administrative Aspects of the ISS Contract* (Report No. 554, issued May 31, 2019), we noted that, in FYs 2015 through 2018, T&M contracts appeared to represent about 32 percent of all SEC contract actions.³² As specified in Federal Acquisition Regulation Subpart 16.6, "A time-and-materials contract may be used only when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence." To help ensure T&M contracts are used only when appropriate and to minimize the risk to the agency, we encouraged

³² This includes labor-hour contracts, which are a variation of T&M contracts and differ only in that materials are not supplied by the contractor.

management to assess the SEC's use of T&M contracts and formulate actions that will be taken to reduce the use of T&M contracts whenever possible.

Award Phase Concerns. As previously discussed, in FY 2019, we completed an audit of the SEC's management of its FY 2018 IT investments. With respect to contract management, we determined that, in FY 2018, OA extended on a sole-source basis two contracts for IT acquisitions without adequate documentation to support independent government cost estimates used for the estimated extension prices. Contracting officials based the independent Government cost estimate for one of the two extensions on the contractor's cost/price estimate and did not fully document the data sources and methodology used to develop either extensions' independent Government cost estimate. Without adequate documentation, the SEC has less assurance that anticipated prices for contract extensions—including the extensions we reviewed—are fair and reasonable.

In our report titled *The SEC Has Processes To Manage Information Technology Investments But Improvements Are Needed* (Report No. 555, issued September 19, 2019), we made one recommendation for corrective action related to this issue. Management concurred with the recommendation, which will be closed upon completion and verification of corrective action.

Post-Award Phase Concerns. As previously discussed, we assessed the SEC's management of funds obligated to and spent on the agency's ISS contract. Our report titled *The SEC Can Better Manage Administrative Aspects of the ISS Contract* (Report No. 554, issued May 31, 2019) explained that, under T&M contracts, payments to contractors are made based on the number of labor hours billed at hourly rates and, if applicable, other direct costs. Because of the risk T&M contracts pose to the Government, their use is supposed to be limited to cases where no other contract type is suitable. Shortly after award of the SEC's ISS contract, responsible officials became aware of concerns with the ISS contractor's invoices. Specifically, invoices were routinely submitted months late and included multiple periods of performance, frequent back billing, and adjustments from prior periods of performance already paid. Despite these issues and the inherent risk posed to the Government by T&M contracts, the SEC:

- waived the requirement to use the agency's Contractor Time Management System;
- did not consistently enforce requirements for pre-approval of labor hours outside the contractor's normal hours of performance; and
- did not ensure all contractor employees—including those responsible for performing critical IT assessments, managing data networks, and administering servers and systems, among other essential IT tasks—met minimum labor category requirements.

These conditions—particularly when combined with the known invoicing delays and other complexities—further weakened the contract’s overall internal control environment; affected the agency’s ability to effectively monitor contractor costs; and increased the risk of errors, fraud, waste, and poor contractor performance in key areas supporting the SEC’s IT program. Consistent with generally accepted government auditing standards, we performed tests to gain reasonable assurance of detecting fraud in the areas we reviewed. Although we did not detect likely instances of fraud in the areas we reviewed, we identified nearly \$3 million in unsupported contractor costs and an additional \$42,801 in questioned costs. As a result, the SEC may not be able to (1) rely on the contract’s historical cost information to ensure a fair and reasonable price for any task areas converted from T&M to other pricing structures, as planned, or (2) meet its stated goal of cost-reduction in the out years of the ISS contract.³³

To address these issues, we made five recommendations for corrective action. Management concurred with the recommendations, which will be closed upon completion and verification of corrective action.

In FY 2020, we will further assess the SEC’s contract management and acquisition processes across each phase of the contracting life cycle. Specifically, we will report on any acquisition-related matters identified as a result of ongoing and planned assessments of the SEC’s IT program. To follow up on concerns identified in FY 2019 related to the SEC’s ISS contract, we will assess the SEC’s oversight and monitoring of the ISS contractor’s performance. Lastly, we will continue to support the SEC’s efforts to train contracting officers and CORs about the potential for procurement-related fraud.

CHALLENGE: Ensuring Effective Human Capital Management

The SEC’s new Strategic Plan establishes that the agency is committed to developing and strengthening its human capital, which strengthens the SEC’s ability to achieve its goals.³⁴ Moreover, the SEC Chairman’s May 2019 congressional testimony noted that maintaining a high level of staff engagement, performance, and morale is critical to the agency’s ability to execute its mission on behalf of Main Street investors.³⁵ The SEC’s 2018 Federal Employee Viewpoint Survey results demonstrated that the agency is maintaining a work environment that has resulted in consistently high levels of employee satisfaction. Notably, the SEC continued to improve in important areas of employee engagement and organizational health. However, human capital

³³ Attachment 20 of the ISS contract required the contractor to submit plans to convert selected task areas from T&M to other pricing structures (fixed-price, cost per user, or other offeror suggestions) with the goal of reducing costs for the remaining years of the contract.

