

REPORT NO. 571  
JANUARY 25, 2022

OFFICE OF  
**INSPECTOR  
GENERAL**

OFFICE OF AUDITS

**Registered Investment Adviser Examinations:  
EXAMS Has Made Progress To Assess Risk  
and Optimize Limited Resources, But Could  
Further Improve Controls Over Some Processes**

This report contains non-public information about the U.S. Securities and Exchange Commission's examination program. We redacted the non-public information to create this public version.

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

**M E M O R A N D U M**

January 25, 2022

**TO:** Dan Kahl, Acting Director, Division of Examinations

**FROM:** Carl W. Hoecker, Inspector General 

**SUBJECT:** *Registered Investment Adviser Examinations: EXAMS Has Made Progress To Assess Risk and Optimize Limited Resources, But Could Further Improve Controls Over Some Processes, Report No. 571*

Attached is the Office of Inspector General (OIG) final report detailing the results of our audit of the Division of Examinations' registered investment adviser examination planning processes. The report contains three recommendations that should help improve the Division of Examinations' planning and oversight of registered investment adviser examinations.

On December 14, 2021, we provided management with a draft of our report for review and comment. In its January 10, 2022, response, management concurred with our recommendations. We have included management's response as Appendix II in the final report.

Within the next 45 days, please provide the OIG with a written corrective action plan that addresses the recommendations. The corrective action plan should include information such as the responsible official/point of contact, timeframe for completing required actions, and milestones identifying how management will address the recommendations.

We appreciate the courtesies and cooperation extended to us during the audit. If you have questions, please contact me or Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects.

Attachment

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# EXECUTIVE SUMMARY

Registered Investment Adviser Examinations: EXAMS Has Made Progress To Assess Risk and Optimize Limited Resources, But Could Further Improve Controls Over Some Processes

REPORT NO. 571 | JANUARY 25, 2022

## WHY WE DID THIS AUDIT

Within the U.S. Securities and Exchange Commission's (SEC or agency) Division of Examinations (EXAMS or Division), the investment adviser/investment company (IA/IC) examination program assesses whether, among other things, registered investment advisers (RIAs) and investment companies comply with federal securities laws. RIAs are among the variety of financial professionals that provide services to help individuals manage their investments. Generally, RIAs include firms or individuals that, for compensation, advise others as to the value of securities, or as to the advisability of investing in, purchasing, or selling securities. RIAs represent the largest portion of the registered firm population overseen by EXAMS, and the majority of the Division's examinations are of RIAs.

The overall objective of this audit was to determine whether EXAMS has established effective controls over its RIA examination planning processes to foster compliance with federal securities laws and ensure efficient allocation of its limited RIA examination resources. We also followed up on the implementation of corrective actions in response to recommendations from our 2016 evaluation.

## WHAT WE RECOMMENDED

We made three recommendations to further strengthen the SEC's IA/IC examination program. Management concurred with our recommendations, which will be closed upon completion and verification of corrective actions. This report contains non-public information about the SEC's examination program. We redacted the non-public information to create this public version.

## WHAT WE FOUND

We verified that, in response to the two recommendations from the prior Office of Inspector General (OIG) evaluation (*Office of Compliance Inspections and Examinations' Management of Investment Adviser Examination Coverage Goals*; OIG Report No. 533; March 10, 2016), EXAMS worked to:

- optimize its limited resources and increase its efficiency and effectiveness;
- improve its IA/IC examination program's examination candidate selection processes; and
- implement the U.S. Government Accountability Office's risk-management framework, specifically, within the IA/IC examination program.

OIG Report No. 533 noted that, in fiscal year (FY) 2015, the average number of IA/IC examinations completed per examiner was about three. That number nearly doubled in FY 2021. Additionally, in FY 2015, EXAMS met its annual goal of examining 10 percent of RIAs. Notably, the percentage of RIAs examined improved to 15 percent in FY 2020 and 16 percent in FY 2021.

To meet our objectives, we selected and reviewed a nonstatistical, random sample of 501 RIA examinations from the audit universe of 4,993 RIA examinations approved and closed between FY 2019 and FY 2021, quarter 2. For each examination in our sample, we tested key examination planning processes and controls and found that, although 23 of 26 operated effectively, controls over the remaining RIA examination planning processes need improvement.

For example, for 81 of the 501 RIA examinations we reviewed (or about 16 percent), staff commenced substantive RIA examination procedures before management reviewed and approved key examination planning and scoping processes as part of the examination pre-fieldwork phase. In some cases, staff failed to first request management's approval before commencing substantive examination procedures. In other cases, management failed to provide timely approval when requested. As a result, pre-fieldwork approval—a primary control for ensuring, among other things, that staff execute examinations in accordance with Division policies and procedures—occurred between 1 and 391 days late (or an average of 54 days late) for the 81 RIA examinations in question.

Additionally, for 70 of the 501 RIA examinations we reviewed (or about 14 percent), staff either did not (1) ensure the EXAMS system of record included evidence of required communications with examined registrants, or (2) maintain documents in the Communications section of the system, as required. Inconsistent documentation of examination communications may lead to difficulties in reviewing and supervising examinations.

Lastly, we identified a matter that did not warrant a recommendation, but that we discussed with agency management for their consideration. Specifically, 8 of the 501 examinations we reviewed included non-Division staff participation. However, we were unable to find evidence that an examination supervisor notified registrants of non-Division staff participation for seven of these eight RIA examinations.

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# Abbreviations

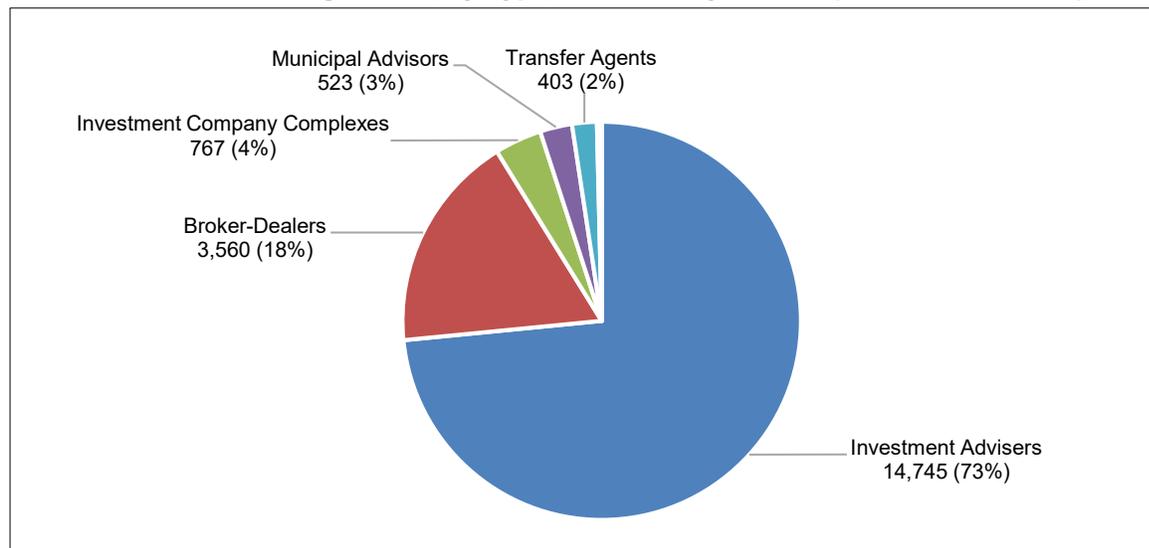
<b>COVID-19</b>	Coronavirus Disease 2019
<b>EPSC</b>	Exam Process Steering Committee
<b>ERPi</b>	Enterprise Resource Performance, Inc.
<b>EXAMS or Division</b>	Division of Examinations
<b>FY</b>	fiscal year
<b>GAO</b>	U.S. Government Accountability Office
<b>IA/IC</b>	investment adviser/investment company
<b>NEP</b>	National Examination Program
<b>OIG</b>	Office of Inspector General
<b>RIA</b>	registered investment adviser
<b>SEC or agency</b>	U.S. Securities and Exchange Commission
<b>TRENDS</b>	Tracking and Reporting Examination National Documentation System

