

# OFFICE OF ECONOMIC ANALYSIS

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## **EXECUTIVE SUMMARY**

*Our review of the Office of Economic Analysis (OEA) found that OEA's work (including research studies and rule-making analyses) is beneficial to the Commission. Commission senior staff were complimentary of OEA's assistance. Some staff made suggestions to enhance that assistance.*

*We also found that the Chief Economist hired motivated staff whose interests are aligned with Commission interests, sought to produce high-quality analyses and encouraged staff to take advantage of training opportunities.*

*Our recommendations concern training OEA's managers; dividing office operations between the Chief Economist and other OEA managers; Commission awareness of OEA's services; guidance to OEA management on Commission expectations; and enhancing OEA's internal operations, policies and procedures.*

*OEA generally agreed with the report's recommendations.*

## **OBJECTIVES AND SCOPE**

Our objectives were to evaluate the usefulness of OEA's activities and to identify possible improvements. We began the audit after receiving information that several OEA staff were working on projects that were not considered useful to the Commission, the office was mismanaged and productivity has declined.

Certain staff members raised various issues with the Commission's Office of Equal Employment Opportunity (EEO). Although we considered the EEO issues during our review, they were not a focus of our analysis.

During the survey, we interviewed OEA and other Commission staff, and reviewed OEA work products and files. We also contacted staff in the economic analysis departments of two other federal government agencies (the Commodities Futures Trading Commission and the Federal Trade Commission) to benchmark the Commission's program and to identify possible best practices. We also followed up on recommendations in our prior review of OEA (Audit No. 251, issued February 7, 1997).

The audit was performed from February 2004 to May 2004 in accordance with generally accepted government auditing standards.

## BACKGROUND

Currently, OEA has 34 staff, consisting primarily of economists with backgrounds in finance, economics or related fields. Eight of the staff are university professors appointed to a one or two year term under the Intergovernmental Personnel Act (IPA).

The IPA program allows employees of non-Federal organizations to be temporarily assigned to federal agencies for up to two years. The program's purpose is to improve government operations by obtaining staff with specialized knowledge and experience. IPA assignments allow the sharing of scarce expertise between the government and outside organizations (*e.g.*, educational institutions), and provide valuable experience for IPA staff.

A Chief Economist and a Deputy Chief Economist manage OEA. In addition, OEA plans to hire four additional managers as part of a Commission-approved reorganization.

OEA's current Chief Economist, a university professor who took a two-year leave of absence to join the Commission, is leaving the Commission in June 2004, to return to his university.

OEA primarily serves to support the work of the Commission. The Office provides economic analysis and expertise during rulemaking and other Commission projects. OEA also performs independent research to enable the Commission to better understand the securities markets and thereby enhance market oversight.

Some examples of recent work by OEA follow:

- Assisting the Division of Enforcement in calculating the monetary harm to be assessed on securities law violators;
- Analyzing the transparency of municipal and corporate bond transaction data for the Office of Municipal Securities;
- Researching the effect that certain illegal acts have on security prices;
- Analyzing mutual fund data to help the Commission target companies that may be engaged in market-timing and after-hours trading;
- Performing studies to measure the impact of decimalization and short-selling on the market;
- Providing advice to the Commission regarding the valuation of derivatives in company financial statements;
- Providing assistance to the Chief Accountant on pension accounting issues;
- Evaluating the Management Discussion and Analysis sections of public company financial statements to determine if they contain adequate disclosures; and
- Analyzing corporate off-balance sheet transactions, based on a Sarbanes-Oxley Act Congressional requirement.

## AUDIT RESULTS

We found that the OEA staff were working on projects that were useful to the Commission. Moreover, the staff collectively appeared to have the necessary expertise and experience to fulfill the Office's mission of providing economic analysis to the Commission.

We also found that the Chief Economist hired motivated staff whose interests are aligned with Commission interests, has encouraged staff to take advantage of training opportunities and sought to produce high-quality analyses.

