

U.S. SECURITIES AND EXCHANGE COMMISSION  
2013 Report and Certification of Internal Supervisory Controls

**Introduction**

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Section 961 of the Act requires that not later than 90 days after the end of each fiscal year, the Securities and Exchange Commission ("SEC" or "Commission") shall report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services on the supervisory controls over the conduct by the Commission of examinations of registered entities,<sup>1</sup> enforcement investigations, and review of corporate financial securities filings. This report is being submitted for the Commission's fiscal year ending September 30, 2013.

**Background**

The SEC's mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. Although the SEC's functional responsibilities are organized among five divisions and 22 offices, the scope of the activities covered in Section 961 fall principally under the purview of: the Office of Compliance Inspections and Examinations ("OCIE"), the Office of Credit Ratings ("OCR"),<sup>2</sup> the Division of Enforcement ("Enforcement"), and the Division of Corporation Finance ("Corporation Finance"). Therefore, in the context of this report, references to "the Commission's internal supervisory controls" or "internal supervisory controls of the Commission" relate to the relevant internal supervisory controls of OCIE, OCR, Enforcement, and Corporation Finance.

OCIE principally administers the examination program for SEC-registered entities including,

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<sup>1</sup> References to "examinations" within this report refer to both examinations and inspections conducted by either the Office of Compliance Inspections and Examinations or the Office of Credit Ratings.

<sup>2</sup> The Dodd-Frank Act also mandated the creation of the Office of Credit Ratings, which was established in June 2012, from a reassigned examination team from OCIE and the realignment of the monitoring team from the Division of Trading and Markets. The certification mandated by Section 961 of Dodd-Frank is required for the "Director of the Division of Enforcement, the Director of the Division of Corporation Finance, and the Director of the Office of Compliance Inspections and Examinations (or the head of any successor division or office)." The SEC has determined that OCR should be considered a successor of OCIE and therefore subject to the reporting requirements of Section 961.

among others, self-regulatory organizations, broker-dealers, transfer agents, clearing agencies, investment companies, and investment advisers. The Office conducts examinations to foster compliance with the securities laws, to detect violations of the law, to identify risks and to inform policy. OCR is responsible for conducting examinations and monitoring the activities of Nationally Recognized Statistical Rating Organizations to assess and promote compliance with statutory and Commission requirements. Enforcement is principally responsible for assisting the Commission in executing its law enforcement function by, among other things, conducting investigations of potential securities law violations; recommending, in appropriate circumstances, that the Commission institute civil actions in federal court or before an administrative law judge; and prosecuting cases on behalf of the Commission. Finally, Corporation Finance is principally responsible for selectively reviewing the disclosure documents that relate to the offer and sale of securities in registered transactions and which publicly-held companies file with the Commission. Through Corporation Finance's review process, the Division provides comments on where it believes companies can improve or enhance their compliance with the disclosure requirements of the federal securities laws.

Staffing within OCIE and Enforcement consists of attorneys, accountants, examiners, subject matter experts, and other employees located both in the Washington, D.C. office and in 11 regional offices located throughout the country. OCR's staff is divided between the SEC headquarters and the New York Regional Office. The majority of the SEC's other offices and divisions, including Corporation Finance, are exclusively located in Washington, DC.

This report describes the scope and methodology used to evaluate the internal supervisory controls and relevant procedures applicable to the OCIE, OCR, Enforcement, and Corporation Finance staff that perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings, respectively. Furthermore, the report describes whether any significant deficiencies in these controls or procedures have been identified to exist as of the end of the fiscal year. The report also includes a description of the inherent limitations of procedures applicable to staff, supervisory controls, and the evaluation process. Finally, the report includes an assessment of control and procedure effectiveness, the Certification of Supervisory Controls that is required by the Act, and the status of the Comptroller General's review pursuant to Section 961(e) of the Act.

### **Internal Supervisory Controls and Procedures Applicable to Staff**

Section 961(b)(1) of the Act requires the assessment of both the internal supervisory controls and Commission procedures applicable to the Commission staff who perform examinations of registered entities (i.e., OCIE and OCR), enforcement investigations (i.e., Enforcement), and reviews of corporate financial securities filings (i.e., Corporation Finance). Neither "internal supervisory controls" nor "procedures applicable to staff" are defined terms in the Act. For

purposes of this report and the attached certification, “procedures applicable to staff” refer to the established “day-to-day” procedures to be followed by the employees charged with these functions. “Internal supervisory controls” refer to the processes established by management of each respective office or division for monitoring that the “procedures applicable to staff” are performed consistently with competence and integrity, and also remain reasonable, adequate, and current.

