



U.S. Securities and Exchange Commission

Office of Inspector General

Office of Audits

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# 2008 Audit of Sensitive Payments (Memorandum Report)



March 27, 2009  
Report No. 448



OFFICE OF  
INSPECTOR GENERAL

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

## MEMORANDUM

March 27, 2009

**To:** Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman  
Kristine Chadwick, Associate Executive Director, Office of Financial  
Management  
Jeffrey Risinger, Associate Executive Director, Office of Human  
Resources  
Sharon Sheehan, Associate Executive Director, Office of  
Administrative Services  
William Lenox, Ethics Counsel and Designated Agency Ethics  
Official, Ethics Office

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

**Subject:** *2008 Audit of Sensitive Payments, Report No. 448*

This memorandum transmits the U.S. Securities and Exchange Commission Office of Inspector General's (OIG) final report detailing the results of our audit of sensitive payments. The OIG conducted this audit in support of the Government Accountability Office's audit of the Commission's Fiscal Year 2008 Financial Statements and as a part of our audit plan.

This report contains six recommendations which, if implemented, will improve the Commission's internal controls over sensitive payments areas. Management concurred with four recommendations, partially concurred with one recommendation, and did not concur with one recommendation.

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: Diego Ruiz, Executive Director, Office of the Executive Director  
Darlene Pryor, Management Analyst, Office of the Executive Director

Richard J. Hillman, Managing Director, Financial Markets and Community  
Investment, Government Accountability Office

# Results of Audit

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**Results.** The Office of Inspector General (OIG) conducted a limited scope audit of sensitive payments in support of the Government Accountability Office's (GAO) audit of the Commission's Fiscal Year (FY) 2008 Financial Statements. Specifically, we assessed the effectiveness of controls over executive functions, including compensation, travel, official entertainment funds, unvouchered expenditures, consulting services, speaking honoraria and gifts, and executive perquisites. Senior government executives at the U.S. Securities and Exchange Commission (SEC or Commission) include the Chairman and four Commissioners who are Presidential appointees, Administrative Law Judges and senior officers who are Senior Executive Service (SES) equivalents. Commission senior officers include the agency's senior level supervisors, such as Division Directors, Deputy Directors, Associate Directors, Regional Directors, Associate Regional Directors, and Office Directors. The Chairman and Commissioners are compensated pursuant to the Executive Schedule pay plan administered by the Office of Personnel Management (OPM), and the Administrative Law Judges are compensated under the administrative law pay plan also administered by OPM. Senior officers are covered by the Commission's senior officer play plan.<sup>1</sup>

Our audit of sensitive payments did not disclose any evidence of fraud and we concluded that overall, controls over sensitive payments are reasonable. However, we identified some specific areas that need improvement. First, while we found that compensation-related expenses for senior executives, including merit pay increases and bonuses, were properly classified and reported, the Commission did not always have adequate justification to support approved compensation that was awarded to senior officers. Second, some senior officers have continued to allow lower-level employees to certify their time and attendance reports, despite this practice having been identified as a weakness in

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<sup>1</sup> The Investor and Capital Markets Fee Relief Act, Public Law 107-123, January 16, 2002, granted the SEC the authority to pay its employees' salaries and benefits at levels commensurate with those paid by the Federal banking agencies (pay parity). The pay parity legislation exempted the SEC from the definition of agency in the statutory provisions governing the SES. See 5 U.S.C. § 3132. After the pay parity legislation was enacted, the SEC's SES members were converted to senior officers.

prior GAO sensitive payment reviews.<sup>2</sup> Third, reimbursements for two senior officers foreign travel were not properly calculated, due to currency conversion errors that resulted in the underpayment of the travel expenses. Finally, the audit disclosed that record keeping could be improved with respect to the return of prohibited gifts and contract files.

Based on our audit findings, we are recommending that:

- (1) Detailed justifications be required for all senior officer merit pay increases of \$20,000 or more, or bonuses of \$20,000 or more;
- (2) Senior officers be notified in writing that their time and attendance must be certified by senior personnel of equal or higher grade;
- (3) OFM revise its policy and procedures to add guidance for calculating foreign travel reimbursements;
- (4) OFM reimburse travelers amounts they were underpaid due to currency conversion and other errors;
- (5) The Ethics Office maintain a record of returned gifts; and
- (6) Contracting files contain complete documentation and indicate which documents are not required to be included in the files.

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<sup>2</sup> GAO Sensitive Payment Memorandum entitled: FY 2006 SEC Financial Statement Audit Summary of Work Performed - Sensitive Payments, October 11, 2006; GAO Sensitive Payment Memorandum entitled: FY 2007 SEC Financial Statement Audit Summary of Work Performed – Sensitive Payments, September 26, 2007. GAO identified this practice as a problem that warranted attention in its management letters to the agency in 2007 and 2008. See GAO-07-0482 SEC Management Letter, April 3, 2007, p. 2 & p. 8; GAO-08-461R SEC Management Letter, April 1, 2008, p. 2 & p. 10.

# Background

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**Background.** Senior government executives have a responsibility to lead and be a model for other personnel in the Federal government. These individuals “are vested with the public trust and hold positions with a high degree of decision-making authority” and, as such, “are subject to the scrutiny and criticism of the public and the media.”<sup>3</sup> “Senior government executives include officers and directors of government corporations and senior executive service (SES) – level officials in executive branch departments and agencies.”<sup>4</sup> At the U.S. Securities and Exchange Commission (SEC or Commission), senior government executives include the Chairman, the Commissioners, Administrative Law Judges and senior officers.