# Background and Objectives

## BACKGROUND

Within the U.S. Securities and Exchange Commission's (SEC or agency) Division of Examinations (EXAMS or Division), the investment adviser/investment company (IA/IC) examination program (hereafter referred to as the IA/IC examination program) assesses whether, among other things, registered investment advisers (RIAs) and investment companies comply with federal securities laws.<sup>1</sup> RIAs are among the variety of financial professionals that provide services to help individuals manage their investments. Generally, RIAs include firms or individuals that, for compensation, engage in the business of advising others (either directly or through publications or writings) as to the value of securities (such as stocks, bonds, mutual funds, exchange-traded funds, etc.), or as to the advisability of investing in, purchasing, or selling securities. RIAs can also be firms or individuals that, for compensation and as part of a regular business, issue or promulgate analyses or reports concerning securities. As Figure 1 shows, RIAs (totaling more than 14,700 firms as of October 2021) represent the largest portion of the registered firm population overseen by EXAMS. Accordingly, examinations of RIAs comprise the majority of the Division's examinations. As Figure 2 shows, RIA examinations conducted by IA/IC staff represented about 74 percent of all examinations completed by the Division in fiscal year (FY) 2021.

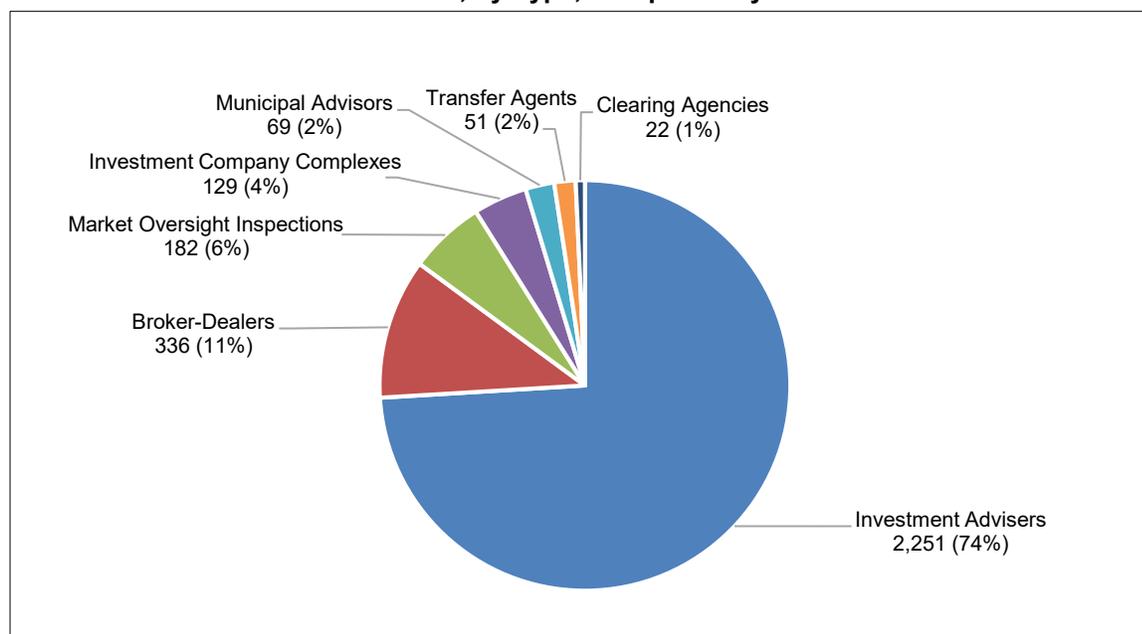
**FIGURE 1. Number of Registrants, by Type, Overseen by EXAMS (as of October 2021)\***



Source: *OIG-generated based on an internal EXAMS report, as of October 27, 2021.*

\* *Regulation Systems Compliance and Integrity entities, national security exchanges, and clearing agencies combined represented less than one percent of the total population and are therefore not depicted.*

<sup>1</sup> With respect to RIAs, this includes the Investment Advisers Act of 1940, which, with certain exceptions, requires that firms or sole practitioners compensated for advising others about securities investments register with the SEC and conform to regulations designed to protect investors. Since the Act was amended in 1996 and 2010, generally only advisers who have at least \$100 million of assets under management or advise a registered investment company must register with the SEC. Other investment advisers typically register with the state in which the investment adviser maintains its principal place of business.

**FIGURE 2. Number of Examinations, by Type, Completed by EXAMS in FY 2021**

Source: OIG-generated based on an internal EXAMS report for FY 2021.

EXAMS staff complete examinations of RIAs at the SEC's headquarters in Washington, DC and at the SEC's 11 regional offices.<sup>2</sup> Ensuring sufficient examination coverage of RIAs is important because:

- The SEC is the primary, and often only, regulator responsible for examining this segment of the registered firm population;
- The amount of assets under RIA management has increased by more than 44 percent over the last 5 years, from about \$67 trillion to about \$97 trillion; and
- RIAs operate within a constantly evolving financial industry and are increasingly complex, interconnected, and dependent on a variety of market participants.

In support of the SEC's Strategic Goal 1, "Focus on the long-term interests of our Main Street Investors," the agency established a performance goal that measures the percentage of RIAs examined each year.<sup>3</sup> The percentage has increased from 10 percent in FY 2014 to 17 percent in FY 2018. For FYs 2019 and 2020, EXAMS reported examining 15 percent of RIAs and, most recently, 16 percent for FY 2021.