## **Scope and Methodology**

### *1. Overview*

The Directors of OCIE, OCR, Enforcement, and Corporation Finance, each with the assistance of his or her supervisory staff and other office or division personnel, evaluated the effectiveness of internal supervisory controls and relevant procedures applicable to staff. The internal supervisory control review encompassed internal controls in place during the entire fiscal year and the assurance of those controls encompassed the 90-day period ending on the final day of the fiscal year ending on September 30, 2013. Upon completion of the evaluation, each Director signed a certification concerning the adequacy of the Commission's internal supervisory controls with respect to his or her office or division.

To facilitate an effective, efficient, and consistent approach to the evaluations, the Agency established a working group consisting of Senior Officers and staff from OCIE, OCR, Enforcement, Corporation Finance, and the Offices of the Chief Operating Officer and the General Counsel. Additionally, the working group, as needed, obtained input from other divisions or offices within the Agency. The working group met and communicated regularly to discuss the development and implementation of the project plans that were prepared by each of the relevant divisions and offices and to ensure a consistent methodology for conducting the Section 961 assessment corresponding with relevant government-wide internal controls standards and guidance. This methodology was revised in 2013 to incorporate a GAO recommendation that the SEC’s internal supervisory controls have clearly defined activities and clear and readily available documentation demonstrating execution of those activities.

Each office followed the documented methodology. OCIE, OCR, Enforcement, and Corporation Finance engaged in a "top-down, risk based" consideration of their functional responsibilities, focusing on assessing whether their respective objective of conducting examinations, investigations, or reviews of corporate financial securities filings with professional competence and integrity had been consistently met during the 90-day period subject to evaluation. This approach involved identifying risks to achieving such objectives, determining whether controls exist to address those risks, and evaluating the operating effectiveness of the controls included in the evaluation. The procedures for collecting information to evaluate the effectiveness of internal

supervisory controls consisted principally of interviews, observation, process walkthroughs, inspection of documents, self-assessments (including the use of sub-certifications), and through the application of judgment, as appropriate.

In addition, relevant members of the working group reviewed and considered background material that included the 2013 review of the internal supervisory controls pursuant to the requirements of Section 961 of Dodd-Frank, the Federal Manager's Financial Integrity Act (FMFIA) assurance statements for fiscal year 2013, results of an agency-wide review of entity level controls, and recent Office of Inspector General and Government Accountability Office findings.

Finally, the offices reviewed any deficiencies identified by assessing their impact on the evaluation of the design and operating effectiveness of internal supervisory controls, including making the determination of whether any such deficiencies were considered significant, either individually or in the aggregate. OCIE, OCR, Enforcement, and Corporation Finance provided summary information for such determination and for the evaluation as a whole to the respective office or division director in order to support the relevant assertions within the certification.

## *2. Examinations and Investigations*

To assess the effectiveness of internal supervisory controls over examinations and investigations and the procedures applicable to the staff performing such functions, OCIE, OCR, and Enforcement developed separate assessment teams that included members of the working group, senior managers, and other staff with extensive experience in conducting examinations or investigations. The assessment team for each function identified and evaluated the risks and related key controls that are important to the function's ability to consistently conduct examinations or investigations with professional competence and integrity, which included the identification of any deficiencies in control design or operating effectiveness.

The evaluation also included an identification of the information technology ("IT") systems used to track examinations and investigations. The assessment teams evaluated how the IT systems are used to support key supervisory controls and the procedures applicable to staff.

The assessment teams for examinations and investigations coordinated their efforts and conducted structured interviews with Home and Regional Office Senior Officers<sup>3</sup> and other staff with the goal of obtaining their assistance and support in the identification and description of controls. In order to assess the effectiveness of supervisory controls, the teams designed tests around the key internal supervisory controls that were determined to be designed appropriately. The teams used

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<sup>3</sup> The Regional Office Directors and Home Office Senior Officers within OCIE, OCR, and Enforcement have supervisory responsibility for staff in their respective offices; accordingly, evaluations of internal supervisory controls over examinations and investigations required the coordinated participation of the Home and Regional Offices.

a combination of random and judgmental sampling techniques to select samples for validating operational effectiveness. The teams obtained and documented evidence to support the effective operation of key supervisory controls.

This process was closely coordinated with the annual Management Assurance statement process performed for FMFIA purposes and used the sub-certification prepared for the FMFIA assurance statement, due to the concurrent nature of the identified risks, controls and gaps. The sub-certifications were provided to the Directors of OCIE and Enforcement, along with key background materials, to support the assertions in the certification required by Section 961(c)(2) of the Act.