Sensitive payments consist of a wide range of executive functions, “including executive compensation, travel, official entertainment funds, unvouchered expenditures, consulting services, speaking honoraria and gifts, and executive perquisites.”<sup>5</sup> Sensitive payments issues are addressed in various Federal laws, regulations, and policies and procedures manuals, including the Office of Personnel Management (OPM) compensation and personnel documents,<sup>6</sup> government travel regulations,<sup>7</sup> and the Comptroller General Opinions.<sup>8</sup>

Although the dollar amounts typically involved in sensitive payments are usually not large enough to materially affect the fair presentation of financial statements, sensitive payments are nonetheless a concern.<sup>9</sup> Senior executives, because of the high level of authority they exercise, may have the opportunity to bypass the organization’s established internal controls over sensitive payment areas.<sup>10</sup> Because senior government executives are subject to a high degree of scrutiny, public disclosure of either actual or perceived improprieties involving sensitive

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<sup>3</sup> GAO Guide for Evaluating and Testing Controls Over Sensitive Payments (GAO Guide), GAO/AFMD-8.1.2, Revised May 1993, at 6.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> See, e.g., OPM Compensation Policy Memorandum (CPM) 2006-19, December 21, 2006; CPM 2008-01, January 4, 2008, and 2007 & 2008 pay tables.

<sup>7</sup> See Federal Travel Regulation, 41 C.F.R Chapters 300 through 304.

<sup>8</sup> See, e.g., *GAO Comptroller General Opinion B-289903, Gifts of Goods and Services to the Government*, March 4, 2002.

<sup>9</sup> GAO Guide at 6.

<sup>10</sup> *Id.*

payments could result in significant criticism of the entity.<sup>11</sup> Thus, it is essential that measures are taken to ensure that the Commission's senior executives adhere to established policies and procedures over sensitive payments to prevent inappropriate acts and conduct that might damage the agency's reputation.

## Objectives, Scope, and Methodology

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**Objectives.** We conducted a limited scope audit of sensitive payments in support of the Government Accountability Office's (GAO) audit of the Commission's Fiscal Year (FY) 2008 Financial Statements. The objective of the audit was to assess the effectiveness of management controls over sensitive payments to Commission senior executives, such as bonuses, official entertainment funds, speaking honoraria and gifts, etc., in detecting fraud, waste or mismanagement.

**Scope.** The Office of Inspector General (OIG) conducted a limited scope audit in support of the GAO's audit of the Commission's FY 2008 Financial Statements. Specifically, this audit examined sensitive payment transactions from October 1, 2007 to September 30, 2008. Our work on sensitive payments was conducted from May to September 2008. However, we subsequently expanded fieldwork covering our review of executive compensation. Our initial testing disclosed that two senior officers received substantial merit pay and/or bonus awards during FY 2008. As a result, we expanded our review of senior executive compensation to include all senior officers who received merit pay increases of \$20,000 or more, as well as bonuses of \$20,000 or more, during FY 2008.

**Methodology.** We performed limited testing on various sensitive payments areas to detect fraud, waste or mismanagement. To test executive compensation we initially selected a random sample of ten biweekly compensation payments to Commission senior executives for the period between October 1, 2007 and June 30, 2008, to determine whether the payments were properly supported, authorized and within legal limits. We subsequently expanded our testing of executive compensation to include a review of all senior officer merit pay increases of \$20,000 or more that were combined with bonuses of \$20,000 or more.

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<sup>11</sup> Id.

Our testing of senior executive travel reimbursements included reviewing a judgmental sample of six trips that were taken between October 1, 2007 and June 30, 2008, to determine, among other things, whether the trips were authorized and reimbursements were properly calculated.

We reviewed other sensitive payment areas, such as entertainment funds, speaking honoraria and gifts, and executive perquisites, by obtaining and analyzing relevant documentation and regulations, including the Standards of Ethical Conduct for Employees of the Executive Branch.<sup>12</sup> We tested the effectiveness of the policies and procedures for detecting conflicts of interest on the part of Commission senior officials by examining a judgmental sample of financial disclosure forms that were submitted by eight individuals who became senior officers during FY 2008.

In the contracting and consulting area, we judgmentally selected six contracts that were in effect as of May 31, 2008, to determine whether the contracting and consulting services were authorized, payments were properly approved, and the contract files contained the proper documentation.

**Generally Accepted Government Auditing Standards.** The OIG performed a limited scope audit in support of the GAO's audit of the SEC's FY 2008 Financial Statements, to assess the effectiveness of the Commission's management controls over sensitive payments. We conducted this performance audit in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>12</sup> 5 C.F.R. Part 2635.

# Findings and Recommendations

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**Senior Executive Compensation.** Executive compensation consists of salary, merit pay increases, awards, bonuses, etc., that senior agency officials receive during a given year. Within the Commission, senior officers who receive a satisfactory performance rating are eligible for:

1. Senior officer pay adjustments, i.e., merit increases;
2. Senior officer performance awards, i.e., bonuses, and
3. Incentive awards, i.e., Commendable Act or Service Awards.<sup>13</sup>

Commission policies and procedures do not prescribe specific dollar amounts for merit pay increases or bonuses that senior officers may receive, except that salaries and bonuses must not exceed budgeted amounts, or the Commission's salary and total pay caps.<sup>14</sup>

To determine whether there was adequate support for executive compensation and to ensure it did not exceed allowable amounts, we obtained and reviewed the universe of all compensation that Commission senior executives received from October 1, 2007 to June 30, 2008. We selected a judgmental sample of 10 senior officer's compensation payments for our review. We then assessed whether:

1. Merit pay and bonus awards were authorized and properly justified and approved;
2. Salaries were within the SEC salary limits of \$215,700 for calendar year 2007 and \$221,100 for calendar year 2008; and
3. Total pay was within the applicable limits of \$238,900 for calendar year 2007 and \$244,900 for calendar year 2008.

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<sup>13</sup> Securities and Exchange Commission Senior Officer Program Performance Management System, Last Updated July 16, 2002. According to OHR, on occasion senior officers receive special act, i.e., incentive awards, which may be given out at any time during the year.

<sup>14</sup> The SEC has chosen to use the Vice President's salary as the salary cap for Commission senior officers and staff (SK) positions. This amount was \$215,700 for calendar year 2007 and \$221,100 for calendar year 2008. See OPM CPM 2008-01 and 2006-19. The SEC also has a separate total pay cap for senior officers that allow them to receive bonuses exceeding the salary cap. The senior officer's total pay cap was \$238,900 for 2007 and \$244,900 for 2008 (meaning that a senior officer's total salary and bonuses could not exceed these limits).

