

OCTOBER 1, 2011 TO MARCH 31, 2012



# Office of Inspector General

*Semiannual Report to Congress*

U.S. SECURITIES AND EXCHANGE COMMISSION

# OIG Mission

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SEMIANNUAL REPORT TO CONGRESS | OCTOBER 1, 2011–MARCH 31, 2012



**T**he mission of the Office of Inspector General (OIG) is to promote the integrity, efficiency, and effectiveness of the critical programs and operations of the United States (U.S.) Securities and Exchange Commission (SEC or Commission). This mission is best achieved by having an effective, vigorous, and independent office of seasoned and talented professionals who perform the following functions:

- Conducting independent and objective audits, evaluations, investigations, and other reviews of SEC programs and operations;
- Preventing and detecting fraud, waste, abuse, and mismanagement in SEC programs and operations;
- Identifying vulnerabilities in SEC systems and operations and recommending constructive solutions;
- Offering expert assistance to improve SEC programs and operations;
- Communicating timely and useful information that facilitates management decision making and the achievement of measurable gains; and
- Keeping the Commission and Congress fully and currently informed of significant issues and developments.

U. S.  
SECURITIES  
AND  
EXCHANGE  
COMMISSION



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## Message from the Acting Inspector General

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I am pleased to present this Semiannual Report to Congress as the Acting Inspector General of the U.S. Securities and Exchange Commission (SEC or Commission). This report describes the work performed by the SEC Office of Inspector General (OIG) for the period of October 1, 2011, through March 31, 2012. This report is required by the Inspector General Act of 1978, as amended.

The audits, reviews, and investigations described in this report illustrate the commitment of the SEC OIG to promoting the efficiency and effectiveness of the SEC, as well as the impact the Office has had on SEC programs and operations.

During this reporting period, our Office of Audits issued several reports on matters pertinent to agency operations. These included a review of the SEC's systems and network logs, and an audit of the management of SEC-furnished and SEC-funded property used by contractors.

Four of the five products issued by the Office of Audits during this period were authored with the assistance of outside contractors, whose work was overseen by our Office of Audits staff. These included a follow-up report to our June 13, 2011 review of the SEC's cost-benefit analyses undertaken in connection with rulemakings required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In this follow-up work, our

expert examined the economic analyses performed by the SEC in connection with five specific Dodd-Frank Act rulemakings. Based upon our review, we identified several significant issues and made six concrete recommendations to the agency, including a recommendation that the agency consider ways for economists to provide additional input into cost-benefit analyses for SEC rulemakings to assist in including both quantitative and qualitative information to the extent possible. Our recommendations included that the Office of the General Counsel reconsider its guidance that the SEC should perform economic analyses for rulemaking activities to the extent that the SEC exercises discretion and should consider whether a pre-statute baseline should be used whenever possible. We also recommended that SEC rulemaking teams generally use a single, consistent baseline in the cost-benefit analyses of their rulemakings related to a particular topic.

We were very pleased during this reporting period that in addition to our contractor-based reports,



the Office of Audits issued a very important audit report on the SEC's use of justifications and approvals (J&A) in contracting. This audit was prompted, in part, by an investigation conducted by the OIG in a prior reporting period, in which a J&A was allegedly used improperly to effectuate a sole-source leasing action. A sole-source acquisition is a contract that is entered into or proposed to be entered into by an agency after soliciting and negotiating with only one source or vendor and, with limited exceptions, requires a J&A. Our audit identified certain issues arising out of a particular regional office's sole-source contracting actions, and we also found that the agency may not be receiving the best value for its expert services contracts. While we did find that the SEC's Office of Acquisitions' (OA) has taken positive steps to increase competition in contracting at the SEC resulting in significant increases in the contract dollars the agency competed from fiscal years 2009 to 2011, we noted that the current internal guidance for preparing J&As is potentially confusing to OA's contracting officers and contract specialists who prepare J&As. Over the past few years, OA management has issued various guidance regarding J&A policy and procedures to its staff. However, OA's contracting officers and contract specialists expressed confusion about the guidance they should use for processing J&As. A full description of our review is contained in the Audits and Evaluations Conducted section of this report.

There were also numerous investigations and inquiries conducted by this Office during the reporting period. These included investigations of alleged procurement violations and an alleged violation of a federal conflict-of-interest statute by a former senior official, and inquiries into prohibited hiring practices, allegations of a sole-source contract being improperly awarded, and allegations of an SEC manager's acceptance of free or discounted legal services in violation of the standards of ethical conduct.

The OIG also completed an investigation into allegations that the SEC's Division of Enforcement

(Enforcement) improperly destroyed records relating to matters under inquiry (MUI) over the past two decades and that the SEC made misleading statements in a response that was sent to the National Archives and Records Administration (NARA) concerning the SEC's potential unauthorized destruction of MUI records. This OIG investigation found that SEC Enforcement staff destroyed documents related to closed MUIs that should have been preserved as federal records. These documents included anonymous correspondence and complaints, correspondence from the SEC requesting documents from companies in the course of MUIs, and correspondence which accompanied companies' document production responses. Notwithstanding these instances of record destruction in connection with MUIs that were closed without becoming investigations, the OIG did not learn of any particular investigation that was hampered by the destruction of MUI records.

Also during this reporting period, the OIG conducted a comprehensive investigation after receiving 23 anonymous complaints concerning a single SEC regional office. The allegations included claims of general misconduct, time and attendance abuse, mistreatment, employment preselection, waste of travel resources, and improper disclosure of confidential information. The OIG also considered allegations regarding travel policy violations at the regional office. Together, these complaints alleged that 27 different regional office staff members engaged in various forms of misconduct. The OIG conducted a comprehensive and thorough investigation and found that many of the complaints were unsubstantiated, while others had already been addressed by management. However, the OIG's investigation found some areas of concern. The most significant area of concern identified during the investigation was evidence that a senior attorney made oral or written comments of an inappropriate or sexual nature over the last 12 years despite having been disciplined for his improper behavior. Furthermore, because we received numerous com-

plaints regarding time and attendance matters, the  
OIG recommended that the regional office promptly  
implement a previous OIG recommendation,  
initially made in February 22, 2010, that devices  
to capture building entry and exit information be  
installed in the regional office. A detailed description  
of the investigations and inquiries conducted by the  
Office during this semiannual reporting period can  
also be found in this report.

Finally, the departure in January 2012 of former  
Inspector General H. David Kotz was a notable loss  
for the OIG and the agency. I am extremely proud  
of the professionalism and hard work that the OIG  
staff has exhibited while the Commission moves  
to fill this important vacancy. Additionally, I am  
appreciative of the support the Office has received  
from numerous SEC staff members during this  
transitional period for the OIG.

A handwritten signature in blue ink, appearing to read "Noelle L. Maloney". The signature is fluid and cursive, with a large, sweeping flourish at the end.

Noelle L. Maloney  
*Acting Inspector General*





# Management and Administration

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## AGENCY OVERVIEW

**T**he SEC's mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust and characterized by transparency and integrity. The SEC's core values consist of integrity, accountability, effectiveness, teamwork, fairness, and commitment to excellence. The SEC's goals are to foster and enforce compliance with the federal securities laws; establish an effective regulatory environment; facilitate access to the information investors need to make informed investment decisions; and enhance the Commission's performance through effective alignment and management of human resources, information, and financial capital.

SEC staff monitor and regulate a securities industry comprising more than 35,000 registrants, including approximately 10,000 public companies, 11,000 investment advisers, about 7,500 mutual funds, and about 5,000 broker-dealers, as well as national securities exchanges and self-regulatory organizations, 500 transfer agents, 15 national securities exchanges, nine clearing agencies, and 10 credit rating agencies. Additionally, the agency has oversight responsibility for the Public Company Accounting Oversight Board (PCAOB), the Financial Industry Regulatory Authority (FINRA), the Municipal

Securities Rulemaking Board (MSRB), and the Securities Investor Protection Corporation (SIPC). While about 3,200 smaller investment advisers will transition to state regulation under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the SEC is gaining responsibility for directly overseeing approximately 700 larger private fund advisers, including hedge funds.

In order to accomplish its mission most effectively and efficiently, the SEC is organized into five main divisions (Corporation Finance; Enforcement; Investment Management; Trading and Markets; and Risk, Strategy, and Financial Innovation) and 18 functional offices. The Commission's headquarters is in Washington, D.C., and there are 11 regional offices located throughout the country. As of September 30, 2011, the SEC employed 3,844 full-time equivalents (FTEs), consisting of 3,806 permanent and 38 temporary FTEs.

## OIG STAFFING

During the reporting period, the OIG welcomed two audit managers and an assistant inspector general for investigations to the staff, thereby maintaining its capacity to conduct its oversight responsibilities.

In October 2011, Steven Kaffen joined the OIG as an audit manager. Mr. Kaffen came to the OIG

from the Peace Corps OIG, where he served as assistant inspector general for auditing and senior auditor. During his eight years at the Peace Corps OIG, he supervised headquarters and field audits and personally conducted financial and administrative audits in 34 countries. Mr. Kaffen began his career with Arthur Young (now known as Ernst & Young), where he served as an audit manager in New York, New York, and as director of accounting and auditing in Paris, France. Mr. Kaffen was also director of controls and procedures and a financial controller for Levi Strauss & Co. In addition, he was supervisory committee chairman of Levi Strauss & Co.'s federal credit union. Further, Mr. Kaffen has consulted for UNICEF, Deloitte, and 20th Century Fox. He was a Peace Corps volunteer in Russia and a United Nations elections monitor in Bosnia and East Timor. Mr. Kaffen has a bachelor's degree in accounting from the University of Maryland and a master's of business administration degree with honors from Syracuse University. He is a certified public accountant and member of the American Institute of Certified Public Accountants.

In November 2011, Shannon Williams joined the OIG as an audit manager. Ms. Williams came to the OIG from the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), where she was an audit director. At SIGTARP, Ms. Williams oversaw audits related to financial institutions support programs, asset support programs, and auto industry support programs. Prior to joining SIGTARP, Ms. Williams was an audit manager at J.P. Morgan, focusing on the trading operations for securitized products and rates within the investment banking division. Ms. Williams is a certified public accountant and has a bachelor's degree in accounting from Rutgers School of Business.

In January 2012, David P. Weber joined the OIG as the Assistant Inspector General for Investigations. Mr. Weber came to the OIG from the Federal

Deposit Insurance Corporation (FDIC), where he served as a supervisory counsel and chief of enforcement and was responsible for overseeing banking enforcement activities and investigations involving state-chartered banks and bank failures. Before joining the FDIC, Mr. Weber served for more than a decade as the special counsel for enforcement at the Office of the Comptroller of the Currency. Mr. Weber also previously served as the law clerk to a U.S. district judge in New York and, in that capacity, assisted with criminal and civil cases before the United States Court of Appeals for the Second Circuit. Mr. Weber is admitted to practice law in the District of Columbia and New York and before several United States district courts and the United States Supreme Court. He has a bachelor's degree cum laude in criminal justice from Utica College and holds a juris doctor degree magna cum laude from the Syracuse University College of Law. Mr. Weber is a certified fraud examiner and a member of the Association of Certified Fraud Examiners.