Commission senior staff were complimentary of OEA's assistance and planned to continue using OEA's services.

We believe that OEA can improve its operations in several respects, as described below.

### MANAGEMENT TRAINING

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As stated in the Background, a new Chief Economist will join the Commission in July 2004, and four new OEA managers are being hired as part of a reorganization. In addition, the Deputy Chief Economist will have new responsibilities because of the reorganization.

OEA's managers will need training to enable them to carry out their new responsibilities. The training should include, but not be limited to: an orientation to the various Commission offices and divisions; rules relating to publishing research and other ethics rules; government procurement regulations; the employee performance management system; policies and procedures relating to the union, EEO, and grievances; and employee relations, leadership, teambuilding, and conflict resolution.

The training can be obtained from the Employee Development Branch in the Office of Human Resources and Administrative Services, private vendors, and the Ethics Office, as appropriate. OEA's managers could also participate in retreats and training seminars with other Commission managers.

#### **Recommendation A**

OEA should provide training to its managers as discussed above.

### MANAGEMENT DUTIES

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OEA's Chief Economists typically return to their academic institutions after a two-year period. As college professors, their focus is on research and teaching, rather than day-to-day management. Their knowledge of the Commission's organizational structure (as opposed to the securities markets) is necessarily limited. Accordingly, their strengths would relate to policy setting, strategic research initiatives, and hiring of distinguished staff.

On the other hand, the Deputy Chief Economist and supporting management are career civil service positions. These positions could be appropriately devoted to day-to-day management, employee relations, and compliance with government rules.

Appendix A contains an example of how duties could be divided between the Chief Economist and other OEA managers. While there could be overlapping duties, it would be useful to assign most day-to-day management responsibilities to the Deputy Chief Economist (and supporting OEA management), allowing the Chief Economist to focus more exclusively on policy issues.

### **Recommendation B**

The Commission's Executive Director and the Managing Executive Director for Operations, in consultation with OEA, should decide how duties should be divided in OEA.

## **COMMISSION GUIDANCE ON PRIORITIES AND RESEARCH NEEDS**

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We found that the majority of OEA's activities result from its direct support of office and division initiatives and are beneficial to the Commission. The Chief Economist also chooses some independent research projects. In choosing these projects, the Chief Economist strives to initiate projects that add value to the Commission.

A risk for OEA is that its independently chosen research may not always directly support the Commission's mission or current priorities, and hence may be disregarded by the Commission. Sufficient means have not yet been developed for OEA to obtain guidance on Commission priorities.

Such guidance would help OEA better contribute to the Commission by clarifying the best allocation of time between OEA's research activities and its direct support of divisions and offices. The guidance would also identify research projects for OEA to work on. One way to obtain this guidance would be for the Chairman to include the Chief Economist in the Chairman's weekly senior staff meetings. Additionally, OEA could routinely meet with division directors to learn about new rulemakings and other items of importance.

### **Recommendation C**

In consultation with the Chairman's Office, OEA should develop ways to obtain guidance on Commission priorities and research needs. OEA should also routinely meet with division directors.

## **AWARENESS OF OEA ACTIVITIES**

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We found that some Commission managers are not sufficiently aware of the services OEA offers. We have some suggestions to help OEA increase Commission awareness of its services.

### *Webpage*

OEA does not have a webpage on the Commission's Intranet (the Insider). This webpage could contain descriptions of the office and services offered by OEA, its research and other activities, an organizational chart, a listing of staff and data resources, contacts for assistance and links to other relevant information.

Additionally, OEA's public Internet webpage at <http://www.sec.gov/about/economic.shtml> has not been updated since January 2003 (e.g., to show current staff) and could also contain information that OEA chooses to list on an "Insider" webpage.

### **Recommendation D**

In consultation with the Office of the Secretary (which maintains the Insider webpages), OEA should develop a webpage on the "Insider" containing the information discussed above. OEA should also update its public webpage on the Internet.