The payments identified in Table 1 below consist of a combination of gross biweekly salary, bonuses, and relocation reimbursements for 10 Commission senior officers that are identified as sample 1-10.

**Table 1: Senior Officer Gross Biweekly Salary & Executive Compensation Benefits**

Sample No.	Payment Date	Payment Amount
1 <sup>^</sup>	October 23, 2007	\$59,758 <sup>15</sup>
2 <sup>*</sup>	December 4, 2007	\$8,268
3 <sup>*</sup>	February 12, 2008	\$8,145
4 <sup>*</sup>	April 22, 2008	\$8,308
5 <sup>∞</sup>	May 20, 2008	\$28,475
6 <sup>*</sup>	May 6, 2008	\$8,468
7 <sup>∞</sup>	March 25, 2008	\$18,475
8 <sup>*</sup>	December 18, 2007	\$7,910
9 <sup>*</sup>	October 9, 2007	\$7,666
10 <sup>*</sup>	July 15, 2008	\$8,475

Source: Office of Human Resources

<sup>^</sup> Salary and Relocation Reimbursement

<sup>∞</sup> Salary and Bonus

<sup>\*</sup> Salary Only

To test the accuracy of the senior officer’s executive compensation we requested documents from the Office of Financial Management (OFM) and the Office of Human Resources (OHR) to support the annual merit pay increases, awards, bonuses, relocation reimbursements, etc.

## **Finding 1: Justification is Needed for All Senior Officer Merit Pay Increases and Bonuses.**

Compensation-related expenses, such as merit pay increases and bonuses, were properly classified and reported, but in some instances were not properly supported with adequate justification.

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<sup>15</sup> This payment of \$59,758 to a senior officer reflected salary, as well as relocation reimbursements incurred in July and August 2007 in connection with the senior officer’s taking a position with the Commission in another state. OFM provided documentation showing that the relocation reimbursements were paid by check to the senior officer in a series of payments between August 17, 2007 and October 4, 2007. Hence, the \$59,758 amount identified in our sample in the payroll system did not actually reflect a lump-sum payment and the reimbursement payments appear to have been made in a timely manner.

**Senior Officers Received Sizeable Merit Pay Increases and Bonuses.** Our review of executive compensation and supporting documentation found that salaries, pay increases and bonuses were properly classified and reported. However, the Commission did not always have adequate documentary support to justify all approved compensation that was awarded to senior officers.

Our initial testing of executive compensation revealed that two senior officers in our sample (Nos. 5 and 7 in Table 1 above) received substantial salary increases (based on merit), and/or lump sum bonuses (one for \$20,000 and one for \$10,000). We thereafter expanded our executive compensation scope and requested information on all senior officer merit pay increases and bonuses that were approved and awarded during FY 2008.<sup>16</sup>

At our request, OHR provided us with an *Award Spreadsheet* that identified proposed and approved merit pay increases and bonuses for Commission senior officers for the performance period ending September 30, 2007. The spreadsheet listed among other things, all senior officers, their current salaries, their proposed merit pay increases and bonus amounts, and their approved merit pay increases and bonus amounts. OHR officials informed us that each year the Chairman sends a memorandum to all senior officers instructing them to prepare a written justification to support proposed merit pay increases and bonuses.<sup>17</sup>

Based on our analysis of the *Award Spreadsheet*, we requested justification and documentation to support senior officer merit pay increases and bonuses of \$20,000 or more that was awarded during FY 2008. We found that a total of seven senior officers received merit pay increases of \$20,000 or more and bonuses of \$20,000 or more.<sup>18</sup> As shown in Table 2 below, these merit pay increases and bonuses ranged from combined totals of \$44,657 to \$85,082. Specifically, one senior officer received a \$24,657 merit increase; another received a \$55,720 merit increase, and five received \$65,082 in merit increases. In addition, all seven received \$20,000 lump-sum bonuses. OHR staff informed us that detailed justifications to support these merit pay increases and bonuses were not required because the seven senior officers identified in our sample all reported directly to the Chairman.

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<sup>16</sup> Merit pay increases raise the senior officer's salary on a permanent basis, while a bonus award is a single, lump-sum payment. According to OHR, senior officer's merit pay and performance awards for the performance period October 1, 2006 through September 30, 2007, were distributed during Fiscal Year 2008.

<sup>17</sup> We were informed by OHR, however, that written justifications are not required for merit pay increases and bonus awards to senior officers who report directly to the Chairman.

<sup>18</sup> We also noted that four other senior officers received \$20,000 bonuses.

**Table 2: Senior Officers Receiving Merit Increases of \$20,000 or More and Bonuses of \$20,000 or More for Performance Year Ending 9/30/07**

Senior Officer	Merit Pay Increase	Bonus Amount	Total
1	\$24,657	\$20,000	\$44,657
2	\$55,720	\$20,000	\$75,720
3	\$65,082	\$20,000	\$85,082
4	\$65,082	\$20,000	\$85,082
5	\$65,082	\$20,000	\$85,082
6	\$65,082	\$20,000	\$85,082
7	\$65,082	\$20,000	\$85,082

Source: Office of Human Resources

We did not find any evidence of fraud or payments that went over the established limits or budgeted amounts. We determined that the merit pay increases and bonuses did not exceed the SEC’s established \$215,700 salary cap for calendar year 2007 and the \$221,100 salary cap for calendar year 2008, as well as the total pay limits of \$238,900 for calendar year 2007 and \$244,900 for calendar year 2008 for senior officers.<sup>19</sup>

However, we believe that because of the significant dollar amounts involved, the Chairman’s office should provide justification to support awarding senior officers merit pay increases of \$20,000 or more, or bonuses of \$20,000 or more.

**Recommendation 1:**

The Chairman’s office should provide a detailed justification for all senior officer merit pay increases of \$20,000 or more, or bonuses of \$20,000 or more.