³⁴ U.S. Securities and Exchange Commission, *Strategic Plan Fiscal Years 2018-2022*; October 11, 2018.

³⁵ Chairman Jay Clayton, *Testimony before the Financial Services and General Government Subcommittee of the U.S. Senate Committee on Appropriations*; May 8, 2019.

management remains a management and performance challenge for the SEC.³⁶ In FY 2019, we continued to monitor the SEC's progress toward further improving its management of human capital, including monitoring the impacts of the hiring freeze, as discussed on pages 3 and 4 of this document. Also, as we discuss further below, we stayed abreast of continuing changes to the SEC's performance management program, and agency actions to respond to prior OIG and GAO work in this area.

Continuing Changes to the SEC's Performance Management Program. The SEC has made incremental changes to its performance management program each year since FY 2016. As changes have occurred, the agency's Office of Human Resources (OHR) has sought to timely answer questions through its askHR portal; keep the workforce informed with updates in *SEC Today*; and offer employees and supervisors training, information sessions, user guides, and other resources. However, the incremental changes made each year have created additional challenges and, at times, delays that have impacted all non-bargaining unit and bargaining unit employees.

In FY 2016, OHR conducted a four-tier performance management pilot that included more than 800 non-bargaining unit employees in select offices across the SEC. The four-tier program was designed to:

- streamline the performance management process while clarifying expectations;
- promote more frequent and meaningful performance feedback; and
- empower employees in performance conversations and motivate future performance.

Notable differences between the four-tier program and the five-tier program that was in effect included fewer critical objectives—only two for all employees, and one additional critical element for managers—and an emphasis on ongoing feedback intended to promote continuous performance improvement.

The SEC partnered with the U.S. Office of Personnel Management's (OPM) Human Resources Solutions in February 2016 for an evaluation of the SEC's four-tier pilot program. OPM subsequently reported to SEC management that the pilot program streamlined the performance management process to make it more efficient and meaningful for employees; however, many of the pilot requirements depended on action from supervisors who, according to OPM, would benefit from specific guidance to ensure they would be able to successfully implement the program. In addition, although

³⁶ We also noted that, in the March 2019 update to its High-Risk Series, GAO again recognized "Strategic Human Capital Management" as a government-wide high-risk area needing attention by Congress and the executive branch. [U.S. Government Accountability Office, *HIGH-RISK SERIES Substantial Efforts Needed to Achieve Greater Progress on High-Risk Areas* (GAO-19-157SP; March 6, 2019)]. Additionally, in July 2019, the Council of Inspectors General on Financial Oversight reported "Managing Human Capital" as a cross-cutting challenge facing multiple financial-sector regulatory organizations. [Council of the Inspectors General on Financial Oversight, *Top Management and Performance Challenges Facing Financial-Sector Regulatory Organizations* (Approved July 2019)].

OPM determined that the pilot program complied “for the most part” with the Code of Federal Regulations and the Human Capital Assessment and Accountability Framework, OPM identified some instances of potential non-compliance and made recommendations for improvement.³⁷

For the FY 2017 performance cycle, the SEC transitioned all non-bargaining unit employees from the five-tier performance management program to the four-tier program, while bargaining unit employees transitioned to the four-tier program on a pilot basis. Also, OHR announced in July 2017 that the SEC was upgrading its online learning and career management system (LEAP) to include a performance management module. According to OHR, the module would provide “streamlined performance management tasks, tools and reminders,” and allow employees to “Easily complete and submit [performance work plan] self-assessments . . . and narratives . . . paper-free.”³⁸ In mid-September 2017, OHR notified employees that the FY 2017 performance management cycle would be closed out in LEAP.³⁹

In FY 2018, the SEC again changed its performance management program for bargaining unit employees. Specifically, although bargaining unit employees remained on the four-tier program pilot and were evaluated on the four-tier rating system, their ratings were “translated into an official rating of ‘Acceptable’ or ‘Unacceptable.’”⁴⁰ Meanwhile, supervisors continued to evaluate and rate non-bargaining unit employees on the four-tier system.