### *E-Mailing Literature*

Commission staff told us they would welcome receiving relevant academic articles or other professional literature from OEA. OEA could ask Commission staff if they would like to join an e-mail list so they could receive literature that is relevant to their field (or OEA could simply e-mail literature to relevant Commission staff as it comes across such literature).

### **Recommendation E**

OEA should e-mail professional literature to staff expressing an interest in such material.

### *Press Releases*

OEA staff informed us that a press release was formerly issued when new staff joined OEA. The releases were distributed to all Commission employees via e-mail and described the employee's background and planned work in OEA. The releases were discontinued some time ago.

### **Recommendation F**

OEA should consider resuming issuing press releases for new OEA staff.

## **WORKING PAPERS**

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Recently, OEA has proposed initiating a Working Paper Series to publicize its research findings. OEA has consulted the Office of General Counsel (OGC) to ensure that relevant legal and ethical considerations are addressed.

OEA plans to subject its Working Papers to peer review. The Office of Management and Budget is encouraging federal agencies to use peer review as a quality assurance measure.<sup>1</sup>

### **Recommendation G**

OEA should implement its planned Working Papers Series, consistent with OGC legal guidance. Subjecting the working papers to peer review would be useful.

## **CODE LIBRARY**

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OEA staff sometimes write computer code to facilitate data analysis. While many codes are complex and unique, others are generic and can be reused for data analysis, saving time.

Several staff agreed that it would be useful if OEA set up a code library, accessible to all OEA staff. The library would include a brief description of each code available to OEA and the originator's name in an electronic index.

### **Recommendation H**

OEA should consider setting up a code library that is accessible to all OEA staff, as discussed above.

## **POLICIES AND PROCEDURES**

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### *Personal Research*

As explained in the Background, OEA hires some of its staff through the IPA program. These employees are typically professors who will return to their academic institutions after their OEA term appointment ends. These staff typically need to publish research studies in order to become tenured at their universities.

One risk of this arrangement is that IPA staff could focus more on their personal research than on Commission-related research. The current Chief Economist told us that he has sought to hire IPAs whose personal interests are aligned with Commission goals. In addition, he indicated that he has stressed to his IPA staff that they must prioritize Commission work.

We found that the current IPAs generally devote their time to Commission related work. However, OEA lacks written procedures to this effect. Written procedures would be especially useful because OEA is undergoing a reorganization and hiring new management.

Written procedures should also address personal research conducted by permanent staff members, who could also be inclined to work on personal research studies/publishing.

### **Recommendation I**

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<sup>1</sup> OMB Revised Bulletin on Peer Review (# 2004-08). April 15, 2004.

OEA should implement written procedures to help ensure that research by IPAs and permanent staff focuses on Commission priorities (e.g., considering past research by candidates in the hiring process, notifying new staff in writing that Commission-related research has priority, and establishing guidelines for and monitoring personal research by staff).

### Tracking Projects

OEA staff work on numerous projects, from long-term research or rulemaking to ad hoc projects lasting only a few days. Recently, OEA began tracking projects through a Workflow Tracking System in a Microsoft Access database.

The tracking system identifies the staff member assigned, the hours charged to the project, the division or office being assisted, and the project's priority, due date and completion date. The system is intended for Commission workflow tracking and budget support, and as a historical record of OEA work. OEA is considering eventually revising or replacing the system.

We found that several staff were not consistently tracking their work in the system, which limited its usefulness.

## **Recommendation J**

OEA should develop procedures to ensure that data in its tracking system (or a replacement) are complete and accurate.

### Project Re-Assignments Upon Employee Departures

OEA staff, especially IPA staff, frequently leave the Commission after one or two years. This staff turnover creates a risk that projects may not be completed when a key person leaves. OEA currently does not have procedures to mitigate this risk.

## **Recommendation K**

OEA should develop procedures to ensure that departing employees document their projects and the projects are reassigned before their departure.

### Archiving

OEA stores hard copies of its studies and other work in folders organized by month. An Access database lists the documents and where they can be found.