**Finding 2: Lower Level Employees Certify Senior Officer’s Time and Attendance Reports**

Some senior officers allowed lower level employees to certify their time and attendance reports, despite the fact that GAO previously identified this practice as an internal control weakness.

During previous GAO reviews of Commission sensitive payments, the practice of lower level employees certifying senior executives’ time and attendance reports

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<sup>19</sup> SEC 2007 and 2008 Senior Officer Pay Charts and Total Pay Limits.

was identified as an internal control weakness. Our review of senior executive time and attendance reports for FY 2008, in connection with our review of executive compensation payments, revealed that in some cases senior officers have continued to allow lower level employees to certify their reports. Thus, we found that this practice is still occurring. Overall, these transactions were not material and did not impact the financial statements. However, in accordance with proper internal controls over time and attendance matters, senior officials should ensure that their time and attendance is approved by senior personnel of equal or higher grade.

**Recommendation 2:**

The Office of Human Resources should send a written notification to Commission senior executives, reminding them that their time and attendance should be certified by a senior official of equal or higher grade.

### **Finding 3: Reimbursement of Foreign Travel Expenses Should be Calculated Properly.**

Two senior officers who traveled outside the country on Commission business were underpaid reimbursable expenses due to currency conversion errors.

**Senior Executive Travel.** We reviewed the population of senior executive's travel expenses for the period from October 1, 2007 to June 30, 2008. We judgmentally selected and reviewed six transactions to determine whether:

- Travel orders were authorized and approved;
- Travel vouchers were authorized and approved;
- Travel expenses were properly classified, reported and reimbursed;
- Travel advances were authorized and approved; and
- Outstanding advances were promptly collected or applied to future trips.

Our review identified two occasions in our sample involving foreign travel where it appears that the SEC underpaid senior officers for reimbursements by immaterial amounts. In the first scenario, a senior officer traveled on official government business from the United States to London and then to Rome. We found that OFM processed the reimbursed travel expenses based on an incorrect currency conversion rate used by the traveler, which resulted in the traveler being underpaid.

In another case, a senior officer was underpaid as a result of both a currency conversion rate error and an external host paying portions of the travel. The

senior officer traveled from the United States to Paris to London, and then to Manhattan, New York. An underpayment occurred because as in the situation described above, the traveler used an incorrect currency conversion rate to calculate the reimbursement. The underpayment also appeared to result from confusion about which travel expenses were being paid by the host. While we found documentation indicating that the London portions of the senior officer's trip would be paid by the host, it appeared that the host had not paid the entire amount of the expenses the senior officer incurred in London.

**Foreign Travel Guidance.** In both cases described above, the travelers calculated their reimbursements using a daily conversion rate for each day of their stay at a particular location. The OFM travel webpage contains a link to the Department of State's website on foreign per diem rates. The site contains no guidance on the use of daily rates. State Department officials informed us that their policy is to use daily rates, but said they could not speak to the SEC's policy.

OFM officials informed the OIG that the office does not have any written policy describing how foreign travel expenses should be calculated. However, OFM's practice is to calculate the traveler's hotel expenses and value added tax (VAT) using either the currency conversion rate on the credit card statement, or the rate as of the traveler's hotel checkout day. OFM officials indicated that incidentals, such as taxi, parking, laundry, etc., are calculated by using the daily rate on the day the expense is incurred. Although OFM offers a one-day training class, as well as an on-line training course, that cover areas such as foreign per diem rates, calculating foreign travel expenses, etc., the training is not mandatory and no further guidance is available to travelers on how to calculate reimbursable foreign travel expenses.

Our audit determined that the two senior officers were underpaid for foreign travel expenses by nominal amounts and OFM should reimburse them for the underpaid amounts. We further determined that OFM should revise its policies and procedures to provide guidance to SEC employees on how to calculate reimbursable foreign travel expenses.

**Recommendation 3:**

The Office of Financial Management should revise its policies and procedures to inform travelers of the proper currency conversion rates that should be used when requesting reimbursement for foreign travel expenses.

**Recommendation 4:**

The Office of Financial Management should reimburse travelers the amounts that they were underpaid due to currency conversion and other errors.

**Official Entertainment, Reception and Representation Funds.** Official entertainment funds, or reception and representation expenses, are authorized for some Federal agencies. These costs typically are associated with entertaining visiting dignitaries and State functions, and the amount of these funds is generally limited by law.<sup>20</sup> The SEC is authorized to spend reception and representation expenses of up to \$3,500 annually.<sup>21</sup> We obtained a list from OFM for official entertainment fund expenses for FY 2008, as of June 30, 2008. OFM also provided us with the *Un-Liquidated Obligation by Organization Report*, which identified the \$3,500 representation funds limit and the budget object class and organization code for purchases.

OFM provided us with documentation for the two reception and representation expenses that were incurred during FY 2008. We reviewed the support provided to ensure the expenditures were properly approved and classified. The first expense was associated with token gifts (cufflinks and tie pins) that were purchased from the SEC Recreation and Welfare Association<sup>22</sup> store for \$280. The Chairman presented these gifts to foreign leaders during an official overseas trip. We confirmed that the \$280 was the only reception and representation expenditure as of June 30, 2008, the end of the third quarter of FY 2008.

The second expense, which occurred in the fourth quarter of FY 2008, was related to a luncheon that cost approximately \$430, for an Australian government delegation to celebrate the signing of a mutual recognition agreement between the SEC, the Australian government, and the Australian Securities and Investments Commission.<sup>23</sup> We determined that the reception and representation expenditures totaling \$710 during FY 2008 did not exceed the authorized \$3,500 limit and were properly approved and classified.

**Speaking Honoraria and Gifts.** We met with the SEC's Designated Agency Ethics Official (DAEO) to obtain an understanding of the Commission's policies for speaking honoraria and gifts. The DAEO indicated that the Commission has a strict policy regarding executives accepting and receiving gifts. We obtained a copy of the Ethics bulletin and Ethics NewsGrams pertaining to gifts that are located on the Ethics website on the Insider, the Commission's Intranet. The Ethics guidance explicitly prohibits the solicitation, or acceptance of gifts from

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<sup>20</sup> GAO Guide at 17.