During the semiannual reporting period, former Assistant Inspector General for Investigations James David Fielder left the OIG for an opportunity outside the Commission, and audit manager Anthony Barnes accepted a position in another SEC Office. Finally, on January 27, 2012, H. David Kotz left the Office after serving as Inspector General since December 2007. During his tenure, Mr. Kotz oversaw numerous high-profile investigations and audits, notably, the OIG's investigation of the failure of the SEC to uncover the Bernard L. Madoff Ponzi scheme, audits of the SEC's oversight of Bear Stearns and related entities, and reviews of economic analyses undertaken by the Commission in connection with Dodd-Frank Act rulemakings. Upon Inspector General Kotz's departure, Noelle L. Maloney was named Acting Inspector General. Subsequently, on March 23, 2012, Jacqueline Wilson was named Acting Deputy Inspector General.



## Congressional Requests and Briefings

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**D**uring this semiannual reporting period, the OIG continued to keep Congress fully and currently informed of the OIG's investigations, audits, and other activities through written reports, meetings, and by telephone.

The OIG's previous semiannual report to Congress discussed a report issued on June 13, 2011, which contained the OIG's initial assessment of the SEC's cost-benefit analyses related to six specific rulemakings that had been identified in a May 4, 2011, letter from several members of the U.S. Senate Committee on Banking, Housing and Urban Development (Senate Banking Committee). In the June 13, 2011, report, the OIG stated that it would issue a subsequent report on the results of the OIG's further review of the SEC's cost-benefit analyses. During this reporting period, the OIG completed its additional review of the cost-benefit analyses performed by the SEC in connection with rulemakings under the Dodd-Frank Act and issued Report No. 499, *Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings*. The report is discussed in detail in the Audits and Evaluations Conducted section of this report and is available at [http://www.sec-oig.gov/Reports/AuditsInspections/2012/Rpt%20499\\_FollowUpReviewofD-F\\_CostBenefitAnalyses\\_508.pdf](http://www.sec-oig.gov/Reports/AuditsInspections/2012/Rpt%20499_FollowUpReviewofD-F_CostBenefitAnalyses_508.pdf).

On March 29, 2011, the OIG provide a report to the U.S. Senate Committee on Homeland Security and Governmental Affairs, the U.S. House of Representatives Committee on Oversight and Government Reform, and the Office of Management and Budget (OMB) on the SEC's compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA) for fiscal year 2011. In its report, the OIG noted that, as reflected in the SEC's fiscal year 2011 Performance and Accountability Report (PAR), the SEC had conducted a risk assessment and determined that none of its programs and activities were susceptible to significant improper payments at or above the threshold levels set by OMB. The OIG report further noted that the SEC's fiscal year 2011 PAR stated that the SEC had determined that the implementation of a payment recapture program for the SEC (which does not administer grant, benefit, or loan programs) was not cost-effective, but that the SEC nonetheless strives to recover any overpayments identified through other sources. Based upon its review of the SEC's IPERA Risk Assessment Summary Report and supporting documentation, the OIG determined that the SEC was in compliance with IPERA.

Also during the reporting period, the OIG provided briefings to, and had discussions with, Members of Congress and Congressional staff concerning the

work of the OIG and issues impacting the SEC. For example, on January 24, 2012, the then-Inspector General and then-Deputy Inspector General met with the Honorable Jo Ann Emerson (R-Missouri), Chairwoman, Subcommittee on Financial Services and General Government, U.S. House of Representatives Committee on Appropriations. The discussions during the meeting covered a variety of topics, including disciplinary actions taken by the agency, general accountability of the agency, and implementation of consultant recommendations. On March 20, 2012, the Acting Inspector General and an OIG staff member briefed staff of the Senate Banking Committee concerning the OIG SEC Employee Suggestion Program, which was established pursuant to section 966 of the Dodd-Frank Act. Specifically, the discussions focused on the number and type of suggestions received under the program, the characteristics of the persons submitting suggestions (*e.g.*, support staff, senior staff), and publicizing the existence of the program. The Acting Inspector General and OIG staff member also briefed the committee staff concerning the first OIG SEC Employee Suggestion Program awards ceremony held in December 2011, at which several SEC employees who had made suggestions resulting in agency cost savings were honored.

During the reporting period, the OIG also received a Congressional request for investigative work and provided information to Congress concerning completed inquiries and investigations. In mid-October 2011, the OIG received a request from staff of the Senate Banking Committee that the OIG, as well as the OIGs of other financial regulatory agencies, inquire into the leak of a draft rule to the public. The OIG commenced an inquiry into the leak, which was pending at the end of the reporting period. On December 20, 2011, the former Inspector General provided a letter to the Honorable Barney Frank (D-Massachusetts), Ranking Member, U.S. House of Representatives Committee on Financial Services, which summarized the work the OIG had performed during its inquiry into a complaint that had previously been forwarded to the Inspector General for review. On December 21, 2011, the Inspector General provided the Honorable Charles Grassley (R-Iowa), Ranking Member, U.S. Senate Committee on the Judiciary, and the Honorable Tom Coburn (R-Oklahoma), Ranking Member, Permanent Subcommittee on Investigations, U.S. Senate Committee on Homeland Security and Governmental Affairs, with a previously requested biannual report on all closed investigations, evaluations, and audits conducted by the OIG.



## Advice and Assistance Provided to the Agency

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**D**uring this semiannual reporting period, the OIG provided advice and assistance to SEC management on several issues that were brought to the OIG's attention through various means. The OIG conveyed this advice and assistance through written communications and in meetings and conversations with Commission officials. The advice and assistance included suggestions for improvement in SEC programs and operations received through the OIG SEC Employee Suggestion Program, which was established pursuant to section 966 of the Dodd-Frank Act.

Specifically, the Inspector General met with SEC contractors responsible for reviewing the roles, responsibilities, and workload of the various Commission divisions and offices and provided detailed information concerning the OIG's functions, staffing, and workload. The Acting Inspector General and Counsel to the Inspector General also met with contractors in connection with the SEC's annual entity-level assessment. Specific topics discussed during the meeting included ethics and compliance, risk and prioritization of audits and investigations, internal policies and procedures, and maintenance of the OIG SEC Employee Suggestion Program.

In addition, OIG staff completed an agency hiring manager recruitment outreach survey and provided

a suggestion to the SEC's Office of Acquisitions that agency contract staff information be tracked on a SharePoint spreadsheet rather than by e-mail. Further, the Acting Inspector General and the Counsel to the Inspector General met with officials from the Office of Compliance Inspections and Examinations (OCIE) on two occasions to discuss several new initiatives that OCIE has recently undertaken and implemented.

Also during the reporting period, the OIG received a suggestion through the OIG SEC Employee Suggestion Program regarding fee-bearing filings made through the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system and the process by which EDGAR users request refunds of excess filing fees paid. Currently, users must submit refund requests by mail or facsimile, and it was suggested that an online refund request form or process be developed to make this process more efficient for both filers and Office of Financial Management (OFM) staff. After reviewing and analyzing the suggestion received, the OIG forwarded it to OFM staff, who responded favorably to the suggestion and submitted a request to make this change effective in June 2012. The change is expected to result in increased efficiency and will provide an additional layer of internal controls to the filing fee refund process.



Another suggestion received during the reporting period through the OIG SEC Employee Suggestion Program pertained to potential improvements to the existing process followed at SEC Headquarters when an SEC employee has forgotten his or her identification badge and needs to obtain access to SEC facilities. Under the current process, the guards located at the security desk at SEC Headquarters main entrance call the SEC badge office to confirm that the individual seeking admission is an SEC employee or contractor. However, if an employee arrives in the morning before the badge office has opened, the security guards are required to find an

alternate method of confirming the employee's identity, which can lead to delays. The employee who made the suggestion indicated that it would be more efficient for the security personnel at the guard desk to have the ability to confirm employment without having to check with the badge office. The OIG provided the suggestion to the Office of FOIA, Records Management, and Security, which informed the OIG that it is in the process of implementing changes to alleviate the inefficiencies involved in verifying employment outside the operating hours of the badge office.



## Coordination with Other Offices of Inspector General

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**D**uring this semiannual reporting period, the SEC OIG coordinated its activities with those of other OIGs, as required by section 4(a)(4) of the Inspector General Act of 1978, as amended. Specifically, the SEC Inspector General or a senior OIG staff member attended meetings of the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

In addition, the SEC Inspector General was a member of CIGIE's Professional Development Committee, the purpose of which is to provide educational opportunities for members of the CIGIE community and to assist in ensuring the development of competent personnel. During the reporting period, the SEC Inspector General or a senior SEC OIG staff member attended meetings of the Professional Development Committee. As part of its participation in the Professional Development Committee activities, the SEC OIG provided substantial comments on draft revisions to the Quality Standards for Federal Offices of Inspector General (Silver Book). The Counsel to the Inspector General also participated in the activities of the Council of Counsels to the Inspector General, an informal organization of OIG attorneys throughout the federal government who meet monthly and coordinate and share information.

Further, during the reporting period, the SEC OIG responded to numerous requests for information or surveys received from CIGIE or other OIGs. These information requests and surveys related to, among other things, nonfederal employee whistleblower protections, common practices for conducting vulnerability assessments and penetration testing, practices regarding congressional communications, auditor position grades, numbers of criminal and noncriminal investigators, needs for training in technical writing skills, and training of mission-support personnel.

In addition, the SEC Inspector General participated in the activities of the Council of Inspectors General on Financial Oversight (CIGFO), which was created by section 989E of the Dodd-Frank Act. CIGFO is chaired by the Inspector General of the Department of the Treasury and also includes the inspectors general of the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the Department of Housing and Urban Development, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Credit Union Administration, and the SEC and the Special Inspector General for the Troubled Asset Relief Program. Under the Dodd-Frank Act,

CIGFO is required to meet at least quarterly to facilitate the sharing of information, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight. CIGFO is also required to submit an annual report to the Financial Stability Oversight Council and Congress. The report must include a section that highlights the concerns and recommendations of each inspector general who is a member of CIGFO and a summary of the general observations of CIGFO.