### *3. Reviews of Corporate Financial Securities Filings*

To assess the effectiveness of internal supervisory controls over reviews of corporate financial securities filings and the procedures applicable to the staff conducting those reviews, Corporation Finance established an assessment team that included senior management and other staff members. The assessment team identified and evaluated risks and related key controls that are important to Corporation Finance's ability to consistently conduct reviews with professional competence and integrity, which included the identification of any deficiencies in control design or operating effectiveness.

The evaluation included the support and assistance of Senior Officers and other staff responsible for the reviews of corporate financial securities filings. In order to assess the effectiveness of supervisory controls, the team designed and executed tests of key internal supervisory controls which included a combination of random and judgmental sampling techniques to select samples for validating operational effectiveness. The team obtained and documented evidence to support the effective operation of key supervisory controls.

This process built upon the annual Management Assurance statement process performed for FMFIA purposes. The assessment team provided the Director with key background materials to support the assertions in the certification required by Section 961 (c)(2) of the Act.

### **Inherent Limitations**

All control systems, including internal supervisory controls, are subject to inherent limitations. No matter how well-conceived and operated, an internal control system cannot provide absolute assurance regarding the achievement of objectives, nor can an evaluation of an internal control system provide absolute assurance that significant deficiencies will be identified. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that internal

supervisory controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Because of the nature, including breadth, of the Commission's examination, investigation, and review of corporate financial securities filings functions, as well as limitations on resources, management and staff within the relevant offices and divisions must exercise judgment in conducting examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings. As such, controls are inherently designed to allow for the application of judgment in decision-making. There may be instances where judgments made in good faith are in hindsight deemed inappropriate.

The evaluations of internal supervisory controls and procedures applicable to staff covered by this report for the Commission's fiscal year ending September 30, 2013 represent the fourth evaluation conducted pursuant to the requirements of Section 961 of the Act. The SEC will continue to enhance the approach taken in 2013 to improve the effectiveness and efficiency of the efforts going forward. The results of GAO's review under Section 961(e) may also result in adjustments to the process in future years.

Despite the limitations described above, it is our belief that the evaluations of the Commission's internal supervisory controls and procedures applicable to staff provide a reasonable and justifiable basis for the conclusions expressed in this report.

### **Significant Deficiencies**

Section 961(c)(2)(D) requires each respective Director of OCIE, Enforcement, and Corporation Finance and any successor offices, such as OCR, certify that he or she has disclosed to the Commission any significant deficiencies in the design or operation of internal supervisory controls that could adversely affect the ability of the Division or Office to consistently conduct inspections, or investigations, or reviews of corporate financial securities filings with professional competence and integrity. Under the terms of Reorganization Plan No. 10 of 1950, the executive and administrative functions of the Commission are transferred to the Chairman of the Commission, including, among other functions, the appointment and supervision of personnel employed under the Commission.<sup>4</sup> Accordingly, the Director of each respective Division or Office should make any required disclosures to the Chairman of the Commission. To make this clear, the attached certification states that the respective Directors have "disclosed to the Chairman of the Commission any significant deficiencies in the design or operation of internal supervisory controls...." A copy of this report is also being provided to each Commissioner.

As part of the evaluations described above, the respective OCIE, OCR, Enforcement, and

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<sup>4</sup> 15 F.R. 3175, 64 Stat. 1265, Section 1(a).

Corporation Finance assessment teams evaluated their findings to determine whether any deficiencies existed as of September 30, 2013. The severity of all deficiencies identified was evaluated to determine whether any, either individually or in the aggregate, constituted a significant deficiency. Upon completion of this process, **no significant deficiencies in internal supervisory controls were identified in the twelve months ending September 30, 2013.**

For purposes of making the determinations described above, a “significant deficiency” meriting the attention by the Chairman of the Commission, is any deficiency, or combination of deficiencies, in internal supervisory controls that inhibits the respective office or division from achieving the overall goals established by senior management for consistently conducting examinations, investigations, or reviews of corporate financial securities filings with professional competence and integrity.

### **Assessment of Effectiveness**

Based on the results of the evaluations described above, as of September 30, 2013, the internal supervisory controls of the Commission with respect to OCIE and OCR examinations, Enforcement investigations, and Corporation Finance reviews of corporate financial securities filings are effective, and the procedures of the Commission applicable to the OCIE, OCR, Enforcement, and Corporation Finance staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings, respectively, are effective.