Finally, in November 2018, shortly after the start of the FY 2019 performance cycle on October 1, OHR announced: “The development of FY 2019 Performance Work Plans (PWP) in LEAP for both senior officers and SK employees has been delayed. The Office of Human Resources will distribute guidance via *SEC Today* when PWPs are available in LEAP and ready for issuance.”⁴¹ Six months later (during which a month-long government shutdown occurred), on May 7, 2019, OHR notified employees that 2019 performance work plans would soon be available to rating officials in LEAP.⁴² At the same time, OHR told employees that it was “not implementing major substantive changes to the [performance management] program,” but that “modifications and highlights pertaining to the 2019 cycle” included:

³⁷ United States Office of Personnel Management, *The U.S. Securities and Exchange Commission Performance Management Pilot Evaluation*.

³⁸ *SEC Today* announcement, *Sneak Peek: New Performance Management Module in LEAP*; July 18, 2017.

³⁹ Memorandum to All SEC Employees, *FY 2017 Performance Management Cycle Closeout for SK Employees*; September 14, 2017.

⁴⁰ *SEC Today* announcement, *FY 2018 Performance Self-Assessments Due Oct. 9*; September 19, 2018.

⁴¹ *SEC Today* announcement, *Delay in FY 2019 Performance Work Plan Issuance*; November 19, 2018.

⁴² *SEC Today* announcement, *2019 Performance Management Cycle Underway*; May 7, 2019.

- transitioning the performance management cycle from the fiscal year to the calendar year;⁴³
- incorporating the SEC's 2018 strategic goals in all employee performance work plans; and
- converting critical element ratings, which will continue to reflect the four-tier rating scale, to an official rating of "Acceptable" or "Unacceptable" for all employees.

Successfully implementing these and other planned changes to the SEC's performance management program will require OHR to effectively communicate with rating officials and employees and continue partnering with stakeholders, including the National Treasury Employees Union.

Responding to Prior OIG and GAO Work. In September 2018, we issued a report titled *The SEC Made Progress But Work Remains To Address Human Capital Management Challenges and Align With the Human Capital Framework* (Report No. 549, issued September 11, 2018). The report identified (1) steps OHR had taken to address the human capital management challenges the agency faces, (2) limitations and delays in OHR's efforts, and (3) additional challenges and opportunities for improvement. In the report, we made nine recommendations for corrective action. Management concurred with the recommendations and, to date, has taken action sufficient to close all but two of them.

In addition, Section 962 of the Dodd-Frank Wall Street Reform and Consumer Protection Act mandates GAO to report triennially on the SEC's personnel management, including the competence of professional staff; the effectiveness of supervisors; and issues related to employee performance assessments, promotion, and intra-agency communication.⁴⁴ GAO issued its first and second reports in 2013 and 2016, respectively, and will issue its third report by December 31, 2019.⁴⁵ In April 2019, GAO notified the SEC that five priority recommendations related to workforce and succession planning, performance management, and communication and collaboration remained open.⁴⁶ According to the Director of OHR, the SEC has made progress to address GAO's concerns related to workforce and succession planning and

⁴³ The FY 2019 cycle began on October 1, 2018, and will end on December 31, 2019. Future performance cycles will follow the calendar year from January 1 through December 31.

⁴⁴ Pub. L. No. 111-203, § 962, 124 Stat. 1376, 1908-09 (2010).

⁴⁵ U.S. Government and Accountability Office, *Securities and Exchange Commission: Improving Personnel Management Is Critical for Agency's Effectiveness* (GAO-13-621; July 18, 2013).

U.S. Government and Accountability Office, *Securities and Exchange Commission: Actions Needed to Address Limited Progress in Resolving Long-Standing Personnel Management Challenges* (GAO-17-65; December 29, 2016).

⁴⁶ U.S. Government Accountability Office, *Priority Open Recommendations: Securities and Exchange Commission* (GAO-19-379SP; April 3, 2019).

communication and collaboration. As a result, the SEC expects closure of four of the five open priority recommendations.

We commend agency management for corrective action taken to date, and encourage management to fully implement all agreed-to corrective actions to continue improving its personnel management.

In FY 2020, we will continue to monitor the SEC's efforts to (1) implement a new performance management program, and (2) address previously identified human capital management challenges. We will also assess the results of GAO's latest personnel management review.

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The OIG SEC Employee Suggestion Program, established under the Dodd-Frank Wall Street Reform and Consumer Protection Act, welcomes suggestions by all SEC employees for improvements in the SEC's work efficiency, effectiveness, productivity, and use of resources. The OIG evaluates all suggestions received and forwards them to agency management for implementation, as appropriate. SEC employees may submit suggestions by calling (202) 551-6062 or sending an e-mail to OIGESProgram@sec.gov.

COMMENTS AND IDEAS

The SEC OIG also seeks ideas for possible future audits, evaluations, or reviews. We will focus on high-risk programs, operations, and areas where substantial economies and efficiencies can be achieved. Please send your input to AUDPlanning@sec.gov.