During this reporting period, the SEC Inspector General attended a CIGFO meeting held on December 8, 2011, and an SEC OIG staff member participated in CIGFO's conference calls. In addition, the SEC OIG provided its submission for inclusion in the CIGFO

2012 Annual Report. This submission contained a discussion of recent examples of oversight work performed by the SEC OIG, including the June 13, 2011, report on the OIG's review of economic analyses performed by the SEC in connection with Dodd-Frank Act rulemakings; the January 27, 2012, report on the OIG's follow-up review of the cost-benefit analyses performed in selected Dodd-Frank Act rulemakings; and the June 15, 2011, report on the SEC's establishment of an Office of Minority and Women Inclusion as required by the Dodd-Frank Act. The SEC OIG's submission also discussed planned oversight work, including an audit of the SEC's processes related to tips, complaints, and referrals received by the Commission and a study of the whistleblower protections established by the Dodd-Frank Act.



# Audits and Evaluations

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## OVERVIEW

**T**he OIG is required by the Inspector General Act of 1978, as amended, to conduct audits and evaluations of agency programs, operations, and activities. The OIG's Office of Audits focuses its efforts on conducting and supervising independent audits and evaluations of the programs and operations of the various SEC divisions and offices. The Office of Audits also hires independent contractors and subject matter experts to conduct work on its behalf. Specifically, the Office of Audits conducts audits and evaluations to determine whether

- there is compliance with governing laws, regulations, and policies;
- resources are safeguarded and appropriately managed;
- funds are expended properly;
- desired program results are achieved; and
- information provided by the agency to the public and others is reliable.

Each year, the Office of Audits prepares an annual audit plan. The plan includes work that is selected for audit or evaluation based on risk and materiality, known or perceived vulnerabilities and inefficiencies, resource availability, and complaints received from Congress, internal SEC staff, the Government Accountability Office (GAO), and the public.

## Audits

Audits examine operations and financial transactions to ensure that proper management practices are being followed and resources are adequately protected in accordance with governing laws and regulations. Audits are systematic, independent, and documented processes for obtaining evidence. In general, audits are conducted when firm criteria or data exist, sample data are measurable, and testing internal controls is a major objective. Auditors collect and analyze data and verify agency records by obtaining supporting documentation, issuing questionnaires, and through physical inspection.

The OIG's audit activities include performance audits of SEC programs and operations relating to areas such as the oversight and examination of regulated entities, the protection of investor interests, and the evaluation of administrative activities. The Office of Audits conducts its audits in accordance with generally accepted government auditing standards (Yellow Book) issued by the Comptroller General of the United States, OIG policy, and guidance issued by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

## Evaluations

The Office of Audits also conducts evaluations of SEC programs and activities. Evaluations consist of reviews that often cover broad areas and are

typically designed to produce timely and useful information associated with current or anticipated problems. Evaluations are generally conducted when a project's objectives are based on specialty and highly technical areas, criteria or data are not firm, or needed information must be reported in a short period of time. Office of Audits evaluations are conducted in accordance with OIG policy, Yellow Book nonaudit service standards, and guidance issued by CIGIE.

### **Audit Follow-Up and Resolution**

During this semiannual reporting period, SEC divisions and offices made significant efforts to reduce the backlog of open recommendations while ensuring that the most recent recommendations were fully implemented. Based on the appropriate evidence and documentation provided to the OIG by management to support its implementation of OIG recommendations, the OIG closed 86 recommendations related to 15 different Office of Audits reports during this semiannual reporting period.

## **AUDITS AND EVALUATIONS CONDUCTED**

### **Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings (Report No. 499)**

#### **BACKGROUND**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was signed into law on July 21, 2010. The law reformed the financial regulatory system, including how financial regulatory agencies operate. Among other things, the Dodd-Frank Act required the SEC to undertake a significant number of studies and rulemakings, including regulatory initiatives addressing derivatives; asset securitization; credit rating agencies; hedge funds, private equity funds, and venture capital funds; municipal securities; clearing agencies; and corporate governance and executive compensation. Although the Dodd-Frank Act mandated specific

rulemakings, it gave the SEC varying degrees of discretion to determine the content of particular rules.

On May 4, 2011, the SEC OIG received a letter from several members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs requesting that the Inspector General review the economic analyses performed by the SEC in connection with six specific rulemaking initiatives undertaken pursuant to the Dodd-Frank Act.

On June 13, 2011, the OIG released a report on the results of its initial assessment of the cost-benefit analyses conducted for these six rulemakings (the phase I review). The OIG concluded that the SEC had conducted a systematic cost-benefit analysis for each of the six rules, but found that the level of involvement of the Division of Risk, Strategy, and Financial Innovation (RiskFin) varied considerably from rulemaking to rulemaking. In addition, the phase I review found a lack of macro-level analysis and a lack of quantitative analysis on the impact of the rules. In the report on phase I, the OIG stated its intention to further analyze these areas.

The OIG's follow-up, or phase II, analysis examined the economic analyses performed by the SEC in connection with five additional Dodd-Frank Act rulemakings. For this phase II report, as for the phase I report, the OIG retained an expert, Albert S. Kyle, to assist with the review of SEC cost-benefit analyses in Dodd-Frank Act rulemakings. Professor Kyle is the Charles E. Smith Chair Professor of Finance at the University of Maryland's Robert H. Smith School of Business.

The overall objectives of the phase II review were to:

- assess whether the SEC is performing cost-benefit analyses for rulemaking initiatives that are statutorily required under the Dodd-Frank Act in a consistent manner across SEC divisions and offices and in compliance with applicable federal requirements and

- determine whether problematic areas exist where rigorous cost-benefit analyses were not performed for rulemaking initiatives and where improvements are needed and best practices can be identified to enhance the overall methodology used to perform cost-benefit analyses.

## RESULTS

Based on its review of the cost-benefit analyses performed for the rulemakings selected, the OIG found overall that SEC rulemaking teams consistently adhered to internal policies for preparing cost-benefit analyses and, as a result, the cost-benefit analyses followed a systematic process from inception to completion. However, the OIG identified the significant issues, summarized below, during its review.

The extent of quantitative discussion of cost-benefit analyses varied among rulemakings, and none of the rulemakings examined in the phase II review attempted to quantify either benefits or costs other than information collection costs as required by the Paperwork Reduction Act. In addition, Professor Kyle opined on the crucial role that economists play in ensuring that cost-benefit analyses incorporate both qualitative and quantitative information.

In its cost-benefit analyses for Dodd-Frank Act rulemakings, the SEC generally focused on discretionary components—portions of rulemakings in which the Commission is able to exercise choice. Professor Kyle opined that in addition to satisfying statutory requirements, a cost-benefit analysis is intended to inform the public and other parts of government, including Congress, of the effects of alternative regulatory actions. While a September 2010 memorandum from the former SEC General Counsel took the view that where the SEC has no discretion, there are no choices to explain, OMB Circular A-4, which provides guidance to executive agencies on conducting cost-benefit analyses required by Executive Order 12866, specifies that the baseline agencies should establish for use in defining the

costs and benefits of an alternative “normally will be a ‘no action’ baseline.” Therefore, to the extent that the SEC performs cost-benefit analyses only for discretionary rulemaking activities, in the opinion of Professor Kyle, the SEC may not be fulfilling the essential purposes of such analyses—providing a full picture of whether the benefits of a regulatory action are likely to justify its costs and discovering which regulatory alternatives would be the most cost-effective.

The SEC sometimes used multiple baselines in its cost-benefit analyses that were ambiguous or internally inconsistent. For example, in the SEC’s interim final temporary rule for registration of municipal advisors, portions of the cost-benefit analysis assumed as a baseline a minimal registration process that would allow municipal advisors to continue their usual activities with limited disruption. However, other parts of the cost-benefit analysis assumed that municipal advisors would be required to cease their advisory activities in the absence of a registration process, resulting in a shutdown of the municipal advisory market.

There was often considerable overlap between the cost-benefit analyses and efficiency, competition, and capital formation sections of the releases for Dodd-Frank Act regulations, and we found that redundancy could be reduced by combining these two sections.

Some SEC Dodd-Frank Act rulemakings lacked clear, explicit explanations of the justification for regulatory action. Specifically, some of the rulemakings that were premised on market failure alluded to market failure but did not explicitly cite it as a justification or fully discuss it. Other rulemakings included language that erroneously suggested a market failure justification and contained no compelling alternative rationale in support of the action. OMB Circular A-4 identifies market failure as one of several possible justifications for federal agency regulation. In discussing this point, the circular

provides that an agency must demonstrate that proposed action is necessary before recommending regulatory action, citing Executive Order 12866's requirement that agencies "promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well being of the American people." According to Professor Kyle, a more focused discussion of market failure in cost-benefit analyses would lay out the rationale for regulation more clearly to Congress, the general public, and the SEC itself.

Although some of the SEC's Dodd-Frank Act rulemakings may result in significant costs or benefits to the Commission itself, internal costs and benefits were rarely addressed in the cost-benefit analyses. According to Professor Kyle, however, considering internal administrative costs and benefits is consistent with the purposes of a cost-benefit analysis and provides a more complete picture of economic costs and benefits associated with government regulation.

### RECOMMENDATIONS

Based on the results of our review, the OIG issued its report on January 27, 2012, and made the following recommendations:

- (1) SEC rulewriting divisions and RiskFin should consider ways for economists to provide additional input into cost-benefit analyses for SEC rulemakings to assist in including both quantitative and qualitative information to the extent possible.
- (2) The Office of the General Counsel, in consultation with RiskFin, should reconsider its guidance that the SEC should perform economic analyses for rulemaking activities to the extent that the SEC exercises discretion and should consider whether a pre-statute baseline should be used whenever possible.
- (3) SEC rulemaking teams should generally use a single, consistent baseline in the cost-benefit analyses of their rulemakings related to a particular topic. The baseline being used should be specified at the beginning of the cost-benefit analysis section. If multiple baselines are appropriate, such as for evaluating alternative approaches or explaining the SEC's use of discretion, they should also be explained and justified.
- (4) SEC rulewriting divisions should consider discontinuing the practice of drafting separate cost-benefit analysis and efficiency, competition, and capital formation sections and instead provide a more integrated discussion of these issues in rule releases.
- (5) The Commission should consider directing rulemaking teams to (a) explicitly discuss market failure as a justification for regulatory action in the cost-benefit analysis of each rule that is based in whole or in part on perceived market failure or (b) in the absence of market failure, demonstrate a compelling social purpose that justifies regulatory action.
- (6) SEC rulemaking teams should consider including internal costs and benefits in the cost-benefit analyses of rulemakings.

Management ultimately concurred with all of the report's six recommendations. This report is available on the OIG's website at <http://www.sec-oig.gov/Reports/AuditsInspections/2012/499.pdf>.