<sup>21</sup> Consolidated Appropriations Act, 2008, Public Law 110-161, December 26, 2007.

<sup>22</sup> The SEC Recreation and Welfare Association is a non-appropriated funding instrumentality designed to promote employee welfare and morale.

<sup>23</sup> See SEC Press Release 2008-182, *SEC, Australian Authorities Sign Mutual Recognition Agreement*, August 25, 2008, <http://www.sec.gov/news/press/2008/2008-182.htm>.

prohibited sources, or that is given because of one's official position, unless an exclusion or exception applies.<sup>24</sup>

We asked the DAEO to explain how the SEC handles situations when SEC personnel receive inappropriate gifts. The DAEO stated that gifts deemed inappropriate are sent back to the source and he provided us with copies of sample letters that are used to accompany returned gifts. However, when we asked the DAEO for an account of the total number of gifts that were returned in FY 2008, he indicated that the Ethics Office did not track the number of returned gifts. We determined that the SEC's policy and practices concerning the receipt and acceptance of gifts are in accordance with the requirements of the Standards of Ethical Conduct for Employees of the Executive Branch,<sup>25</sup> but believe that the Ethics Office should maintain a record of the returned gifts for which it has knowledge.

**Recommendation 5:**

The Ethics Office should enhance its process for the return of prohibited gifts by keeping an account of the prohibited gifts received by SEC employees that are returned to the source of the gift of which the Ethics Office has knowledge.

**Unvouchered Expenditures.** Unvouchered expenditures are funds within government entities that may be used at the discretion of the entity's chief executive or head to further its mission. These expenditures do not require the same level of documentation as typical transactions, and the amount of these funds is limited by law.<sup>26</sup> The SEC did not authorize or process any unvouchered expenditures in FY 2008.

**Senior Executive Perquisites.** Executive perquisites are benefits that are available to senior executives, such as reserved parking, limousine service, dining facilities, office space and furnishings, and other government owned or furnished facilities.<sup>27</sup>

We met with the DAEO to obtain an understanding of the SEC Ethics Office's role regarding executive perquisites. The DAEO informed us that the Ethics Office is not involved in determining or monitoring executive perquisites, although the office does provide informal guidance upon request.

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<sup>24</sup> Ethics NewsGram: Don't Ask - You May Not Solicit Anything of Value, October 5, 2005.

<sup>25</sup> See 5 CFR § 2635.201-205.

<sup>26</sup> GAO Guide at 18.

<sup>27</sup> GAO Guide at 20.

There are three main categories of perquisites for senior executives at the Commission: 1. parking, 2. drivers, and; 3. office furniture funds.

**Parking and Drivers.** As of December 16, 2008, the SEC had issued 23 parking permits to the Chairman, Commissioners, Chief Administrative Law Judge, Division Directors, Deputy Division Directors, and Office Directors at the Station Place Headquarters facility. The Commission has 11 Regional Directors, all of whom have reserved parking at the respective regional office. The SEC's Chairman is assigned a vehicle and personal driver. All other SEC senior officials have access to a government vehicle and driver when needed for official government business.

**Office Furniture.** The Chairman and four SEC Commissioners are each authorized to spend up to \$5,000 during their term to furnish their offices. All furniture that is purchased is the SEC's property and remains with the Commission when the Chairman or Commissioner leaves the agency.

We did not identify any furniture purchases during FY 2008 prior to June 30, 2008. However, three new SEC Commissioners were sworn in during July and August 2008, and they were each authorized \$5,000 to furnish their offices. We reviewed data showing that two of the three new Commissioners used the allotted funds to purchase furniture prior to the end of the FY 2008. One Commissioner used \$576 to purchase bookcases, and another Commissioner spent \$4,720 to purchase new office furniture. The amounts spent were within the allotted \$5,000, and we did not identify any discrepancies.

**Ethics Office and Conflicts of Interest.** We met with the DAEO to obtain an understanding of the Commission's policies on informing senior executives of and identifying potential ethics violations and conflicts of interest. We requested a list of the senior officers who were appointed during FY 2008 and requested financial disclosure forms for eight, based on judgmental sampling. The DAEO provided us with a certification that the senior officer's financial disclosure forms were submitted and reviewed in accordance with the Office of Government Ethics regulations at 5 C.F.R. Part 2634, with the exception of one senior officer who was granted a 45-day extension to file the form.

**Review of Contracting and Consulting Services.** The SEC's contracting and consulting staff in the Office of Acquisitions within the Office of Administrative Services address the potential for senior executive conflicts of interest problems, including:

- Direct or sole source contract selection by senior executives;
- Ownership interest in companies with which the agency does business, as evidenced by the financial disclosure forms and other records;

- Senior executive approval of contractor invoices for payment; and
- Repeated use of the same contractors.

We judgmentally selected six contracts that were in effect as of May 31, 2008, to determine whether the contract and the consulting services were authorized and payments were properly approved. Our testing included identifying evidence for the receipt of goods and services; assessing whether the amounts were correct; and determining whether payments were approved by appropriate officials, the purchases were made for official government purposes, and expenses were properly classified.

We identified two contracts from our sample where the amounts paid under the contract appeared to have exceeded the total dollar value of the contract. On one contract, the total dollar value of the contract was \$4.5 million, but our testing revealed receipts and invoices totaling over \$4.5 million as of June 2008. We brought this discrepancy to the attention of the contracting officer, who explained that two contract modifications were timely executed bringing the total contract value to over \$10 million. The contracting officer provided OIG with the proper documentation to support the current contract amount.

On another contract, the OIG was provided with information showing a contract award of \$347,125 and receipts and invoices totaling \$392,125, \$45,000 more than the contract amount. The contracting officer provided us with a contract modification showing an increase to the contract for \$45,000.