An OEA staff member occasionally reminds staff to archive their work. However, several staff told us that they do not know which documents to archive or do not archive their documents. OEA's policies and procedures manual does not explain which documents to archive or the format of archived documents.

## **Recommendation L**

OEA should issue a written policy explaining which documents to archive and their format.

## **SURVEY OF SENIOR STAFF**

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We surveyed several Commission senior staff in the Divisions of Enforcement, Market Regulation, Investment Management and Corporation Finance, and in the Office of Compliance, Inspections and Examinations (OCIE). We asked the staff for their opinion of OEA's work and any suggestions for improvement.

Overall, the staff surveyed were pleased with OEA's work and planned to continue using OEA's services. They also offered some suggestions for enhancing OEA's services. Their comments are summarized in Appendix B.

### **Recommendation M**

OEA should consider the suggestions in Appendix B and take appropriate action.



### Illustrative Examples of Division of Management Responsibilities<sup>2</sup>

<b>Chief Economist</b>	<b>Deputy Chief Economist</b>
Recommends Commission action and advises the Chairman and Commission on major economic policy issues.	Manage Operations
Establish office policy	Implement office policy
Define OEA's mission and strategy	Work under the general policy direction of the Chief Economist with wide latitude to exercise independent judgment.
Prioritize resources	Prepare office budget and performance goals
Conduct risk assessments	Provide rule-making support
Implement Commission advice	Act as an OIT contact
Develop OEA's research agenda	Decide personnel issues
Hire staff	Hire staff
Liaison with the Commission	Supervise staff
Give speeches	Complete employee performance appraisal process
Delegate authority to the Deputy Chief Economist to act on behalf of the Chief Economist	Assign work
Ensure proposed projects contribute to Commission objectives	Support Chief Economist's studies and analyses
Manage and direct major economic studies	Conduct and oversee office analyses and studies
Establish office-wide policies and procedures	Implement office-wide policies and procedures
Recommend Commission action and legislative changes	Recommend Commission action and legislative changes
Provide economic consulting services to the Chairman, Commission and senior managers of the Commission.	Supervise and direct major economic studies
Conduct professional outreach activities	Build economic models
	Establish priorities among studies and other office tasks
	Ensure proposed projects contribute to Commission objectives
	Provide economic consulting services to the Chairman, Commission and senior managers of the Commission.

<sup>2</sup> There could be overlapping duties in certain functions such as hiring and other office operations.

### Comments by Senior Staff

- OEA's contributions are invaluable.
- OEA's updated cost-benefit analysis guidance was useful.
- The current Chief Economist is very practical and OEA work products are geared to assist the Commission with its day-to-day operations.
- OEA has been very helpful to OCIE over the past couple of years and very supportive of the Commission's mission. OEA's quantitative analyses have provided objective support for OCIE's findings.
- OEA has been a great help to Enforcement in determining the amount of disgorgement penalties to assess.
- OEA recently analyzed an economic study that was presented by a defense counsel in an Enforcement case. OEA found the study to be invalid, redid the study and came to an objective conclusion that supported Enforcement's allegations against the defendant.
- OEA has provided useful assistance to Corporation Finance's rulemaking group.
- OEA staff worked on a very good study regarding municipal trading data.
- OEA staff are very responsive and supportive of Market Regulation's initiatives and provides constructive and useful information.

### Suggestions by Senior Staff

- It would be useful if the Commission library subscribed to *Thomson Financial First Call*. This would enable OEA to access historical data regarding analyst estimates on a company's earnings per share and whether the company met those estimates. Enforcement sometimes questions whether a company has manipulated its earnings to meet an analyst's estimates.<sup>3</sup>
- OEA should send relevant copies of academic articles or other literature to appropriate Commission staff, as OEA comes across such items.
- OEA should inform Commission staff of how it is able to assist the Commission.
- OEA should inform Commission staff of all the data resources that are available to OEA.

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<sup>3</sup> The library has prepared the contract paperwork and is awaiting final Commission approval of the subscription.