### **Certification of Internal Supervisory Controls**

See Exhibit A - Section 961(c)(2) Certification

### **Summary of Review by GAO**

Section 961(e) of the Act requires a review by the Comptroller General of the United States of the adequacy and effectiveness of the Commission's internal supervisory control structure and procedures not less frequently than once every three years. Section 961(b)(3) of the Act requires this report to contain a summary of the GAO's review.

The GAO began a review under Section 961(e) in March 2012 and released their report in April 2013, *“Continued Management Attention Would Strengthen Internal Supervisory Controls”* (GAO-13-314). The report concluded that the agency’s overall internal control framework to implement Section 961 meets GAO’s standards, including identifying and assessing internal controls and reporting the results of testing to SEC management and Congress.

In the engagement, GAO selected and tested a sample of internal supervisory controls from the list

of existing operating controls for the fiscal year ending September 30, 2011 (“2011 reporting cycle”). The 2011 reporting cycle, in fact, was the first year that the SEC conducted testing of the internal supervisory controls identified by Section 961. During this first year of detailed testing, OCIE, Enforcement, and Corporation Finance identified a number of deficiencies requiring corrective action and management attention, although SEC management determined that none of these deficiencies rose to the level of a material weakness or significant deficiency. The GAO’s report reached a similar conclusion with respect to the 2011 reporting cycle and notes that the SEC has already taken, or is taking steps, to address nearly all the deficiencies identified by GAO. Since many of these deficiencies had already been identified by OCIE, Enforcement, and Corporation Finance during their 2011 testing, corrective action in many cases was already underway or completed at the time that GAO conducted its testing.

Building on the procedures that GAO performed on the 2011 reporting cycle, OCIE, Enforcement, and Corporation Finance conducted additional testing on the effectiveness of internal supervisory controls for the 90-day period ending September 30, 2013 (“2012 reporting cycle”). While GAO was not in a position to evaluate the results of this assessment of internal supervisory controls for the 2012 reporting cycle, SEC management did not identify any material weaknesses or significant deficiencies during this testing. The results of this assessment were reported to Congress in December 2012.

Subsequent to the completion of GAO’s report, SEC management in 2013 prepared a corrective action plan to identify the actions that had been taken, or would be taken, to address the specific deficiencies identified by the GAO. To address the report’s recommendation, the offices revised their documented procedures to more clearly specify how each of the offices would evaluate the design of internal supervisory controls to ensure that such controls have clearly defined activities and clear and readily available documentation demonstrating execution of those activities. Following the completion of these corrective actions, SEC management plans to communicate the results of these efforts to GAO and to request that the findings be considered closed.

**Exhibit A**

**SECTION 961(c)(2) CERTIFICATION**

Pursuant to the requirements of Section 961(c)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, I hereby certify that:

1. I am directly responsible for establishing and maintaining the internal supervisory controls of the Division or Office of which I am the head.
2. I am knowledgeable about the internal supervisory controls of the Division or Office of which I am the head.
3. I have evaluated the effectiveness during the 90-day period ending on the final day of the fiscal year ended September 30, 2013 of the internal supervisory controls of the Division or Office of which I am the head.
4. I have disclosed to the Commission any significant deficiencies in the design or operation of internal supervisory controls identified as a result of the evaluation described above that could adversely affect the ability to consistently conduct with professional competence and integrity, respectively:
  - (a) inspections and examinations by the Office of Compliance Inspections and Examinations and its successor office, the Office of Credit Ratings,
  - (b) investigations by the Division of Enforcement, or
  - (c) reviews of corporate financial securities filings by the Division of Corporation Finance.

This certification concerning the adequacy of the Commission's internal supervisory controls is based on the review described in the accompanying report of the internal supervisory controls and procedures applicable to the staff that performs the duties described above within the Division or Office of which I am the head and is accurate to the best of my knowledge and belief. This review was performed with the assistance of my supervisory staff and other personnel within my Division or Office.

**With Respect to Inspections and Examinations:**

Name: Andrew Bowden



Date: 12/16/13

Title: Director

Office of Compliance Inspections and Examinations

Name: Thomas J. Butler



Date:

12/17/2013

Title: Director

Office of Credit Ratings

**With Respect to Reviews of Corp. Financial Securities Filings:**

Name: Keith Higgins



Date: 12/16/13

Title: Director

Division of Corporation Finance

**With Respect to Investigations:**

Name: George Canellos  
Title: Co-Director  
Division of Enforcement



Date:

12/17/13

Name: Andrew Ceresney  
Title: Co-Director  
Division of Enforcement



Date:

12/12/13