During its review of the six selected contract files, the OIG did not find any actual conflicts of interest. However the OIG discovered that not all required documentation was in the contract files. Below is a list of several documents that should be included in a contract file, if applicable to the particular contract.<sup>28</sup>

- *Central Contractor Registration (CCR)* database search printout -- The CCR is the primary registrant database for the Federal government. The “CCR collects, validates, stores and disseminates data in support of agency acquisition missions.”<sup>29</sup>
- *Statement of Work (SOW)* – Identifies the tasks to be conducted by the contractor and/or the outcomes to be achieved.

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<sup>28</sup> The Federal Acquisition Regulation (FAR) contains extensive, specific requirements for contract file documentation. See 48 C.F.R. 4.802.

<sup>29</sup> <http://www.ccr.gov>.

- *Price Negotiation Memorandum (PNM) or Price Reasonableness Determination (PRD)* – The document signed by the contracting officer establishing that the contract was awarded, or order was made, at a fair and reasonable price.
- *Justification and Approval (J&A) for Sole Source Award* – The document the contracting officer signs to justify awarding a contract or order without providing for full and open competition.

Our review found that a J&A was required for two of the six contracts we reviewed, but was missing in one of the files. Table 3 illustrates the overall results of the OIG’s contract file review.

**Table 3: Contract Documents Found in the Sample**

Contract No.	Central Contractor Registration Documentation	Statement of Work	Price Negotiation Memorandum/Price Reasonableness Determination/Sole Source Justification	Findings
1	√	√	√	J&A not required. The file had an evaluation memorandum in place of the PNM or PRD.
2	√	√	√	J&A not required.
3	√	√	X	J&A not required. <sup>30</sup>
4	√	√	√	N/A
5	√	√	√	N/A
6	√	√	X	The file did not include a J&A or price evaluation.

Source: Office of Administrative Services, Office of Acquisitions contract files

√ - Documents available

X – Documents missing

<sup>30</sup> Subsequent to audit fieldwork, the agency located a PNM for this contract. However, the PNM was previously not in the contract file.

While the OIG recognizes that some documents may not be required for a particular contract, we believe that the contract files should include all required pertinent documents, and specify which documents are not required and, therefore, are not included in the file.

**Recommendation 6:**

The Office of Acquisitions should ensure that each contracting file contains the required documents and specifies, possibly on the contract checklist, which documents are not required to be included in the file.

# Criteria

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**Federal Acquisition Regulation (FAR) Subpart 4.8, Government Contract Files, 48 C.F.R. 4.800 et seq.** Contains requirements for establishing, maintaining and disposing of government contract files.

**Federal Travel Regulation, 41 C.F.R. § 301-1.1, etc.** The FTR implements statutory requirements and Executive Branch policies for travel by Federal civilian employees and others authorized to travel at Government expense.

**GAO Comptroller General Opinion B-289903 – March 4, 2002.** Comptroller General of the United States decision regarding whether Federal agencies may accept gifts of goods or services from private sources.

**GAO Guide for Evaluating and Testing Controls Over Sensitive Payments, GAO/AFMD-8.1.2, Revised May 1993.** Provides a framework for evaluating and testing the effectiveness of internal controls that have been established in various sensitive payment areas.

**Investor and Capital Markets Fee Relief Act, Public Law 107-123, January 6, 2002.** This “pay parity” legislation granted the SEC the authority to pay its employees’ salaries and benefits at levels commensurate with those paid by the Federal banking agencies, and exempted the SEC from the definition of agency in the statutory provision governing the Senior Executive Service, see 5 U.S.C. § 3132.

**OPM Compensation Policy Memoranda (CPM) 2006-19 (December 21, 2006) and 2008-01 (January 4, 2008).** Provides guidance on the Executive Orders implementing annual pay adjustments and information on the 2007 and 2008 pay adjustments for the General Schedule pay system and certain other pay systems and schedules. Contain links to the Office of Personnel Management’s 2007 and 2008 salary tables.

**SEC Ethics Office Bulletins and NewsGrams.** Provides guidance to the Commission’s employees on issues such as conflicts of interest, gifts, and financial disclosure. The Ethics staff also drafts, comments on, and implements regulations concerning ethical conduct issues.

**SEC Senior Officer Pay Charts for 2007 and 2008.** Consist of senior officer base pay rates, locality percentages and salary caps for calendar years 2007 and 2008.

**SEC Senior Officer Performance Management System, Last updated July 16, 2002.** Constitutes the system for managing the performance of all SO Executives of the senior officer program, including the appraisal and rating process, performance awards and pay adjustments.

**Standards of Ethical Conduct for Employees of the Executive Branch, 5 C.F.R. Part 2635.** Sets forth the ethical standards of conduct and obligations of employees of the Federal executive branch, including rules pertaining to gifts and conflicts of interest.

# Summary of Recommendations

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## **Recommendation 1:**

The Chairman's office should provide a detailed justification for all senior officers receive merit pay increases of \$20,000 or more, or bonuses of \$20,000 or more.

## **Recommendation 2:**

The Office of Human Resources should send a written notification to Commission senior executives, reminding them that their time and attendance should be certified by a senior official of equal or higher grade.

## **Recommendation 3:**

The Office of Financial Management should revise its policies and procedures to inform travelers of the proper currency conversion rates that should be used when requesting reimbursement for foreign travel expenses.

## **Recommendation 4:**

The Office of Financial Management should reimburse travelers the amounts that they were underpaid due to currency conversion and other errors.

## **Recommendation 5:**

The Ethics Office should enhance its process for the return of prohibited gifts by keeping an account of the prohibited gifts received by SEC employees that are returned to the source of the gift of which the Ethics Office has knowledge.

## **Recommendation 6:**

The Office of Acquisitions should ensure that each contracting file contains the required documents and specifies, possibly on the contract checklist, which documents are not required to be included in the file.