According to EXAMS management, the Division has sought to increase its RIA coverage by (1) implementing program efficiencies, both through process and technology; (2) realigning internal staffing to address the coverage rates for RIAs; and (3) continuing investments in human capital through ongoing staff training and onboarding experienced subject matter experts. Nonetheless, the Division's *2021 Examination Priorities* acknowledged that there remains a significant risk that, in light of industry

<sup>2</sup> The SEC has regional offices in Atlanta, Boston, Chicago, Denver, Fort Worth, Los Angeles, Miami, New York, Philadelphia, Salt Lake City, and San Francisco.

<sup>3</sup> SEC Fiscal Year 2022 Congressional Budget Justification and Annual Performance Plan, and Fiscal Year 2020 Annual Performance Report (May 28, 2021), Performance Goal 4.

growth, increased complexity, and other factors, EXAMS “does not have sufficient resources to adequately cover the RIA space.” Additionally, the Division’s coverage rates “will likely not keep pace with the continued growth in the population and complexity, without corresponding staffing increases.” EXAMS further stated, “While the Division has made great strides to improve the coverage rate, the risks of diminished coverage, quality, and effectiveness are possible without further support. Ultimately, this trend is concerning and a focus for the Division of Examinations.”<sup>4</sup>

**Impact of the Global Pandemic on EXAMS’ IA/IC Examination Program.** Early in the Coronavirus Disease 2019 (COVID-19) pandemic, EXAMS issued a statement on its operations, noting the shift to correspondence examinations (that is, examinations without on-site visits) and its outreach efforts to registered firms to assess pandemic-related operational resiliency challenges.<sup>5</sup> According to its *2021 Examination Priorities*, the Division focused on examining whether RIAs’ business continuity plans were updated, operational and effective, and addressing increased cybersecurity risks facing firms and investors. EXAMS subsequently published a COVID-19 Risk Alert to share observations from this work and provided observations and recommendations to assist firms’ pandemic response.

**Recommendations From Prior Office of Inspector General (OIG) Work, OIG Report No. 533.** In March 2016, we issued *Office of Compliance Inspections and Examinations’ Management of Investment Adviser Examination Coverage Goals* (hereafter referred to as OIG Report No. 533).<sup>6</sup> In our report, we noted, among other things, that EXAMS had worked to increase its examination coverage of RIAs, including creating the Division’s Office of Risk Analysis and Surveillance. EXAMS had also enhanced its use of advanced quantitative techniques and technology, and continued to seek new ways to increase its efficiency and RIA examination coverage. However, we identified areas for improvement and made two recommendations for corrective action. Specifically, we recommended that the Division provide to the OIG the results of a consultant’s efficiency study and consider the study’s results. We also recommended considering recommendations received from the Division’s Risk and Exam Process Steering Committee (renamed the Exam Process Steering Committee [EPSC])<sup>7</sup> and considering fully implementing within the IA/IC examination program the U.S. Government Accountability Office’s (GAO) risk-management framework, which we further describe below. Based on our review of the Division’s corrective actions taken and planned, in March 2017, we closed both recommendations from OIG Report No. 533.

**Resource Optimization Study Recommendations.** With regard to the efficiency study mentioned in Recommendation 1 from OIG Report No. 533, in September 2015, the SEC commissioned Enterprise Resource Performance, Inc. (ERPi) to conduct a resource optimization study of EXAMS to provide advice and recommendations for increasing its organizational efficiency and effectiveness. Throughout the 12-month assessment, the ERPi team gathered data and interviewed a wide array of National

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<sup>4</sup> U.S. Securities and Exchange Commission, *Division of Examinations, 2021 Examination Priorities* (March 3, 2021).

<sup>5</sup> According to policy, examination staff may conduct the entire examination without going onsite by using correspondence and telephone interviews to gather necessary information. During examination planning, staff determine whether the examination could be conducted as a correspondence examination without the need for an onsite visit.

<sup>6</sup> On December 17, 2020, the Commission unanimously supported the decision to rename the Office of Compliance Inspections and Examinations the “Division of Examinations.”

<sup>7</sup> The EPSC is now the Exam Process Advisory Committee.

Examination Program (NEP) examiners, examination managers, assistant regional directors, associate regional directors, regional directors, and national leadership. The study also assessed NEP's tools, technologies, and methodologies; analyzed SEC/NEP strengths, weaknesses, and trends; and developed recommendations. In November 2016, ERPi provided EXAMS management the study's results, along with 20 recommendations categorized into the following 4 themes:

1. Modify organizational structures and roles to enable efficiency in examinations.
2. Improve scheduling, workload management, and data collection in the examination process.
3. Drive efficiency and effectiveness by further enabling examiners.
4. Embed methods and processes to monitor, control, and improve the NEP.

We discuss actions taken in response to ERPi's recommendations on page 6 of this document.

**EPSC Recommendations.** With regard to the steering committee recommendations mentioned in Recommendation 1 from OIG Report No. 533, in 2014, EXAMS's Risk and Exam Process Steering Committee reviewed each regional office's process for selecting examination candidates to determine whether additional guidance was needed to enhance and promote consistency across the Division. In November 2014, the steering committee issued to EXAMS senior management a draft memorandum stating that, among other things, "...the significant differences among the examination candidate selection processes is an area of exposure for the NEP," and recommending that EXAMS management consider defining the minimal steps for selecting candidates for examination. When we issued OIG Report No. 533 in March 2016, the memorandum was still a draft document. In November 2016, the EPSC issued the final memorandum to EXAMS senior management, including the observations and recommendations about the process for selecting registrants for IA/IC examinations. The final memorandum noted that, although regional selection processes may vary somewhat, the EPSC favored regional variation and autonomy, which was largely driven by differences in registrant composition, regional office staffing levels, and other factors. However, the EPSC acknowledged that, although there was overwhelming support for continued regional autonomy, there was also broad support for some minimum common procedures, as suggested in OIG Report No. 533. The memorandum included five recommendations for improving the IA/IC examination program's examination candidate selection processes. We discuss actions taken in response to these recommendations on page 7 of this document.

**GAO's Risk-Management Framework.** As previously stated, Recommendation 2 from OIG Report No. 533 asked EXAMS to consider fully implementing GAO's risk-management framework in the IA/IC examination program.<sup>8</sup> OIG Report No. 533 pointed out that GAO had reported on the benefits of risk management and identified elements of a risk-management framework for federal agency oversight

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<sup>8</sup> In 2005, GAO developed the risk-management framework based on best practices, Office of Management and Budget circulars, GAO's *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999), and the Government Performance and Results Act of 1993. In a December 2016 report to the Committee on Oversight and Government Reform, U.S. House of Representatives, GAO updated its risk-management framework to more fully include evolving requirements and essential elements for federal enterprise risk management; see U.S. Government Accountability Office, *ENTERPRISE RISK-MANAGEMENT: Selected Agencies' Experiences Illustrate Good Practices in Managing Risk* (GAO-17-63, December 2016).

efforts. According to GAO, risk management is a strategy for helping make decisions about assessing risks, allocating resources, and taking actions under conditions of uncertainty.<sup>9</sup> As Table 1 shows, GAO's risk-management framework has five phases. We discuss actions taken to implement the framework on page 9 of this document.