### **SEC's Use of Justifications and Approvals in Sole-Source Contracting (Report No. 507)**

#### BACKGROUND

In testimony on July 6, 2011, before the House Transportation and Infrastructure Committee, Subcommittee on Economic Development, Public

Buildings and Emergency Management, the former SEC Inspector General informed the subcommittee that the OIG would conduct an audit of the SEC's use of justifications and approvals (J&A) in sole-source contracting. The subject of the hearing was the OIG's investigation regarding the SEC's lease for 900,000 square feet of office space at Constitution Center, costing approximately \$556.8 million over 10 years. Prominent in the leasing investigation was a J&A that was alleged to have been improperly used to support the sole-source contracting action for the Constitution Center lease. In addition, the OIG received complaints about the SEC's use of J&As. As a result, the OIG conducted this audit based on improprieties found in the leasing investigation and complaints alleging similar improprieties.

A sole-source acquisition is a contract that an agency enters into, or proposes to enter into, after soliciting and negotiating with only one source (vendor). With limited exceptions, a sole-source contract requires a J&A. The Federal Acquisition Regulation (FAR) sets forth the policies and procedures and identifies the statutory authorities that must be applied when contracts are not awarded under full and open competition. According to the FAR, agencies may engage in contracting without providing for full and open competition under the following circumstances:

- Only one responsible source and no other supplies or services will satisfy agency requirements (FAR § 6.302-1)
- Unusual and compelling urgency (FAR § 6.302-2)
- Industrial mobilization; engineering, developmental, or research capability; or expert services (FAR § 6.302-3)
- International agreement (FAR § 6.302-4)
- Authorized or required by statute (FAR § 6.302-5)
- National security (FAR § 6.302-6)
- Public interest (FAR § 6.302-7)

The SEC primarily uses three of these circumstances as justification for other than full and open competition: FAR § 6.302-1, FAR § 6.302-2, and FAR § 6.302-3 (specifically for expert services).

The SEC's Office of Administrative Services (OAS), Office of Acquisitions (OA) consists of a policy branch and four contracting branches that are staffed with contracting officers and contracting specialists. In addition, OAS has delegated senior officials in the SEC's regional offices the authority to enter into and modify contracts with vendors on behalf of the Commission subject to certain limitations. OA has taken positive steps to increase competition in contracting at the SEC, as indicated by significant increases in the contract dollars the Commission competed from fiscal years 2009 to 2011.

The overall objective of the audit was to assess the SEC's use of J&As in contracting. Specific audit objectives were to assess the following:

- OA's approval processes and procedures for J&As, including the roles of contracting officials and legal counsel;
- whether applicable federal statutes and regulations and OA's policies and procedures are followed in preparing and approving J&As;
- whether J&As are appropriately used under the circumstances presented; and
- whether the use of J&As has impacted competition.

## RESULTS

The OIG reviewed a sample of 64 sole-source contracts, with a total contract value of approximately \$10 million, that the SEC awarded in fiscal years 2009 to 2011. Five of the 64 sole-source contracts, which were awarded by a regional office director, did not have approved, written J&As, as required by FAR §§ 6.303 and 6.304. Further, the OIG found another 3 of the 64 contracts had



J&As that were signed by the contracting officer after the contract had been awarded. Finally, the OIG found that OA awarded a contract in 2010 that required the competition advocate's review and approval, but did not have the competition advocate's signature.

During the audit, the OIG also found that a sole-source contract was awarded using the authority for "unusual and compelling urgency" that did not comply with FAR requirements. The circumstances identified in the J&A supported the use of this authority; however, the contract exceeded the authorized period of performance allowed under FAR § 6.302-2. For sole-source contracts awarded using the unusual and compelling urgency authority, the period of performance is limited to the time necessary to perform the urgent work under the contract and the time the agency needs to enter into another contract for the required goods and services through the use of competitive procedures. This time cannot exceed one year unless the head of the agency determines that exceptional circumstances apply.

Additionally, with respect to the sole-source contracts that cited FAR § 6.302-3 (for obtaining expert services), the OIG found that most vendors received multiple contracts with the SEC, that the typical statements used in the expert witness J&As related to removing barriers to competition lacked real substance, and that any market research was limited and informal. The SEC's selection of expert witnesses is affected by variables such as witness expertise, availability, willingness to testify for the SEC, courtroom demeanor, and the trial attorney's confidence in the expert witness. Further, the unpredictable timeline of a trial can result in an unexpected and urgent need for an expert witness. These circumstances tend to limit the pool of potential witnesses for particular cases. As a result, the SEC may not be receiving the best value available for all of its expert witness contracts.

Finally, the OIG found that OA's current internal guidance for preparing J&As is potentially confusing to its contracting officers and contract specialists who prepare J&As. Over the past few years, OA management has issued guidance regarding J&A policy and procedures to its staff. However, some of this guidance has been withdrawn and OA's contracting officers and contract specialists indicated confusion about the guidance they should use for processing J&As.

## RECOMMENDATIONS

Based on the results of its audit, the OIG issued its report on March 28, 2012, and recommended the following:

- (1) OA should review contracting operations at the regional office where sole-source contracts were identified as having no J&As. OA should further provide training to staff involved in the procurement process to ensure that they are familiar with competition requirements in contracting, when sole-source contracting is appropriate, and how to properly prepare J&As.
- (2) OA should establish procedures to regularly review a sample number of regional office contracts to ensure that their contracting practices comply with the FAR and Commission regulations and operating procedures.
- (3) OA should review all open sole-source contracts awarded using FAR § 6.302-2, Unusual and Compelling Urgency, that are over the simplified acquisition threshold and ensure that each contract's period of performance does not exceed one year. If any contract's period of performance exceeds one year, OA should modify the period of performance or obtain required approval from the Chairman for exceptional circumstances.

- (4) OA should conduct an assessment of the manner in which vendors are chosen as expert witnesses using FAR § 6.302-3 for sole-source contracts and examine whether opportunities exist to expand the vendor competition base.
- (5) OA should publish comprehensive policies and procedures governing the J&A process at the Commission. This guidance should reflect a thorough analysis of the current process to determine if it includes sufficient controls to ensure that J&As comply with federal statutes and regulations and are appropriately used under the circumstances presented.
- (6) OA should communicate its policies and procedures governing the J&A process at the Commission to contracting officers and contract specialists and provide training as necessary. OA should properly notify its staff when previously issued OA guidance (policies and procedures) and administrative regulations are revised, superseded, or no longer available for use.

Management concurred with all of the report's recommendations. The report is available on the OIG website at <http://www.sec-oig.gov/Reports/Audits-Inspections/2012/507.pdf>.

### **SEC's Controls Over Government Furnished Equipment and Contractor Acquired Property (Report No. 503)**

#### **BACKGROUND**

The SEC OIG contracted with Castro & Company, LLC, to conduct an audit of the SEC's government-furnished equipment (GFE) and contractor-acquired property (CAP) and to identify potential areas for improvement. The scope of the audit primarily covered OAS, the Office of Information Technology (OIT), and OFM.

Part 45 of the FAR defines government-furnished property (GFP) as property in the possession of, or directly acquired by, the government and subsequently furnished to a contractor for performance of a contract. It defines CAP as property acquired, fabricated, or otherwise provided by a contractor for performing a contract and to which the government has title. Examples of GFP include servers and machinery the government provides to a contractor to use at the contractor's facility to fulfill contract requirements. For the purposes of Report No. 503, GFE and CAP were referred to as GFP.

When the SEC issues GFP to a contractor, the contractor is required to manage and account for it in accordance with the FAR and to have a system to manage it. The contractor should initiate and maintain the processes, systems, procedures, records, and methodologies necessary for effective control of GFP in its possession.

The overall objective of the audit was to determine whether sufficient management controls over GFP held by contractors were in place and operating effectively. The specific audit objectives were to determine whether

- the SEC has reliable records to assess which contractors have received GFP and the dollar value of the assets provided;
- contracting officer's representatives or others responsible for administration of property are properly trained and perform their required duties in accordance with SEC policy;
- contractors that were provided GFP by the SEC have performed annual inventories of property in accordance with their contracts and the FAR;
- SEC contractors that were provided GFP by the SEC have adequate policies and procedures for management and disposal of property, including sanitization and disposal of information technology property such as media, magnetic tapes, removable media, and hard drives, which can contain sensitive data; and

- assets held by contractors are properly accounted for and reported in the SEC's financial statements.

## RESULTS

Castro and Company, LLC, made the following findings during its audit:

- OAS and OIT could not identify the universe of property issued to contractors that was designated as GFP, and they have not clearly defined property that is considered GFP. As a consequence, there is an increased risk that the SEC is not complying with the FAR, and property that is lost, stolen, or misused may not be detected.
- The database used to track and monitor information technology equipment is not reliable because its controls are insufficient and do not ensure that the information in the database is accurate and complete.
- OIT has not completed a timely inventory of the SEC's information technology equipment and lacks up-to-date information technology equipment policies and procedures.
- Contracting officers, contract specialists, and contracting officer's representatives are not properly trained regarding their GFP responsibilities.

## RECOMMENDATIONS

Based on the results of the audit, the OIG issued its report on March 28, 2012, and made the following recommendations:

- (1) OAS, in conjunction with OIT, should revise SECR 9-3, Report of Survey Program, and SECR 9-2, Property Management Program, and clearly define property that is designated as GFP. OAS and OIT should further identify in SECR 9-3 and 9-2 the particular circumstances that are needed to meet the GFP requirements in accordance with Part 45 of the FAR.
- (2) OIT should revise its policy to specify how often the office will conduct wall-to-wall inventories of the SEC's information technology equipment and how frequently the Configuration Management Database (CMDB) should be updated.
- (3) OIT should coordinate with the contracting officer's representative or other property accountability officer, as designated in the contract, to ensure that government-issued property items are properly returned to OIT and the items are promptly removed from the CMDB when the contractor is no longer using them or when the contract is no longer active.
- (4) OIT should develop and implement procedures for monitoring information technology equipment at the regional offices that are communicated to appropriate personnel. These procedures should address the regional offices' roles in monitoring information technology equipment issued to contractors, including their responsibilities when a contractor employee exits a contract or when the equipment is moved to a new location.
- (5) OIT should revise its policies and procedures to establish clear accountability within the Asset Management Branch that is associated with properly tracking and monitoring information technology equipment, including documenting the issuance and receipt of information technology equipment to specific Commission contractors.
- (6) When OIT completes the 2012 wall-to-wall inventory of information technology equipment, it should use this information to establish a baseline of the equipment in the CMDB.
- (7) OAS, in conjunction with OIT, should develop periodic training for contracting officers, contract specialists, and contracting officer's representatives that clearly defines and addresses

their responsibilities related to GFP consistent with Part 45 of the FAR, Government Property, and SECR 9-2, Property Management Program.

(8) OAS should ensure that when the Commission issues GFP to contractors, the contracting officer (and where appropriate the contract specialist) includes language in the contract that specifies

- the name of the equipment;
- what equipment will be retained, disposed of, or returned to the government;
- when the equipment will be disposed of or returned to the government; and
- who can accept the returned equipment.