## Acronyms and Abbreviations

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CCR	Central Contractor Registration
DAEO	Designated Agency Ethics Official
FY	Fiscal Year
GAO	Government Accountability Office
J&A	Justification and Approval for Sole Source Award
OFM	Office of Financial Management
OHR	Office of Human Resources
OIG	Office of Inspector General
OPM	Office of Personnel Management
PNM	Price Negotiation Memorandum
PRD	Price Reasonableness Determination
SOW	Statement of Work
SEC or Commission	U.S. Securities and Exchange Commission
SES	Senior Executive Service

# Management's Response



EXECUTIVE DIRECTOR

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

## MEMORANDUM

**TO:** H. David Kotz  
Inspector General

**FROM:** Diego T. Ruiz  
Executive Director

**DATE:** March 25, 2009

**SUBJECT:** Management Response to Report No. 448, *Audit of Sensitive Payments*

This memorandum provides management's response to OIG Report No. 448, *Audit of Sensitive Payments*, dated March 17, 2009. This audit was conducted by OIG in support of the Government Accountability Office's audit of the Commission's FY 2008 financial statements.

As Executive Director, I greatly appreciate the work that OIG conducted as part of this audit. It is very important that Commission officials adhere to established policies and procedures over sensitive payments to prevent inappropriate acts and conduct that might damage the agency's reputation. For this reason, I am pleased to know that the OIG audit found that the agency maintains reasonable controls over sensitive payments, and did not find any evidence of fraud.

I am also pleased to acknowledge a number of other favorable findings in OIG's report. The OIG audit of the SEC's official entertainment, reception, and representation funds determined that expenditures from these accounts were properly documented, approved, and classified, and did not exceed the authorized limits. In addition, the audit also found that the SEC did not authorize or process any unvouchered expenses in FY 2008. Further, the audit did not identify any senior executive conflict of interest problems in connection with approval of contracting and consulting services. Finally, the OIG audit concluded that the SEC's policies and practices concerning the receipt and acceptance of gifts are in accordance with the requirements of the Standards of Ethical Conduct for Employees of the Executive Branch.

We appreciate the six recommendations made by OIG for improvements to the agency's management of sensitive payments, and concur in full with four, and in part on one other. The six recommendations include two relating to Senior Officer pay; two relating to foreign travel reimbursements; one relating to gifts; and one relating to documents retained in contracting files. We do not concur with one recommendation made by OIG. A more detailed discussion of management's response to each recommendation follows:

**Recommendation #1: The Chairman's office should provide a detailed justification for all senior officer merit pay increases of \$20,000 or more, or bonuses of \$20,000 or more.**

**Management Response:** We are pleased that OIG's review of senior executive compensation and supporting documentation found that salaries, pay increases, and bonuses were properly classified and reported. We are also pleased that OIG did not find any evidence of fraud or payments that went over the established limits or budget amounts.

Management concurs with OIG's recommendation that a detailed justification should be provided in instances where bonuses or merit pay increases for an agency senior executive would be \$20,000 or more. To implement this recommendation, the Executive Director will work with the Director of the Office of Human Resources to appropriately define the additional justification that should be provided. The Executive Director—who along with the Chief of Staff and the General Counsel serves on the Senior Officer Performance Review Board responsible for providing recommendations to the Chairman on Senior Officer merit pay and bonuses—will also ensure that, in the future, this additional documentation is prepared to justify any instance where a Senior Officer should receive a merit pay or bonus of more than the amount specified in the OIG report.

It is important to note that the merit pay adjustment provided to the seven Senior Officers in March 2008 was unique, and is unlikely to recur. In 2006, as a cost-saving measure to help offset the cost of the SEC's new facilities in Washington, New York, and Boston, then-Chairman Christopher Cox limited the initial salary of seven newly-hired direct-report Senior Officers to his own salary level of \$152,000, well below the \$212,100 salary cap for agency staff. During the two years that these division and office heads earned these reduced salaries, this policy saved the agency approximately \$700,000, according to the Office of Human Resources. In early 2008, Chairman Cox lifted the pay limitation and authorized merit pay increases for these seven Senior Officers to match the salaries earned by most other division and office heads reporting to the Chairman, which resulted in the merit pay increases identified in OIG's report. None of the merit increases was retroactive and, as is noted in OIG's report, in no case did these merit increases cause any employee to exceed the agency's salary cap or total pay limits.

**Recommendation #2: The Office of Human Resources should send a written notification to Commission senior executives, reminding them that their time and attendance should be certified by a senior official of equal or higher grade.**

**Management Response:** We are pleased that the OIG audit did not find any evidence of fraud or material errors in its audit of Senior Officer time and attendance. We are also pleased to note the SEC's adoption in June 2008 of Quicktime, an electronic time and attendance verification and certification system, which we believe successfully addresses the previous GAO audit findings related to internal controls to which OIG's report refers. We understand that the samples giving rise to OIG's recommendation were taken before the implementation of the Quicktime system.

With respect to OIG's specific recommendation, the Office of Human Resources agrees that Senior Officers should be appropriately reminded of the applicable laws, regulations, and agency policies governing certification of Senior Officer time and attendance. In the case of the majority of SEC Senior Officers, including those at the Associate and Deputy Director level, SEC policy is for time and attendance to be certified by a senior official of equal or higher grade, generally their supervisor. We note that the SEC Chairman has authorized office heads (including Division Directors, Office Directors, and Regional Directors) to delegate their time and attendance certification to a lower administrative level. This policy, which was approved by the SEC Chairman on July 31, 2008, pursuant to the authority in 5 CFR 630.101, was undertaken in accordance with guidance provided by the Government Accountability Office,<sup>1</sup> whose authority to prescribe acceptable methods of maintaining employee time and attendance is expressly cited in that regulation. The Office of Human Resources will prepare and send a written notification to all senior executives reminding them of their obligations, and, with respect to office heads, will periodically review the delegations that have been made in each division, office, and regional office to ensure they remain current.

**Recommendation #3: The Office of Financial Management should revise its policies and procedures to inform travelers of the proper currency conversion rates that should be used when requesting reimbursement for foreign travel.**

**Management Response:** Management concurs with this recommendation. The Office of Financial Management will review its current policy of requiring travelers to use the currency conversion rate in effect on the last day in a particular foreign location, rather than using separate daily conversion rates, when requesting reimbursement of the travel expenses. The Office of Financial Management will also prepare appropriate guidance for travelers, and will include this information in an appropriate place on the Commission's intranet web site.