**TABLE 1. GAO Risk-Management Framework**

Phase	Definition
1. Strategic Goals, Objectives, and Constraints Identification	Identifying the strategic goals that an agency is trying to achieve and the steps needed to attain those goals, including determining limitations or constraints that can affect the desired outcomes.
2. Risk Assessment	Identifying the key aspects of potential risks.
3. Alternatives Evaluation	Considering measures to reduce the identified risks.
4. Management Selection	Management selecting where resources and investments will be made based on selecting the appropriate alternatives for reducing risks.
5. Implementation and Monitoring	Applying and monitoring the selected alternatives for reducing risk to help ensure ongoing effectiveness, including the implementation of new policies, procedures, and controls and how these procedures are documented and maintained.

Source: U.S. Government Accountability Office, *SEC Can Further Enhance Its Oversight Program of FINRA* (GAO-15-376, April 2015).

## OBJECTIVES

The overall objective of this audit was to determine whether EXAMS has established effective controls over its RIA examination planning processes to foster compliance with federal securities laws and ensure efficient allocation of its limited RIA examination resources. We also followed up on the implementation of corrective actions in response to the two recommendations from OIG Report No. 533.

To address our objectives, among other work performed, we (1) met with representatives from EXAMS' Office of Chief Counsel to gain an understanding of the Exam Manual (containing the Division's examination procedures); (2) performed walkthroughs of EXAMS' systems and tools, including the Tracking and Reporting Examination National Documentation System (TRENDS) and the new TRENDS Cloud system; (3) selected a nonstatistical, random sample of 501 closed RIA examinations from our scope period of FY 2019 through FY 2021, quarter 2 for testing, and tested examination planning attributes; and (4) obtained and reviewed documents and information supporting the actions taken to address the two recommendations made in OIG Report No. 533.

Appendix I includes additional information about our scope and methodology, including our review of internal controls and prior coverage.

<sup>9</sup> U.S. Government Accountability Office, *Further Refinements Needed to Assess Risks and Prioritize Protective Measures at Ports and Other Critical Infrastructure* (GAO-06-91, December 2005).

# Results

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We found that EXAMS has taken steps to address both recommendations from OIG Report No. 533, which aided in ensuring efficient allocation of its limited RIA examination resources during the period we reviewed. We sampled and tested RIA examination planning processes and controls including background reviews, identification of risks, examination scoping, supervisory review, and asset verification procedures. Effective processes and controls help ensure that EXAMS identifies noncompliance with federal securities laws and makes efficient use of its limited resources. We found that most processes and controls operated effectively during the period we reviewed; however, some need improvement.

## **FINDING 1. AS RECOMMENDED, EXAMS HAS UPDATED AND IMPROVED ITS PROCESSES FOR ASSESSING RISK AND SELECTING RIAs FOR EXAMINATION**

We determined that EXAMS implemented corrective actions in response to the two recommendations from our prior evaluation. Specifically, in response to OIG Report No. 533, Recommendation 1, management considered the results of the ERPI resource optimization study and the EPSC memorandum and took actions to implement recommendations from both. In addition, management's response to OIG Report No. 533, Recommendation 2, led to the creation of a new risk-management framework for the IA/IC examination program. Implementing these recommendations has resulted in efforts to optimize EXAMS' limited resources, increase the Division's efficiency and effectiveness, improve IA/IC candidate selection processes, and realize the benefits of GAO's risk-management framework to help address the risks facing the IA/IC examination program.

### **EXAMS' Response to Resource Optimization Study Recommendations**

We determined that EXAMS considered the 20 ERPI resource optimization study recommendations. We reviewed documents supporting management's review and analyses of ERPI's 20 recommendations, actions taken to implement 13 of the recommendations, and rationale for not implementing the remaining 7 recommendations. We followed up with EXAMS personnel for additional information, clarification, and supporting documents regarding implemented and not-implemented recommendations. Additionally, EXAMS provided walkthrough demonstrations of the systems supporting the IA/IC examination program, including the TRENDS Cloud system. To optimize its limited resources and increase efficiency and effectiveness, as recommended by ERPI, EXAMS:

- *Moved TRENDS to a new, cloud-based platform.* According to EXAMS management, this new platform is expected to improve the system's adaptability, workflow capability, and data standardization.
- (b)(5); (b)(8)  
[REDACTED]

- *Took steps to promote the adoption of existing tools and technology.* EXAMS' Office of Technology Solutions conducted regional "road shows" to highlight tools and professional services offered, including centralized asset verification and eDiscovery support for examination teams. In February 2020, EXAMS also refreshed its new examiner training to integrate the use of relevant systems and technology into the "mock exam" portion of the training. Lastly, EXAMS launched a new examination support service, which, among other things, assists examiners with data staging, cleansing, transformation, enrichment, and analysis.
- *Advanced its centralized asset verification program.* According to EXAMS management, this effort has enabled growth in the number of exams involving asset verification, as well as the amount of assets verified during these exams. By adding contractor resources and introducing additional tools, EXAMS' reports have reduced examiner burden by continuously improving the efficiency of the examination process to allow for requests of data from a larger population of accounts rather than relying on smaller samples of data.
- *Engaged in a pilot program to advance risk-based prioritization through analysis of public data.*

(b)(8)

## EXAMS' Response to EPSC Recommendations

We determined that EXAMS accepted and/or addressed the five EPSC recommendations for improving the IA/IC examination program's processes for selecting registrants for examination. The EPSC recommended that minimum common procedures and documentation processes be required for each regional IA/IC examination program, including adopting and implementing procedures for analyzing registrant populations each year and reviewing certain key common information sources. In response, each regional office:

- *Created and maintained regional registrant review, risk analyses, and examination selection processes.* Each region has documented in an exam-planning memorandum the sources of information relied on to analyze and assess the risks in regional registrant populations, as well as the general methodology each region uses to determine which registrants to select for examination.
- *Created and submitted to the National Associate for the IA/IC examination program annual regional examination plans.* The plans include, at a minimum, an estimate of the number of exams that each region expects to initiate (allocated by examination category and subcategory), as well as the names of registrants identified for examination.

In addition, as recommended, EXAMS updated the Exam Manual to reflect the adoption of the EPSC recommendations and made all Division staff aware of the updates on August 1, 2017. The Division also created an Exam Planning and Registrant Selection Practices Working Group in response to an EPSC recommendation. EXAMS management created the group to act as a forum for regional representatives to discuss registrant selection processes with a view toward considering implementing successful registrant selection practices employed in other regions. EXAMS management also adopted a

recommendation to develop additional analysis tools—based on suggestions from a number of regions—and, as a result, developed and/or enhanced new and existing resources to assist risk-based decision making by EXAMS staff. Finally, the Division leveraged technology developed by other SEC divisions.