(9) OIT should issue GFP to contractors only after it obtains proof that the vendor's contract has language authorizing the contractor to receive the equipment.

Management concurred with all of the report's recommendations. The report is available on the OIG website at <http://www.sec-oig.gov/Reports/Audits-Inspections/2012/503.pdf>.

### **Assessment of SEC's System and Network Logs (Report No. 500)**

#### **BACKGROUND**

In August 2010, the SEC OIG contracted with C5i Federal, Inc. (C5i), to assist with the completion and coordination of the OIG's input to the Commission's response to OMB Memorandum 10-15, FY 2010 Reporting Instructions for the Federal Information Security Management Act and Agency Privacy Management. The response was submitted to OMB in November 2010 and reported on by the OIG in Report No. 489, 2010 Annual FISMA Executive Summary Report. As part of its work, C5i assessed and reviewed the SEC's continuous monitoring of information technology operations

audit logs, and the OIG documented the results of the assessment in Report No. 497, Assessment of SEC's Continuous Monitoring Program. During its assessment, C5i was unable to verify whether all log settings and user activities were being captured for all servers. As a result, in May 2011, the OIG modified its contract with C5i to include an assessment designed to determine whether audit log data were being captured consistent with the requirements of the Federal Information Security Management Act of 2002 (FISMA), Federal Information Processing Standards (FIPS) and National Institute of Standards and Technology (NIST) guidelines.

The overall objective of the review was to independently evaluate and report on how the Commission has implemented information security requirements for audit log management, including the generation, review, protection, and retention of audit logs. An additional objective was to review system and network logs in the SEC enterprise network, access controls to logs, controls over log management and analysis, data log collection, and log storage.

#### **RESULTS**

During the assessment, C5i found the following: (1) some servers were not logging auditable events; (2) OIT's policies and procedures for audit log capture and management were outdated and did not clearly define required components such as roles and responsibilities; (3) servers identified as decommissioned were still actively connected to the SEC's enterprise networks and still accessible, and at least one of the decommissioned servers was not logging auditable events; (4) logs were not generated consistently for application databases because the audit trail functionality built into the database was not always available, resulting in OIT's inability to capture logs for all auditable events; and (5) OIT's Servers and Storage Branch and OIT's Security Branch did not have an alerting mechanism to notify appropriate personnel when some servers were full or had stopped performing logging functions.

## RECOMMENDATIONS

On March 16, 2012, the OIG issued its report containing the following eight recommendations:

- (1) OIT should identify capacity requirements for all servers, ensure that sufficient capacity is available for the storage of audit records, configure auditing to reduce the likelihood that capacity will be exceeded, and implement an alerting mechanism to alert and notify appropriate office/divisions when log storage capacity is reached.
- (2) When updating its policies and procedures, OIT should include log management language that
  - identifies the roles and responsibilities of staff who are involved in log management,
  - requires server logs to be periodically reviewed to check whether log capacity has been exceeded, and
  - requires appropriate OIT officials to be notified when audit logging functions are suspended when log storage capacity has reached its limit.
- (3) OIT should review and update all logging policies and procedures consistent with the policy's review interval requirements and retain evidence of its reviews and any updates to the policy.
- (4) OIT should ensure that all servers connected to the Commission's enterprise network are configured to have logging enabled.
- (5) OIT should update Server Decommission Guidelines and include language to fully document each action that should be performed when decommissioning a server. OIT should also develop a server decommissioning checklist to be included in the Server Decommission Guidelines.

- (6) OIT should conduct a review of application database log management and generation procedures to ensure that audit events are being captured and retained, consistent with OIT policies and procedures and NIST guidelines.
- (7) OIT should implement a mechanism to notify OIT's Server and Storage Branch or OIT's Security Branch when servers stop performing certain necessary functions.
- (8) OIT should implement its plan to develop a computer script that determines whether servers are producing certain necessary logs.

Management concurred with all of the report's recommendations. The report is available on the OIG website at <http://www.sec-oig.gov/Reports/Audits-Inspections/2012/500.pdf>.

### **2011 Annual FISMA Executive Summary Report (Report No. 501)**

#### BACKGROUND

FISMA provides the framework for securing the federal government's information technology. FISMA emphasizes the need for organizations to develop, document, and implement an organization-wide program to provide security for the information systems that support their operations and assets. All agencies must implement the requirements of FISMA and report annually to OMB, using OMB-issued reporting instructions, on the effectiveness of their information security and privacy programs. OMB uses the information to help evaluate agency-specific and governmentwide information security and privacy program performance, develop its annual security report to Congress, help improve and maintain adequate agency performance, and develop the E-Government Scorecard under the President's Management Agenda.

In June 2011, the OIG contracted with Networking Institute of Technology, Inc. (NIT), to assist with the OIG's response to OMB Memorandum 11-33, FY 2011 Reporting Instructions for the Federal Information Security Management Act and Agency Privacy Management Act, which provided instructions for meeting fiscal year 2011 FISMA reporting requirements.

The 2011 FISMA assessment addressed the following security requirements:

- risk management
- configuration management
- incident response and reporting
- security training
- evaluation of agency plan of action and milestones process
- remote access management
- identity and access management
- continuous monitoring management
- contingency planning
- agency oversight of contractor systems
- security capital planning

NIT reviewed and evaluated the Commission's implementation of information security requirements and provided the OIG with the results of its assessment and its recommended responses for submission to OMB through OMB's online FISMA reporting system and for compiling the 2011 FISMA Executive Summary Report. NIT's review included interviewing key OIT personnel and examining policies, procedures, and related documentation.

## RESULTS

During the review, NIT made the following five key findings: (1) OIT's FISMA policies and procedures were outdated or nonexistent; (2) OIT's risk management policy did not adhere to requirements for a comprehensive governance structure and organizational overall risk management strategy and did not address risk from a mission and business process perspective, as described in NIST guidelines; (3) OIT

had not formally defined a tailored set of baseline security controls and had not tailored control sets for specific systems; (4) OIT had not conducted configuration compliance scans and lacked a process for addressing compliance scan results in a timely manner; and (5) OIT had not implemented the technical solution for linking Personal Identity Verification (PIV) cards to multifactor authentication.

## RECOMMENDATIONS

On February 2, 2012, the OIG issued a final report containing the review's findings and the following 13 recommendations to address those findings:

- (1) OIT should develop and implement a detailed plan to review and update OIT security policies and procedures and to create OIT security policies and procedures for areas that lack formal policies and procedures.
- (2) OIT should develop a comprehensive risk management strategy in accordance with the NIST Guide for Applying the Risk Management Framework to Federal Information Systems: A Security Life Cycle Approach that will ensure that management of system-related security risks is consistent with the Commission's mission/business objectives and overall risk strategy.
- (3) OIT should update its current risk management policy to include language regarding developing a comprehensive governance structure and ensure that management of system-related security risks is consistent with the Commission's mission/business objectives and overall risk strategy.
- (4) OIT should develop and implement a formal risk management procedure that identifies an acceptable process for evaluating system risk and is consistent with the Commission's mission/business objectives and overall risk strategy.

- (5) OIT should develop and implement a formal policy that addresses tailoring baseline security control sets.
- (6) OIT should determine whether it should perform the tailoring process at the organization level for all information systems (either as the required tailored baseline or as the starting point for system-specific tailoring) at the individual information system level, or using a combination of organization-level and system-specific approaches.
- (7) OIT should tailor a baseline security controls set (with rationale) for applicable systems in accordance with the guidance provided by the *NIST Guide for Applying the Risk Management Framework to Federal Information Systems: A Security Life Cycle Approach, and the NIST Recommended Security Controls for Federal Information Systems and Organizations*.
- (8) OIT should review and update its configuration management policy to ensure that it complies with the requirements of FISMA and with the guidelines specified in the *NIST Recommended Security Controls for Federal Information Systems and Organizations*, as well as with its internal requirements.
- (9) OIT should review and document its current standard baseline configuration, including identification of approved deviations and exceptions to the standard.
- (10) OIT should conduct compliance scans of its information technology devices, according to the organizationally defined frequency in the policy and procedures, to ensure that all devices are configured as required by OIT's configuration management policy and procedures.
- (11) OIT should update its policy and include language indicating that deviations from the baseline configurations that are identified and documented as a result of the configuration compliance scans are properly remediated in a timely manner.
- (12) OIT should provide a new date to OMB for implementing the technical solution for linking multifactor authentication to PIV cards for system authentication.
- (13) OIT should complete its implementation of the technical solution for linking multifactor authentication to PIV cards for system authentication and require use of PIV cards as a second authentication factor by December 2012.

Management concurred with all of the report's recommendations. The report is available on the OIG website at <http://www.sec-oig.gov/Reports/Audits-Inspections/2012/501.pdf>.

## PENDING AUDITS AND EVALUATIONS

### Review of SEC's Continuity of Operations Plan

A continuity of operations (COOP) plan is essential for maintaining critical agency operations during disruptions that affect normal operations. The SEC's Office of the Chief Operating Officer recently assumed overall responsibility for COOP planning for the Commission. The SEC's Chief Information Officer has oversight responsibility for the disaster recovery component of the SEC's COOP plan.

The SEC has formal COOP policies and procedures and conducts periodic testing of its COOP plan. However, a recently issued OIG report found that OIT failover testing for certain internal information technology applications had been unsuccessful. Another recently issued OIG report found that the SEC's regional offices lacked viable COOP plans

and that the SEC had not tested the maximum user limit for remote access to the SEC's network.

The OIG contracted with TWM Associates, Inc., to conduct a review of the SEC's COOP plan. The objectives of the review are to determine whether the SEC has a viable COOP plan sufficient to support the SEC's operations at its headquarters, Operations Center, Alternate Data Center, and 11 regional offices. TWM Associates, Inc., will also determine whether the SEC is adequately prepared to perform essential functions during a business continuity or disaster recovery event, such as a human or natural disaster, national emergency, or technology failure that could affect the SEC's ability to continue mission-critical and essential functions.

### **The SEC's Controls Over Sensitive and Proprietary Information Collected and Exchanged With the Financial Stability Oversight Council**

The OIG has initiated an audit to identify the controls and protocols that the SEC uses to safeguard sensitive and proprietary information collected by and exchanged with the Financial Stability Oversight Council (FSOC). FSOC, which was created by the Dodd-Frank Act, is charged with identifying threats to the financial stability of the country, promoting market discipline, and responding to emerging risks that could affect the stability of the nation's financial system. FSOC's member agencies are the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Credit Union Administration, the Office of the Comptroller of the Currency, the SEC, and the Department of the Treasury.

The Dodd-Frank Act also created the Council of Inspectors General on Financial Oversight (CIGFO), which includes inspectors general from nine major federal financial entities (the eight FSOC

member agencies and the Special Inspector General for the Troubled Asset Relief Program). CIGFO was established to (1) facilitate information sharing among the inspectors general of these entities, (2) provide a forum for discussing work as it relates to the broader financial sector, and (3) evaluate the effectiveness and internal operations of FSOC.