**Recommendation #4: The Office of Financial Management should reimburse travelers amounts they were underpaid due to currency conversion and other errors.**

**Management Response:** The Office of the Inspector General's audit identified currency conversion errors in the submission of two requests by SEC staff for reimbursement of expenses incurred while on official foreign travel. The Office of Financial Management has calculated the amount of error as \$17.01 and \$36.06, and I understand that OIG agrees with these calculations. Management concurs with the recommendation to reimburse these two travelers for these amounts.

**Recommendation #5: The Ethics Office should enhance its process for the return of prohibited gifts by keeping an account of the prohibited gifts received by SEC employees that are returned to the source of the gift of which the Ethics Office has knowledge.**

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<sup>1</sup> GAO-03-352G, *Maintaining Effective Control Over Employee Time and Attendance Reporting*, January 2003, pages 6 and 9.

**Management Response:** We are pleased that the OIG audit concluded that the SEC's policies and practices concerning the receipt and acceptance of gifts are in accordance with the requirements of the Standards of Ethical Conduct for Employees of the Executive Branch. SEC staff who file financial disclosure documents must report gifts accepted that are over a certain amount, and the Ethics Office regularly reviews these reports to ensure compliance with federal laws and regulations governing acceptance of gifts.

With respect to the specific recommendation suggested by OIG to require tracking of returned gifts, management appreciates the concerns expressed, but must disagree with this recommendation. The OIG report does not state why OIG believes the Ethics Office should maintain a record of returned gifts, nor does it posit a benefit to the agency of creating a new system of records to track returned gifts. Without knowing OIG's rationale for this recommendation, we can only note that such a record would essentially represent a list of employees who have complied with the law. Since the recommendation proposes to require keeping records of only those employees who seek guidance from (or otherwise come to the attention of) the Ethics Office, the incompleteness of such a new system of records would undermine any theoretical benefit that might be gained. At the same time, the administrative and recordkeeping burdens imposed on the Ethics Office of creating and maintaining such a new system of records could be significant, especially for a small office which has more significant other responsibilities, including ones that OIG has emphasized in past reviews.

Furthermore, management notes that there is no requirement in federal law, regulation, or the Standards of Ethical Conduct for Employees of the Executive Branch that an employee or agency maintain records regarding returned gifts. The Office of Government Ethics, which monitors the agency's ethics program, does not require or collect such records, nor has it ever asked for this information.

**Recommendation #6: The Office of Acquisitions should ensure that each contracting file contains the required documents and specifies, possibly on the contract checklist, which documents are not required to be included in the file.**

**Management Response:** Management wholeheartedly agrees that each contracting file should contain all required documents. The SEC maintains its contract recordkeeping files in accordance with the requirements of the Federal Acquisition Regulation (FAR), which as OIG's report notes, contain extensive and specific requirements for contracting file documentation. In addition, the Office of Acquisitions already requires each contracting file to include a checklist of documents, and each contract specialist to initial and date on the checklist each item that is required and included in the file. Management disagrees with the recommendation that documents not required to be included in the file should be listed individually. There is no requirement in the FAR that agencies list which documents are not required to be kept in the contracting file, or which documents are not included in the file. Management is concerned that imposing such a new requirement for all contracts would impose significant administrative burdens on contract specialists, since the list of possible documents is more than two pages long and includes several dozen items. We would point out to OIG that the list of items not required is already present in the file, since by definition it is comprised of the items that have not been checked off as required by the contract specialist.

# OIG's Response to Management's Comments

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We are pleased that management appreciates the work that the OIG conducted as part of this audit and our efforts to ensure that the SEC maintains reasonable controls over sensitive payments. We are also pleased that management has concurred in full with four of our recommendations to improve the agency's management of sensitive payments and in part with another recommendation.

Nonetheless, we are disappointed in management's response to our recommendation that Commission senior executives be reminded that their time and attendance must be certified by a senior official of equal or higher grade. Both the Government Accountability Office (GAO) and the OIG have identified the certification of senior officials' time by lower-level employees as an internal control deficiency and have recommended, beginning in April 2007 by the GAO, that management address this concern. We are surprised that management would take the position that the SEC's adoption of the Quicktime electronic time and attendance system in June 2008 successfully addressed the problem, when the GAO recently conducted an analysis of the Quicktime system's controls and specifically found that it has not, in fact, been configured to prevent lower-level employees from approving higher-level employees' time and attendance reports. We believe that management should reconsider its position and enact this important internal control measure that both the GAO and OIG believe is warranted.

In addition, we are disappointed with respect to two other matters raised in management's response. First, while management responds that it agrees with the concerns expressed by the OIG in the report, it states that it is unwilling to undertake control measures identified in the OIG report to address these concerns because they would involve administrative and recordkeeping burdens. Specifically, management states that it appreciates the concerns expressed by the OIG about the lack of an accounting of the return of prohibited gifts by SEC employees, but is not willing to keep an accounting of those prohibited gifts because of the "administrative and recordkeeping burdens" such a requirement would impose. We are surprised by this response since the recommendation is limited to keeping an account of prohibited gifts received by SEC employees of which the Ethics Office has knowledge, and we understand that the number of these gifts is relatively small.

Second, while management's response states that it "wholeheartedly agrees that each contracting file should contain all required documents," management does not commit to undertake any measures to ensure that this is the case, e.g., by conducting periodic inspections of a sample of contract files to ensure

completeness. In addition, management states that it is unwilling to ensure that the contract files specify which documents are not required to be included in the files, even though management notes that the contract files already contain a checklist of items, indicating that implementing this requirement would impose “significant administrative burdens” on contract specialists. However, this important control measure could be accomplished by simply requiring contract specialists to write “N/A” next to items that do not apply to the contract in question on a checklist that, according to management, may be more than two pages long. Given the importance of strong internal controls in the areas of procurement and contracting as well as ethics, we hope that management reconsiders its position on both of these recommendations.

# 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:

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Office of Inspector General  
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