In creating the exam-planning memorandum described above, each region is expected to consider certain information. This includes the Division’s annual statement on recognized examination priorities, which provides insights into EXAMS’ risk-based approach, including the areas the Division believes present potential risks to investors and the integrity of the United States capital markets. We reviewed the published annual examination priorities from FY 2017 through FY 2021, as well as the priorities examiners assigned to each of the 4,993 RIA examinations included in our audit universe. [REDACTED]

[REDACTED]

(b)(7)(E); (b)(8) [REDACTED]

## EXAMS' Efforts To Implement GAO's Risk-Management Framework

In response to OIG Report No. 533, Recommendation 2, EXAMS took steps to fully implement GAO's risk-management framework in the IA/IC examination program. The SEC procured the services of IBM Global Business Services to interpret and recommend how to apply the concepts of GAO's risk-management framework to EXAMS' inspection and examination programs, including the IA/IC examination program. We obtained and reviewed key deliverables provided by IBM, including the *IA/IC Program Risk-Management Framework Playbook*. The purpose of this Playbook was to communicate the procedures for implementing and executing the IA/IC examination program risk-management framework. Based on guidance provided in the Playbook, EXAMS developed an IA/IC examination program strategic plan and risk matrix to support the implementation of the risk-management framework. The *IA/IC Examination Program Strategic Plan for FY 2020* includes the following four strategic goals:

- Strategic Goal 1:** Develop risk-based priorities and registrant selection procedures to use the IA/IC examination program's limited resources effectively.
- Strategic Goal 2:** Conduct quality, risk-based examinations of RIAs and registered investment companies in furtherance of EXAMS' mission and examination priorities.
- Strategic Goal 3:** Maintain national staff proficiency across all aspects of IA/IC regulation.
- Strategic Goal 4:** Effectively inform stakeholders of regulatory issues, trends, and developments.

These 4 strategic goals are supported by 28 objectives, some of which are tied to actions taken in response to the previously discussed resource optimization study and EPSC recommendations. For example, one of the objectives under Strategic Goal 1 is for regional and SEC Headquarters IA/IC examination program staff to create and annually review local processes for selecting registrants to examine, (b)(8)

Another objective for Strategic Goal 1 is for each regional office and Headquarters to implement annual examination plans.

We reviewed and verified actions taken by EXAMS to implement and monitor IA/IC examination program strategic goals and objectives and determined that the risk matrix created by EXAMS addresses the five phases of GAO's risk-management framework described in Table 1. The risk matrix includes EXAMS' 4 strategic goals and 28 objectives, with at least one potential risk identified for each objective and scored on likelihood and impact. The risk matrix also describes at least one corresponding risk response and/or internal control for each potential risk and includes alternative responses and internal controls. To implement and monitor the risk matrix, EXAMS has named key performance indicators related to each objective, as well as risk response/internal control documentation. Some key performance indicators are quantifiable measures of performance, such as the number of exams of unique registrants completed by the IA/IC examination program. Others are less measurable but indicate that work has been completed.

## Conclusion

Overall, we concluded that EXAMS has worked to (1) optimize its limited resources and increase efficiency and effectiveness, (2) improve its IA/IC examination program's examination candidate selection processes, and (3) implement GAO's risk-management framework, specifically, within the IA/IC examination program. OIG Report No. 533 noted that, in FY 2015, the average

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*Between FYs 2015 and 2021,  
the annual average number of IA/IC  
examinations completed per  
examiner increased from about three  
to almost six*

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number of IA/IC examinations completed per examiner was about three. That number nearly doubled to almost six in FY 2021. Additionally, in FY 2015, EXAMS met its annual goal of examining 10 percent of RIAs. Notably, the percentage of RIAs examined improved to 15 percent in FY 2020 and 16 percent in FY 2021, even though the RIA population continued to increase and the pandemic necessitated remote examining.

Because EXAMS has taken steps to address both recommendations from OIG Report No. 533, which aided in ensuring efficient allocation of its limited RIA examination resources during the period we reviewed and helped address the risks facing the IA/IC examination program, we are not making any recommendations for corrective action at this time.

## **FINDING 2. CONTROLS OVER SOME RIA EXAMINATION PLANNING PROCESSES NEED IMPROVEMENT**

As previously noted, industry growth, increased complexity, and other factors, have increased the inherent risks to the IA/IC examination program. Effective examination planning processes and controls, including required background research, documented risk assessments, examination scoping and staffing determinations, and associated supervisory reviews and approvals help ensure that the SEC efficiently and effectively examines RIAs and assesses their compliance with federal securities laws.

We selected a nonstatistical, random sample of 501 RIA examinations from the audit universe of 4,993 RIA examinations approved and closed during our scope period of FY 2019 through FY 2021, quarter 2.<sup>12</sup> Our sample represented 10 percent of the universe, stratified by SEC regional office and SEC Headquarters. For each examination in our sample, we tested key examination planning processes and controls and found that 23 of 26 processes and controls we tested (or about 88 percent) operated effectively; however, controls over the remaining RIA examination planning processes need improvement. Specifically, as we describe further below, some staff commenced substantive RIA examination procedures before management approved the examination pre-fieldwork phase. In addition, staff did not always consistently maintain key documents in TRENDS, namely documents related to communication with examined registrants. Lastly, as discussed on page 15 of this document, we were unable to find documentation indicating that an examination supervisor notified registrants of non-Division staff participation, as required, for the majority of RIA examinations we reviewed that included non-Division staff.

### **Some Staff Commenced Substantive RIA Examination Procedures Before Management Approved the Examination Pre-Fieldwork Phase**

Exam Manual section 5.05 states that supervisors should approve examination pre-fieldwork in TRENDS before substantive examination procedures commence. For exams that include fieldwork (such as on-site visits), substantive examination procedures commence with the first date of fieldwork. For correspondence examinations, which do not include on-site visits, substantive examination procedures commence with the date of the first interview or document request of the examined registrant targeting a scope area.

Examination management documented pre-fieldwork approval for each examination we reviewed, yet for 81 of the 501 RIA examinations in our sample (or about 16 percent), staff commenced substantive RIA examination procedures before management approved the examination pre-fieldwork phase. We found that 50 of the 81 late approvals occurred because staff commenced substantive examination procedures before first requesting management's approval. For the remaining 31 examinations, staff requested management's approval first, as required, but management failed to provide timely approval. As a result, pre-fieldwork approval—a primary control for ensuring, among other things, that staff execute examinations in accordance with Division policies and procedures—occurred between 1 and 391 days late (or an average of 54 days late) for the 81 RIA examinations in question. In these instances, staff

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<sup>12</sup> Appendix I includes additional information about our sampling methodology.