CIGFO has established a working group of inspectors general to examine the controls and protocols that FSOC and its member agencies are using to ensure that FSOC-collected information, deliberations, and decisions are properly safeguarded from unauthorized disclosure. Members of the CIGFO working group will review their respective agency's management and internal controls over sensitive and proprietary information collected by and exchanged with FSOC. These reviews will use a standard work program to ensure that working group members take a consistent approach to their reviews. The inspectors general will relay their findings to their respective FSOC member agencies, and CIGFO will incorporate the results of all FSOC member reviews into a consolidated working group report.

### **Assessment of the SEC's Records Management Practices**

Congress established the National Archives and Records Administration (NARA) in 1934 to centralize federal record keeping. NARA's mission is to serve the public by safeguarding and preserving the records of the U.S. government, ensuring that the people can discover, use, and learn from this documentary heritage. All federal agencies are required to create a records management program that will enable them to properly maintain or dispose of their records with assistance from NARA.

Through a reorganization in July 2010, the SEC's Office of FOIA, Records Management, and Security assumed responsibility for the Office of Records Management Services (ORMS). ORMS is respon-



sible for coordinating, overseeing, and implementing the SEC's agencywide records management program.

The OIG is conducting an audit to examine whether ORMS

- has established a viable records management program that ensures that permanent SEC records are appropriately maintained and preserved in accordance with applicable federal statutes and regulations; and
- adheres to applicable federal statutes and regulations regarding the retention, disposal, transfer, and recovery of SEC records.

Where appropriate, the OIG will identify areas for improvement and best practices.

### **Assessment of the Operating Effectiveness of the Office of International Affairs**

The Office of International Affairs (OIA) plans, develops, and conducts overseas and U.S.-based trainings and technical assistance for foreign regulatory and law enforcement officials, generally from emerging securities markets. It provides advice on and assists with cross-border securities investigations and litigation originating from the Commission, mainly the Division of Enforcement, or from foreign securities regulators and law enforcement agencies, utilizing multilateral, bilateral, and other arrangements and understandings to facilitate information gathering and sharing.

OIA participates in international policy initiatives in large part through its involvement in standards-setting organizations such as the International Organization of Securities Commissions, which have as their objective the implementation of high-quality multinational securities regulations and accounting, auditing, and enforcement policies and practices. In addition, OIA provides advice on and analysis of regulatory policy initiatives in foreign countries

that may affect the Commission or the U.S. financial markets and advice on and analysis of actual or proposed U.S. regulations that may have international impact.

OIA also serves as a focal point for international travel by SEC staff. It reviews all foreign travel prior to its approval by the Office of the Chief Operating Officer, obtains country clearances from the U.S. Department of State and any visas that are required, and provides international travel guidance on the SEC's internal website.

The OIG is currently conducting an audit of OIA to assess whether OIA

- has established viable policies, procedures, and controls for its program activities;
- effectively tracks and processes requests for technical assistance and enforcement assistance in a timely manner;
- has developed a program that ensures SEC employees' international travel is appropriately processed through OIA;
- adequately communicates the SEC's international travel requirements related procedures to SEC employees; and
- appropriately conducts and reports its staff's international travel in accordance with applicable federal regulations and internal policies and procedures.

Where appropriate, the OIG will identify areas for improvement and best practices.

### **Assessment of the SEC's Hiring Practices for Senior-Level Positions**

The OIG has received several complaints and allegations related to the SEC's failure to follow established policies and procedures in connection with hiring or promoting some senior-level staff. As a result, the OIG is conducting an audit of the Commission's hiring practices for its civil service

senior-level positions. The objectives of the audit are to examine whether the Office of Human Resources (OHR)

- adheres to applicable federal statutes and regulations and has developed and implemented policies and procedures to fill senior-level SEC vacancies for competitive service positions, excepted service positions, and senior officer positions;
- ensures that the SEC's hiring and promotion practices are carried out in a fair and consistent manner and in accordance with applicable federal statutes and regulations and OHR policy requirements;
- adequately and timely communicates its hiring authority, decisions, and changes therein to SEC staff responsible for processing hiring and promotion actions;
- ensures that hiring and promotion decisions are documented in accordance with applicable federal statutes and regulations; and
- has taken appropriate action, in accordance with applicable federal statutes and regulations and OHR policy, when it has received notification that SEC staff have been improperly hired or promoted.

### **Audit of the SEC's Tips, Complaints, and Referrals System**

The SEC typically receives thousands of tips, complaints, and referrals (TCR) every year from investors and the general public, as well as from

broker-dealers, investment advisers, self-regulatory organizations, other government agencies, and foreign regulators. Divisions and offices throughout the SEC's Washington, D.C., headquarters, as well as the SEC's 11 regional offices, receive TCRs, which come in through a variety of means, including web forms, e-mail, telephone, regular mail, and personal interactions with SEC staff.

As part of its mission to protect investors and ensure market integrity, the SEC conducted a comprehensive review of its processes for receiving, recording, tracking, and taking action on TCRs. The review resulted in a comprehensive improvement plan that addressed the SEC's policies, processes, and information systems related to TCRs. In March 2011, as part of the improvement plan, the SEC implemented a new system to enable the SEC to gather TCRs and support the internal business process to review, analyze, qualify, and report on the TCRs submitted.

The OIG will conduct an audit that examines the SEC's TCR system and will assess

- whether the SEC receives, records, tracks, and escalates TCR items in accordance with internal policies and procedures, laws, and regulations;
- the accuracy and completeness of data and reports generated from the TCR system; and
- the controls and procedures utilized to ensure the accuracy and completeness of the transfer of information from the old interim TCR repository to the new TCR system.



U.S.  
SECURITIES  
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COMMISSION



# Investigations

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## OVERVIEW

**T**he OIG's Office of Investigations responds to allegations of violations of statutes, rules, and regulations and other misconduct by SEC staff and contractors. The misconduct investigated ranges from criminal wrongdoing and fraud to violations of SEC rules and policies and the governmentwide standards of conduct.

The Office of Investigations conducts thorough and independent investigations into allegations received in accordance with CIGIE Quality Standards for Investigations and the OIG Investigations Manual. The Investigations Manual contains the procedures by which the OIG conducts its investigations and preliminary inquiries and implements CIGIE Quality Standards. The Investigations Manual sets forth specific guidance on, among other things, OIG investigative authorities and policies, investigator qualifications, independence requirements, procedures for conducting investigations and preliminary inquiries, coordination with the U.S. Department of Justice (DOJ), and issuing reports of investigation.

The OIG receives complaints through the OIG Complaint Hotline, an office electronic mailbox, mail, facsimile, and telephone. The OIG Complaint Hotline consists of both telephone and web-based complaint mechanisms. Complaints may be made anonymously by calling the Hotline, which is staffed

and answered 24 hours a day, 7 days a week. Complaints may also be made to the Hotline through an online complaint form, which is accessible through the OIG's website. In addition to being a mechanism for receiving complaints, the OIG's website provides the public with an overview of the work of the Office of Investigations, as well as links to some investigative memoranda and reports issued by the Office of Investigations. The OIG also receives allegations from SEC employees of waste, abuse, misconduct, or mismanagement within the Commission through the OIG SEC Employee Suggestion Program, which was established pursuant to section 966 of the Dodd-Frank Act.

The OIG reviews and analyzes all complaints received to determine the appropriate course of action. In instances where it is determined that something less than a full investigation is appropriate, the OIG may conduct a preliminary inquiry into the allegation. If the information obtained during the inquiry indicates that a full investigation is warranted, the Office of Investigations will commence an investigation of the allegation. When an investigation is opened, the primary OIG investigator assigned to the case prepares a comprehensive plan of investigation that describes the focus and scope of the investigation, as well as the specific investigative steps to be performed during the investigation. The OIG investigator interviews

the complainant whenever feasible and conducts significant interviews under oath and on the record. The OIG investigator may give assurances of confidentiality to potential witnesses who have expressed a reluctance to come forward.

Where allegations of criminal conduct are involved, the Office of Investigations notifies and works with DOJ and the Federal Bureau of Investigation (FBI), as appropriate. The OIG also obtains necessary investigative assistance from the SEC's Office of Information Technology, including the prompt retrieval of employee e-mails and forensic analysis of computer hard drives. The OIG investigative staff also consults as necessary with the Commission's Ethics Counsel to coordinate activities.

Upon completion of an investigation, the OIG investigator prepares a comprehensive report of investigation that sets forth in detail the evidence obtained during the investigation. Investigative matters are referred to SEC management and DOJ as appropriate. The OIG does not publicly release its reports of investigation because they contain nonpublic information. Decisions regarding whether an OIG investigative report should be publicly released, in response to a Freedom of Information Act request or otherwise, are made by the Commission.

In many investigative reports provided to SEC management, the OIG makes specific findings and recommendations, including whether the OIG believes disciplinary or other action should be taken. The OIG requests that management report back disciplinary or other actions taken in response to the OIG's recommendations within 45 days of the issuance of the report. The OIG follows up as appropriate with management to determine the status of disciplinary action taken in matters referred by the OIG. The OIG may also make recommendations for improvements in policies, procedures, and internal controls in its investigative reports and closed 29 such investigative recommendations during the reporting period.

## INVESTIGATIONS AND INQUIRIES CONDUCTED

### **Destruction of Records and Related Incomplete Statements (Report No. OIG-567)**

On June 15, 2011, the OIG opened an investigation into allegations that the SEC's Division of Enforcement (Enforcement) improperly destroyed records relating to matters under inquiry (MUI) over the past two decades, and that the SEC made misleading statements in a response that was sent to the National Archives and Records Administration (NARA) concerning the SEC's potential unauthorized destruction of MUI records. After the OIG opened this investigation, it was further alleged that the SEC did not have the authority to destroy three categories of documents that are currently not scheduled with NARA: (1) documents produced by third parties, (2) internal work product, and (3) internal e-mails.

During this investigation, the OIG requested and reviewed numerous documents from Enforcement and the Office of Records Management Services. The OIG also obtained and searched the e-mails of 6 current and former SEC employees—a total of over 500,000 e-mails. The OIG took the sworn testimony of 11 current and former SEC employees who had knowledge of the facts relevant to this investigation. In addition, the OIG interviewed 12 current and former SEC employees, and one other individual. The OIG further reviewed Enforcement's database records for MUIs. Finally, the OIG sought and received a written opinion from NARA on several issues that were related to MUI documents and the SEC's response to NARA.