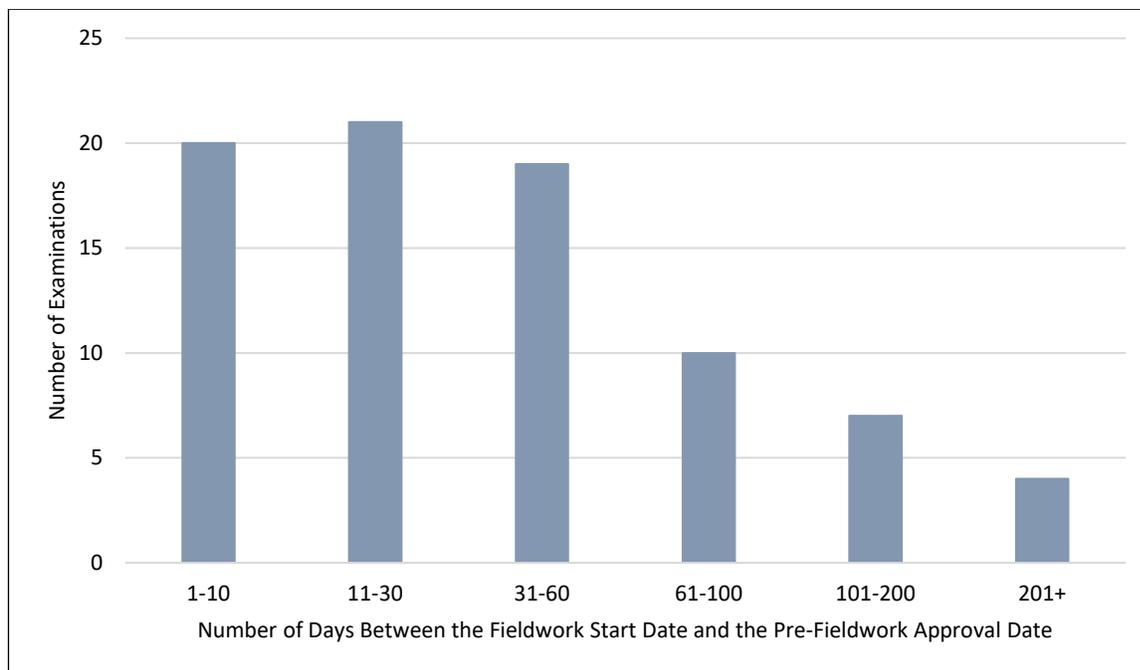
were able to commence substantive examination procedures without management’s approval because the legacy TRENDS system did not include appropriate controls.

*In our sample, pre-fieldwork approvals occurred, on average, 54 days late for 81 examinations*

As Figure 4 shows, pre-fieldwork approval for the 81 examinations in question most often occurred between 1 and 60 days late. For 10 of these 81 examinations, the examination outcome was set before management approved the examination

pre-fieldwork phase, meaning examiners had completed fieldwork and prepared either a deficiency letter, a no comment letter, or a no action letter, communicating to the examined registrant the examination results. Notably, these 81 exceptions were distributed across RIA examinations conducted by the SEC’s regional offices and Headquarters, and we did not identify any meaningful trends to explain their occurrence. However, all examination personnel have access to the Exam Manual and are notified of updates to examination requirements; therefore, examination personnel should be aware of the requirement for management to review and approve each examination’s pre-fieldwork phase before staff commences substantive examination procedures.

**FIGURE 4. Summary of Examinations for Which Pre-Fieldwork Approval Occurred Late**



Source: *OIG-generated based on testing of 501 RIA examinations approved and closed between FY 2019 and FY 2021, quarter 2.*

EXAMS management told us that, in their FY 2020 internal control testing, they self-identified a control deficiency relating to timely scope approvals. EXAMS management also informed us that, over the last six months, they have taken a number of steps to help remediate this deficiency, including establishing a timeliness standard for approving examination scope and instituting a process to monitor and follow up on exams that are potentially ready for scope approval.

Management's approval of each examination's pre-fieldwork phase is important because it includes supervisory review of key examination planning and scoping processes, including staff's review of pertinent registrant filings, financial information, SEC investigations, suspicious activity reports, and Bank Secrecy Act reports, among other things. Moreover, EXAMS management reports that pre-fieldwork processes, including supervisory approval, are among the primary controls to ensure that examinations are staffed with examiners who have the appropriate expertise and skills, and that staff execute examinations in accordance with Division policies and procedures. Without such assurance, the Division may hinder its ability to protect investors, uncover or prevent fraud, monitor risk within the financial markets, and help inform policy through examinations. In sum, the timely submission, review, and approval of the examination pre-fieldwork phase is key to ensuring EXAMS establishes and maintains effective controls over its RIA examination planning processes and ensures efficient use of its limited staff resources.

### **Staff Did Not Always Consistently Maintain Key Documents in TRENDS**

Exam Manual section 6.03 states that, for all examinations, staff should include in the "Communications" section of TRENDS evidence that staff sent to the examined registrant certain required documents, including the examination brochure and a Form 1661.<sup>13</sup> Staff must also record the date the documents were sent, to whom they were sent, and by what method they were delivered. Additionally, Exam Manual section 7.01 explains that all document requests and communications should be uploaded to TRENDS.

For 70 of the 501 RIA examinations we reviewed (or about 14 percent), staff either did not (1) ensure TRENDS included evidence of required communications with examined registrants (that is, we were not able to find required documents in TRENDS); or (2) maintain documents in the Communications section of TRENDS, as required. In these instances, we were able to locate required documents in other sections of the system.

EXAMS management explained that, if staff fail to upload or attach documentation in the appropriate section of TRENDS, the documents should still be found in the TRENDS document library. During our review, we noted inconsistencies in policies. For example, whereas Exam Manual section 6.03 states that staff should maintain documents in TRENDS' Communications section, section 7.01 states that documents only need be uploaded to TRENDS.

Varying documentation policies and guidance may lead to inconsistent documentation of examinations, as we observed, and difficulties in reviewing and supervising examinations. For example, our review was hindered by inconsistent documentation practices, and some key examination documents were found only in mass e-mail uploads by examination staff.

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<sup>13</sup> Form 1661 is a Privacy Act notice providing supplemental information for entities subject to inspection by the Commission and directed to supply information other than pursuant to Commission subpoena.

## RECOMMENDATIONS, MANAGEMENT'S RESPONSE, AND EVALUATION OF MANAGEMENT'S RESPONSE

To improve internal controls over RIA examination planning processes, we recommend that EXAMS:

### Recommendation 1:

Develop controls that help ensure timely supervisory approval of an examination's pre-fieldwork phase.

**Management's Response.** Management concurred with the recommendation. According to the Acting Director of EXAMS, the Division will consider and develop additional controls to ensure the timely supervisory approval of an examination's pre-fieldwork phase. Management's complete response is reprinted in Appendix II.

**OIG's Evaluation of Management's Response.** Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon verification of the action taken.

### Recommendation 2:

Reiterate to examination staff and management the importance of and requirements for timely supervisory approval of each examination's pre-fieldwork phase.

**Management's Response.** Management concurred with the recommendation. According to the Acting Director of EXAMS, the Division will reiterate to examination staff and management the importance of and requirements for timely supervisory approval of each examination's pre-fieldwork phase. Management's complete response is reprinted in Appendix II.

**OIG's Evaluation of Management's Response.** Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon verification of the action taken.

### Recommendation 3:

Review examination documentation requirements regarding communications with registrants to ensure they are clear and examiners maintain such documentation in a consistent manner; update examination policies as needed.

**Management's Response.** Management concurred with the recommendation. According to the Acting Director of EXAMS, EXAMS will review documentation requirements regarding communications with registrants to ensure they are clear and maintained in a consistent manner, and will update division polices, as necessary. Management's complete response is reprinted in Appendix II.

**OIG's Evaluation of Management's Response.** Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon verification of the action taken.

## Other Matter of Interest

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During our audit, we identified a matter that did not warrant a recommendation. We discussed this matter, described below, with EXAMS management for their consideration.

### **Examination Management Did Not Document Registrant Notification of Non-Division Staff Participation in RIA Examinations**

Exam Manual section 5.08 states that, before non-Division staff participate in on-site meetings or telephone calls, or otherwise have initial contact with a registrant, an examination manager or higher-level supervisor should inform the registrant that such staff will be participating in the examination. In addition, when notifying the registrant, EXAMS personnel should disclose the non-Division staff's name, title, and office or division. However, section 5.08 does not require EXAMS personnel to document this disclosure.

During our review, we found that 8 of the 501 examinations we reviewed (or about 2 percent) included non-Division staff participation. However, for seven of these eight examinations (or about 88 percent), we were unable to find evidence that an examination supervisor notified registrants of non-Division staff participation.<sup>14</sup> EXAMS management acknowledged the requirement to notify registrants of non-Division staff participation, but stated that EXAMS personnel are not required (by policy) to document the notification in TRENDS.

Examined registrants should be aware of all SEC staff participating in an examination before an on-site meeting or call with the examination team. Without requiring staff to maintain evidence of such notification, EXAMS management may be unable to ensure compliance with the applicable requirement. We encourage EXAMS management to review its policies and practices pertaining to this requirement.

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<sup>14</sup> Non-Division staff who participated in these seven examinations included staff from the Division of Trading and Markets and the Division of Investment Management. The examinations did not include staff from the Division of Enforcement.

## Appendix I. Scope and Methodology

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We conducted this performance audit from May 2021 through January 2022 in accordance with generally accepted government auditing standards. Those 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.

### Objectives and Scope

Our audit covered EXAMS' RIA examination planning processes and approved RIA examinations closed in TRENDS between October 1, 2018, and March 31, 2021 (that is, FY 2019 through FY 2021, quarter 2). The overall objective was to determine whether EXAMS has established effective controls over its RIA examination planning processes to foster compliance with federal securities laws and ensure efficient allocation of its limited RIA examination resources. We also followed up on the implementation of corrective actions from the prior OIG evaluation, *Office of Compliance Inspections and Examinations' Management of Investment Adviser Examination Coverage Goals* (OIG Report No. 533; dated March 10, 2016).

### Methodology

To address our objectives, among other work performed, we gathered information to become familiar with EXAMS and interviewed pertinent personnel. Specifically, we:

- met with representatives from EXAMS' Office of Chief Counsel to gain an understanding of the Exam Manual (containing the Division's examination procedures);
- performed walkthroughs of EXAMS' systems and tools, including TRENDS and the new TRENDS Cloud system;
- reviewed applicable federal laws and guidance, and relevant SEC policies; and
- obtained and reviewed documentation and information supporting the actions taken to address the recommendations made in OIG Report No. 533.

We also selected and reviewed a nonstatistical, random sample of 501 RIA examinations from the audit universe of 4,993 RIA examinations approved and closed during our scope period.<sup>15</sup> We stratified the sample by SEC office, as Table 2 illustrates.

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<sup>15</sup> During our scope period, EXAMS approved 5,164 RIA examinations. However, we removed from the audit universe 144 RIA examinations that were not closed in TRENDS and 27 examinations that began in 2017, before key examination planning requirements went in to effect on August 1, 2017. This resulted in an adjusted audit universe of 4,993 approved and closed RIA examinations.

**TABLE 2. Number of RIA Examinations Sampled by FY and SEC Office**

SEC Office	No. From FY 2019	No. From FY 2020	No. From FY 2021 Q1-Q2	Total Sample Size
Atlanta	13	13	5	31
Boston	25	23	7	55
Chicago	25	25	9	59
Denver	13	12	4	29
Fort Worth	14	13	5	32
Headquarters	13	10	2	25
Los Angeles	20	17	7	44
Miami	7	6	3	16
New York	41	50	20	111
Philadelphia	24	21	6	51
Salt Lake <sup>16</sup>	-	-	-	-
San Francisco	21	20	7	48
<b>Total</b>	<b>216</b>	<b>210</b>	<b>75</b>	<b>501</b>

Source: *OIG-generated based on TRENDS approved examinations reports.*

We identified examination planning requirements and tested each examination sampled for compliance. Specifically, for each examination in our sample, we accessed TRENDS and reviewed the examination file and supporting documentation to determine whether procedures were followed and controls were operating effectively. We discussed testing exceptions with EXAMS management, as Finding 2 describes. As Finding 1 describes, we also reviewed a subset of the 501 sampled RIA examinations to determine whether examination fieldwork addressed assigned examination priorities. We randomly selected 55 of the 501 RIA examinations from our larger sample, stratified by the SEC's 11 regional offices (5 examinations from each). For each examination included in the subset, we reviewed examination documentation and priorities information contained in TRENDS. We used an Excel random number generator to select sample items, and our sampling was non-statistical; therefore, our results cannot be projected.

## Internal Controls

We identified and assessed internal controls, applicable internal control components, and underlying principles significant to our objectives, as described below.

**Control Environment.** We assessed the control environment established by EXAMS senior management. We reviewed EXAMS' organizational structure and interviewed staff responsible for reviewing and maintaining internal control documentation. We also met with those assigned responsibility

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<sup>16</sup> The Salt Lake Regional Office did not perform any RIA examinations during our scope period. According to EXAMS management, the Salt Lake Regional Office does not have a dedicated examination staff, and the Denver Regional Office conducts examinations of RIAs located in the Salt Lake region.

for achieving EXAMS' objectives, including EXAMS' former Director,<sup>17</sup> Deputy Director, Managing Executive, Acting Chief Counsel, and an Assistant Director.

**Risk Assessment.** We obtained and reviewed EXAMS' FYs 2019 and 2020 management self-assessments and risk control matrices to identify risks and controls related to examination planning processes. We assessed risks recognized by EXAMS management and identified risks we determined to be inherent to examination planning, risk assessment, and registrant selection, including those discussed in the Division's *2021 Examination Priorities*. We also reviewed a security assessment report, system security plan, and the system authorization to operate document for TRENDS.