The OIG issued a report of investigation to management on October 5, 2011, which found that for at least 30 years, Enforcement had opened MUIs as "pre-investigation inquiries." MUIs are distinct from formal investigations in Enforcement and, according to a memorandum from a former Enforcement director, are "opened to collect and

analyze information to determine whether an enforcement investigation should be instituted.” The OIG investigation found that it had been Enforcement’s policy from 1981, when MUIs were first created, until July 20, 2010, to dispose of all documents related to MUIs that were closed without becoming investigations. According to Enforcement, from October 1, 1992, to July 20, 2010, Enforcement had opened 23,289 MUIs, and 10,468 of these MUIs had been closed without becoming an investigation or another MUI.

The OIG investigation found that Enforcement’s case closing manual, which had been posted on Enforcement’s intranet since at least 2001, specifically directed Enforcement attorneys as follows: “After you have closed a MUI that has not become an investigation, you should dispose of any documents obtained in connection with the MUI.” The OIG did not find evidence of an improper motive behind Enforcement’s longstanding policy of destroying documents related to closed MUIs that did not become investigations, although the rationale for the policy was unclear.

The OIG investigation also found that Enforcement staff destroyed documents related to closed MUIs that should have been preserved as federal records. These documents included anonymous correspondence and complaints, correspondence from the SEC requesting documents from companies in the course of MUIs, and correspondence that accompanied companies’ document production responses. However, notwithstanding these instances of record destruction in connection with MUIs that were closed without becoming investigations, the OIG was not aware of a particular investigation that was hampered by the destruction of records for a MUI.

The OIG investigation also found that after an SEC Enforcement attorney informed NARA in June 2010 that the SEC had been destroying records relating to MUIs for years, NARA sent a letter to the SEC on July 29, 2010, asking the SEC to look

into the apparent unauthorized disposal of federal records. However, the OIG found that in the process of drafting a response to NARA, the SEC made no inquiries to determine whether MUI records were in fact destroyed. Instead, Enforcement declared in a letter dated August 27, 2010, that it was “not aware of any specific instances of the destruction of records from any [MUIs that were closed without a subsequent formal investigation], but [could not] say with certainty that no such documents have been destroyed over the past seventeen years.”

The OIG found that the SEC’s August 27, 2010, response to NARA did not comply with federal regulations because it did not provide “a complete description of the records with volume and dates if known” and “a statement of the exact circumstances surrounding the removal, defacing, alteration or destruction of records” as required by 36 C.F.R. § 1230.14(a). In addition, the OIG found that the SEC’s response to NARA omitted information important to understanding the scope and nature of the issue related to the destruction of MUI records. Most significantly, the SEC’s response omitted the fact that it had been Enforcement’s policy to destroy all documents related to closed MUIs that did not become investigations. Despite the statement in the SEC’s August 27, 2010, response letter that Enforcement was not aware of any specific instances of the destruction of records from any MUI that was closed without a subsequent formal investigation, the OIG found that Enforcement was aware of at least one specific instance when records from a MUI closed without a subsequent formal investigation were destroyed.

The OIG investigation also found that although Enforcement, pursuant to its longstanding policy, had destroyed three categories of documents that are currently not scheduled (documents produced by third parties, internal work product, and internal e-mails), the SEC’s archivist opined that these documents were not records that were required to be retained. Although it did not appear that the three

categories of documents were improperly destroyed, the OIG recommended that the SEC seek formal guidance from NARA to ensure that these documents are disposed of in accordance with federal law.

The OIG did not find evidence that the individuals who were responsible for preparing the August 27, 2010, response to NARA intentionally made materially false statements. However, the OIG did find that certain senior Enforcement officials, in light of the information available to them, should have drafted a response to NARA that was more forthcoming. Accordingly, the OIG referred this matter to the Director of Enforcement for oral instruction or counseling of those individuals on the importance of providing full and complete responses to official requests from federal agencies such as NARA.

The OIG also recommended that Enforcement (1) take appropriate steps as necessary, including coordination with Enforcement attorneys nationwide, to determine what federal records from closed MUIs are retrievable, and ensure that any such federal records are retained in the same manner that investigative records are retained pursuant to the current schedule with NARA; (2) work with the SEC's Office of Records Management Services and NARA to determine which MUI and investigative records are legally required to be retained; (3) determine if there are additional federal records that, while not legally required to be retained, should be retained as a matter of Enforcement program policy to enable Enforcement staff to understand what investigative work has been done in closed MUIs and investigations, or for other policy reasons; and (4) review its guidance, including guidance related to automatically generated e-mails, to ensure that it is consistent with Enforcement's federal record retention legal obligations. As of the end of the semiannual reporting period, management had not yet taken action to fully address the OIG's recommendations.

A public version of the OIG's report is available on the Commission's website at <http://www.sec.gov/foia/docs/oig-567.pdf>.

### **Allegations of Violation of Conflict of Interest Statute by Former Senior Enforcement Official (Report No. OIG-564)**

On June 15, 2011, the OIG opened an investigation into allegations that a former senior official in Enforcement may have played an improper role in the decision not to recommend an enforcement action against a large international financial institution shortly before he left employment at the SEC. Specifically, the OIG investigated whether Enforcement previously decided to close an investigation of the financial institution without recommending action against it because the senior Enforcement official was pursuing an employment opportunity with the institution. The OIG also investigated whether there was any relationship between or *quid pro quo* regarding Enforcement's decision to close the investigation of the institution and the senior official's subsequent employment at the institution.

In the course of the investigation, the OIG obtained and searched over 200,000 e-mails of 15 current and former SEC employees. The OIG also took the sworn testimony of four current SEC employees and interviewed four former SEC employees. In addition, the OIG reviewed documents produced by SEC staff that were related to Enforcement investigations and MUIs concerning the financial institution, as well as Enforcement database records.

On October 19, 2011, the OIG issued its report of investigation in this matter. The investigation did not find evidence substantiating the allegation that the former senior Enforcement official played an improper role in the SEC's decision to close its investigation of the institution or that there was a relationship between or *quid pro quo* regarding the SEC's decision to close the investigation and

the former senior Enforcement official's eventual employment by the institution. The OIG found evidence that the former senior Enforcement official had recused himself from the investigation upon initiation of his employment discussions with the institution and that he had not made the decision to close the investigation. Because the OIG found that the former senior Enforcement official had not played a role in the decision to close the investigation of the institution in 2001, the OIG did not find any appearance of impropriety by the former senior Enforcement official regarding the decision to close the investigation. The OIG also did not find that the senior Enforcement official played a role in a previous MUI concerning the institution.

**Investigation of Alleged Ethics Violations, Misconduct, and Time and Attendance Abuse at a Regional Office (Report Nos. OIG-562 and PI 10-61)**

The OIG opened an investigation on May 4, 2011, incorporating several anonymous complaints that referenced a regional office's staff members. The allegations included claims of general misconduct, time and attendance abuse, mistreatment, job preselection, waste of travel resources, and disclosure of confidential information. The OIG also considered allegations regarding travel policy misconduct at the regional office. After opening the investigation, the OIG continued to receive anonymous allegations pertaining to a wide range of misconduct at the regional office.

In total, the OIG investigated 23 complaints. Together, these complaints alleged that 27 different regional office staff members engaged in various forms of misconduct. The OIG conducted a comprehensive and thorough investigation and found that many of the complaints were unsubstantiated and others had already been addressed by management. During the course of the investigation, the

OIG took the sworn testimony of 24 SEC employees who had knowledge of the facts relevant to this investigation and reviewed 2 testimonies taken in previous OIG matters. In addition, the OIG interviewed 3 current SEC employees.

Specifically, the OIG's investigation did not substantiate allegations of staff misconduct pertaining to (1) preselection of a senior manager; (2) improper use of time and attendance codes; (3) abuse of travel compensatory time; (4) waste of travel resources; (5) improper approval of alternate work schedules, overtime, and holiday pay; (6) disclosure of confidential information; (7) inappropriate comments in the workplace; (8) abusive treatment of staff; (9) perjury in OIG testimony; (10) an improper training decision; and (11) unprofessional conduct. However, the OIG's report of investigation, issued on January 24, 2012, found some areas of concern.

The most significant area of concern found during the investigation was evidence that a senior attorney made oral or written comments of an inappropriate or sexual nature over the last 12 years despite being disciplined for his improper behavior. In addition, while investigating the concerns about the senior attorney's inappropriate comments, the OIG discovered that he had used his government-issued travel card for personal reasons and used his government-issued e-mail account inappropriately. Based on these findings, the OIG referred the matter to management for disciplinary action, up to and including termination.

Although the OIG did not substantiate allegations that a regional office attorney engaged in time and attendance abuse, the OIG did find that the attorney's time and attendance records erroneously indicated that he was in the office working on a day when he was on vacation. Accordingly, the OIG recommended that the attorney's time and attendance record be amended to reflect appropriate leave.



In addition, the OIG's investigation determined that a regional office manager provided the names of certain securities law firms to a registrant who ultimately used that information to hire a former SEC attorney as his counsel in connection with his testimony in an Enforcement matter. Although federal employees are ethically prohibited from making endorsements while serving in their official capacity, the SEC Ethics Counsel opined that providing law firm names was not necessarily akin to an endorsement. Therefore, the OIG did not recommend any disciplinary or other administrative action against the manager. The OIG's investigation also substantiated the allegation that a number of regional office staff members socialized with the former SEC attorney following the Enforcement matter proceeding. The OIG consulted with the SEC Ethics Counsel, who opined that no specific ethics rules had been violated but that there may have been an appearance that the former SEC attorney received preferential treatment. However, because several regional office managers had recused themselves from the ongoing matter, the OIG did not recommend any further action.

The OIG's investigation uncovered one incident in which a regional office manager disclosed confidential personnel information. In addition, the OIG found that several staff members expressed concerns about this manager's management style and ability to perform his duties. Finally, the OIG found that evidence of one verbal conflict between support staff members was insufficient to establish misconduct by the staff members. Accordingly, the OIG referred these findings to management for action as deemed appropriate.

Because the OIG received numerous complaints regarding time and attendance matters, the OIG also recommended that the regional office promptly implement a previous OIG recommendation, made in February 22, 2010, that devices to capture building entry and exit information be installed in the regional office.

Management had not yet taken action with respect to the OIG's recommendations at the end of this reporting period.

### **Allegation of Favorable Treatment Provided by Regional Office to Prominent Law Firm (Report No. OIG-536)**

The OIG completed its investigation into a complaint that regional office attorneys provided favorable treatment to a prominent law firm with respect to the firm's alleged role in computer tampering, and the potential cover-up of that tampering, in connection with an ongoing SEC enforcement action involving a fraud scheme. The complainants alleged that a computer firm recommended and hired by the prominent law firm had tampered with the accused fraudster's computers, which had been seized by the court-appointed receiver in the case. In addition, the complainants claimed that the regional office staff and officials likely backed off from investigating or pursuing the law firm for any alleged role in the computer tampering and the alleged cover-up of that tampering because of the existing revolving door between the regional office and the law firm. The complainants also specifically asserted that a now-former regional office official had sought employment with this law firm prior to his departure from the SEC. The complainants further alleged that the regional office staff improperly provided nonpublic information related to this matter to the law firm.