**Control Activities.** We reviewed applicable federal guidance, SEC-wide policies and procedures, EXAMS standard operating procedures, and risk and control matrices to identify and test key control activities. We reviewed control activities related to the supervisory review of examination background research, examination scope, and staffing (collectively referred to as pre-fieldwork), as well as controls for supplemental changes to examination scope. We also reviewed controls related to registrant review, risk assessment, and examination selection documentation, including examination selection processes memoranda and annual plans. We discuss our review and testing of these controls in Findings 1 and 2.

**Information and Communication.** EXAMS management internally communicates its policies and procedures related to the IA/IC examination program through the Exam Manual, EXAMS staff e-mails, and materials posted to its internal web site. EXAMS has an internal site with reference guides, job aids, policies, and other guidance. Furthermore, EXAMS management externally communicates annual examination priorities.

**Monitoring.** We reviewed EXAMS' internal control documentation and standard operating procedures, and discussed with EXAMS management its roles and responsibilities for monitoring the IA/IC examination program. EXAMS management oversees and monitors examination status using internal dashboards and reports. We received a walkthrough of applicable EXAMS systems, including TRENDS, TRENDS Cloud, and other tools.

As this report notes, we found that, overall, EXAMS has improved and updated its processes for assessing risk and optimizing its limited resources and has established an effective internal control system. However, we identified areas for potential improvement related to internal controls within the context of our objectives. Our recommendations, if implemented, should help strengthen aspects of EXAMS' RIA examination management.

## Data Reliability

GAO's *Assessing Data Reliability* (GAO-20-283G, December 2019) states reliability of data means that data are applicable for audit purpose and are sufficiently complete and accurate. Data primarily pertains to information that is entered, processed, or maintained in a data system and is generally organized in, or

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<sup>17</sup> The EXAMS Director left the agency on August 14, 2021.

derived from, structured computer files. Furthermore, GAO-20-283G defines “applicability for audit purpose,” “completeness,” and “accuracy” as follows:

“Applicability for audit purpose” refers to whether the data, as collected, are valid measures of the underlying concepts being addressed in the audit’s research objectives.

“Completeness” refers to the extent that relevant data records and fields are present and sufficiently populated.

“Accuracy” refers to the extent that recorded data reflect the actual underlying information.

To address our objectives, we relied on computer-processed data generated by TRENDS. Specifically, we relied on approved examinations totals generated by TRENDS for our scope period of FY 2019 through FY 2021, quarter 2. To assess the reliability of TRENDS reports, we interviewed responsible EXAMS personnel, reviewed relevant system documentation, performed a walkthrough of TRENDS, and performed data validation tests. We tested the computer-processed data for duplicate records and missing data, and we compared totals to published agency totals. Based on our assessment, we found the data sufficiently reliable for the purpose of this audit.

## Prior Coverage

Between 2016 and 2020, the SEC OIG and GAO issued the following reports of particular relevance to this audit:

### SEC OIG:

- *Office of Compliance Inspections and Examinations’ Management of Investment Adviser Examination Coverage Goals* (Report No. 533, March 2016).
- *Audit of the Office of Compliance Inspections and Examinations’ Investment Adviser Examination Completion Process* (Report No. 541, July 2017).
- *TCP Established Method To Effectively Oversee Entity Compliance With Regulation SCI But Could Improve Aspects of Program Management* (Report No. 551, September 2018).

### GAO:

- *Securities and Exchange Commission: Management Has Enhanced Supervisory Controls and Could Further Improve Efficiency* (GAO-17-16, October 2016).
- *Securities and Exchange Commission: Systematically Assessing Staff Procedures and Enhancing Control Design Would Strengthen Internal Oversight* (GAO-20-115, December 2019).

These reports can be accessed at <https://www.sec.gov/oig> (SEC OIG) and <https://www.gao.gov> (GAO).

## Appendix II. Management Comments

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### MEMORANDUM

TO: Rebecca L. Sharek  
Deputy Inspector General for Audits, Evaluations, and Special Projects  
Office of the Inspector General

FROM: Daniel Kahl   
Acting Director, Division of Examinations

RE: Division of Examination's Response to the Office of Inspector General's draft Report, *Registered Investment Adviser Examinations: EXAMS Has Made Progress to Assess Risk and Optimize Limited Resources, But Could Further Improve Controls Over Some Processes*

DATE: January 10, 2022

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The Division of Examinations ("EXAMS") submits this memorandum in response to the Office of Inspector General's ("OIG") draft report titled *Registered Investment Adviser Examinations: EXAMS Has Made Progress to Assess Risk and Optimize Limited Resources, But Could Further Improve Controls Over Some Processes* ("Report").

EXAMS appreciates the OIG's recognition that over the last several years it has taken steps to (1) optimize its limited resources and increase its efficiency and effectiveness; (2) improve the IA/IC program's examination candidate selection process; and (3) implement the GAO's risk management framework within the IA/IC program.

Furthermore, EXAMS also appreciates the OIG's confirmation through rigorous testing of 501 IA/IC examinations that nearly 90 percent of key IA/IC examination planning processes and controls operated effectively. EXAMS welcomes the OIG's recommendations to further strengthen certain of its internal controls, and, as discussed in the Report, EXAMS has already taken several steps to address the OIG's recommendations.

Our response to the recommendations is in Appendix A. EXAMS will also consider the other matter of interest identified in the Report.

### Appendix A: Management's Responses to OIG's Recommendations

The following are management's responses to each of the recommendations provided in the OIG report.

**Recommendation 1:** Develop controls that help ensure timely supervisory approval of an examination's pre-fieldwork phase.

**Response:** We concur. In addition to the steps already recognized in the OIG report, EXAMS will consider and develop additional controls to ensure the timely supervisory approval of an examination's pre-fieldwork phase.

**Recommendation 2:** Reiterate to examination staff and management the importance of and requirements for timely supervisory approval of each examination's pre-fieldwork phase.

**Response:** We concur. In addition to the steps already recognized in the OIG report, EXAMS will reiterate to examination staff and management the importance of and requirements for timely supervisory approval of each examination's pre-fieldwork phase.

**Recommendation 3:** Review examination documentation requirements regarding communications with registrants to ensure they are clear and examiners maintain such documentation in a consistent manner; update examination policies as needed.

**Response:** We concur. EXAMS will review examination documentation requirements regarding communications with registrants to ensure they are clear and maintained in a consistent manner, and will update Division policies, as necessary.

## Major Contributors to the Report

Colin Heffernan, Audit Manager

John Gauthier, Lead Auditor

Louis Perez Berrios, Auditor

Matthew Fryer, Auditor

## Comments and Suggestions

If you wish to comment on the quality or usefulness of this report or suggest ideas for future audits, evaluations, or reviews, please send an e-mail to OIG Audit Planning at [AUDplanning@sec.gov](mailto:AUDplanning@sec.gov).

Comments and requests can also be mailed to the attention of the Deputy Inspector General for Audits, Evaluations, and Special Projects at the address listed below.

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