During its investigation, the OIG obtained and searched the e-mails of 10 current and former SEC employees for the relevant time period. In addition, the OIG reviewed numerous court pleadings related to the SEC's enforcement action and the alleged tampering. The OIG also took the sworn, on-the-record testimony of six then-current SEC regional office staff members. In addition, the OIG interviewed the complainants and the court-appointed receiver.

The OIG issued its report of investigation on December 5, 2011. The OIG's investigation did not substantiate the allegation that the regional office officials and staff had backed off from investigating the law firm after learning which law firm was involved in the alleged tampering. Rather, the evidence showed the regional office was aware of the identity of the law firm involved prior to the first meeting with the receiver about the tampering issue. The OIG did find that there had been significant movement (in terms of employment) of attorneys between the regional office and the prominent law firm, but the OIG did not substantiate the allegation that the regional office backed off from pursuing the prominent law firm for any improper purpose, including currying favor for potential employment opportunities in the future. The OIG investigation revealed that the prominent law firm did attempt to influence the regional office to take certain actions to rein in the court-appointed receiver, but that the regional office staff took none of the requested actions.

Moreover, the OIG investigation did not substantiate the allegation that a now former regional office official had sought employment from the prominent law firm while he was still employed with the SEC. Specifically, the investigation did not find evidence suggesting that the former official had expressed any interest in working for the prominent law firm, or that his actions in the enforcement matter were designed to assist him in obtaining employment at the prominent law firm or at a different law firm where he was ultimately employed. The OIG investigation also found that the regional office made only minimal efforts to assist in the receiver's investigation of the alleged computer tampering and related cover-up, and that the regional office did not take certain actions that it had agreed to take or could have taken to assist the tampering investigation. However, the OIG did not find sufficient evidence to establish that the regional office's decisions regarding the level of assistance it should provide to the receiver were related to the alleged involvement

of the prominent law firm. In addition, the OIG did not find evidence that a regional office official had leaked information about the tampering investigation to the prominent law firm.

Overall, the OIG concluded that there was insufficient evidence to substantiate the allegations that regional office officials and staff engaged in misconduct by failing to investigate the alleged computer tampering and cover-up because of preferential treatment accorded to the law firm.

### **Misuse of Government Resources and Official Time at Headquarters (Report No. OIG-570)**

The OIG opened this investigation on December 14, 2011, after receiving information that an employee was continuing to use SEC resources and official time in support of a nonprofit business. The employee was the subject of a previous OIG investigation in which similar misconduct was confirmed. The prior investigation concluded that for several years the employee had used substantial Commission resources and official duty hours to support a nonprofit business. The previous investigation also found that although the employee had been repeatedly admonished by her supervisors to stop doing so, the employee continued to operate the business during official duty hours using government resources.

Accordingly, in the prior investigation, the OIG found that the employee had violated SEC and executive branch policies regarding appropriate use of SEC office equipment and information technology resources. On December 17, 2009, the OIG issued its report of investigation to management, recommending that the employee be subject to disciplinary action, up to and including dismissal from federal service. On April 26, 2010, SEC management suspended the employee for 30 calendar days and informed the employee that she could be subject to removal from federal service if she repeated the misconduct.

During the current investigation, the OIG conducted a keyword search of over 60,000 of the employee's e-mails for an 8-month period. Additionally, the OIG reviewed the results of a search performed by OIT of the employee's SEC computer hard drive using specific search terms related to her nonprofit business. The OIG also obtained the employee's time and attendance records for 2011 and the employee's SEC cybersecurity and privacy training certifications for 2010 and 2011. Finally, the OIG contacted the employee multiple times via e-mail and telephone to request that she contact the OIG to schedule her testimony, but the employee never responded to these requests. The OIG's review of the employee's e-mails and hard drive confirmed that she had continued to misuse Commission resources and had used official duty hours to operate her nonprofit business.

On January 13, 2012, the OIG issued its report of investigation in this matter and recommended that SEC management discipline the employee, up to and including dismissal from federal service. On March 21, 2012, the SEC entered into a settlement agreement with the employee, pursuant to which she voluntarily retired from federal service.

### **Allegation of Improper Personal Services Contract (Report No. OIG-569)**

On June 15, 2011, the OIG opened an investigation into allegations made in an anonymous complaint that the SEC's contract with a technology firm was a personal services contract in violation of the FAR. Specifically, the anonymous complaint alleged that SEC officials screened all of the federal contractor prospective employees' resumes, notified the federal contractor of which candidates they wanted to interview, and interviewed all of the federal contractor employees before they were hired.

The complaint further alleged that SEC officials acted as supervisors of these contractor employees, and that government officials acted as their employer by

signing their timesheets and telling them the hours they had to work, and that the contractor employees had to notify SEC officials by e-mail whenever they did not report to work.

During the investigation, the OIG obtained and searched over 180,000 e-mails of 11 current or former SEC employees and contractors. The OIG also took the sworn testimony of 8 current SEC employees and interviewed one current SEC employee. In addition, the OIG obtained and reviewed documents related to the contract that was the subject of these allegations.

The OIG investigation found evidence that the SEC contract at issue was administered as a personal services contract, in violation of the FAR. The OIG found evidence that the contractor's employees were subject to relatively continuous supervision and control by SEC employees in almost all aspects of their work. Specifically, the OIG found evidence that these contractor employees (1) performed work on site at SEC offices; (2) performed their work with tools and equipment furnished by the SEC; (3) performed services to directly support the integral effort of the assigned functions of the SEC; (4) provided the same or extremely similar services as those provided contemporaneously by SEC employees and those that had been provided by SEC employees whom the contractor employees essentially replaced; (5) provided general support services of a long-term duration, as opposed to services related to a short-term, discrete project; and (6) provided services that reasonably required direct or indirect government direction or supervision.

The OIG's conclusions were further supported by evidence that these contractor employees performed work that was principally assigned and reviewed by SEC employees, were interviewed and selected by SEC employees, worked on schedules set by SEC employees, and sought approval from SEC employees to take leave. The OIG issued its report of investigation on March 29, 2012, and recommended that

OFM, in consultation with OGC, request a formal opinion from the Comptroller General of the United States as to whether the Commission violated the Antideficiency Act, which prohibits agencies from employing personal services unauthorized by law. As of the end of this reporting period, the OIG's recommendation was pending.

The OIG investigation also found evidence that SEC employees exhibited an apparent lack of understanding of what constitutes a personal services contract. In addition, the OIG learned that although the contract that was the subject of the allegations had ended, some of the contractor employees who worked on that contract might now be performing the same services at the SEC under other contracts, giving rise to a concern that current SEC contracts are also being administered as personal services contracts in violation of the FAR. Accordingly, the OIG Office of Investigations has referred this concern to the OIG Office of Audits, which plans to conduct an audit to determine whether improper personal services contracts exist more broadly at the Commission.

### **Allegation of Procurement Violations (Report No. OIG-556)**

During the reporting period, the OIG completed its investigation into an anonymous complaint alleging that the SEC awarded a contract for an unnecessary assessment to a firm that the OIG previously found had improperly conveyed material benefits to SEC employees.

During its investigation, the OIG obtained and reviewed over 30,000 e-mails of eight current and former SEC employees and contractors. The OIG also reviewed evidence provided by headquarters offices and various witnesses related to the procurement of the assessment. The evidence included vendor proposals, requisition requests, and vendor evaluation documentation. In addition, the OIG took sworn, on-the-record testimony of three indi-

viduals with knowledge of the facts and circumstances surrounding the allegation.

In a report of investigation dated November 10, 2011, the OIG found no evidence to support the allegations that the assessment procured through the contract was unnecessary. However, the OIG did find that the solicitation was modified twice at the request of the firm that was awarded the contract and that the effect of these modifications was to lower the requisite qualifications for potential bidders and to eliminate certain restrictions. Accordingly, the OIG referred its findings to management for informational purposes.

### **Alleged Acceptance of Free or Discounted Legal Services From a Prohibited Source (PI 11-25)**

On March 14, 2011, the OIG opened a preliminary inquiry into an anonymous complainant's allegations that an SEC manager inappropriately accepted free or discounted legal services from a law firm partner. The complainant alleged that the SEC manager had recommended the partner for appointment as a receiver in an SEC enforcement matter less than a month prior to the provision of the legal services, and that the partner provided the free or discounted service to the manager in gratitude for the appointment and with the expectation of obtaining similar appointments in the future. The complaint further alleged that the SEC manager's acceptance of free or discounted services from the law firm partner created a serious appearance of impropriety. As part of its inquiry, the OIG also looked into the law firm partner's appointment as receiver to determine whether there was evidence of impropriety by the SEC manager or anyone else at the SEC.

During its preliminary inquiry, the OIG obtained and searched over one million e-mails and took the sworn testimony of the SEC manager and another SEC employee. Additionally, the OIG interviewed the SEC Ethics Counsel by telephone.

On February 17, 2012, the OIG issued its memorandum report in this matter. The OIG found that the law firm partner had provided free legal services on behalf of the SEC manager and that this constituted a gift from a prohibited source under the relevant ethics rules. However, the OIG found insufficient evidence to substantiate the allegations that the service was provided in gratitude for the receivership appointment and with the expectation of obtaining similar appointments in the future. The OIG also found no evidence that anything improper occurred with respect to the partner's appointment as receiver.

Regarding the acceptance of the free legal services, the SEC Ethics Counsel opined that there was sufficient evidence of a personal friendship between the law firm partner and the SEC manager to fall within an exception to the ethics rules and, therefore, there was no direct violation of those rules. However, the Ethics Counsel acknowledged that the acceptance of the free legal services created an appearance of impropriety because the law firm partner was a prohibited source. Accordingly, the OIG did not find a basis for recommending disciplinary action against the manager. However, the OIG recommended that the Ethics Office counsel the manager on how to properly address appearance issues in the future. The Ethics Office counseled the manager prior to the end of the reporting period.

### **Prohibited Personnel Practices in Hiring of Headquarters Employee (PI 10-07)**

The OIG conducted an inquiry into an anonymous complaint alleging that an SEC headquarters supervisor violated federal hiring regulations when the supervisor hired the relative of a former SEC manager. During its inquiry, the OIG reviewed hiring documentation, including the relevant vacancy announcement and candidate list. The OIG also obtained and reviewed e-mails of the supervisor who was the subject of the investigation, the subject's supervisor, and the employee hired by the subject. In

addition, the OIG interviewed staff from OHR and the U.S. Office of Personnel Management (OPM) to obtain information about hiring regulations and the Commission's hiring authority. The OIG also contacted the SEC Ethics Office during its inquiry regarding ethical considerations in the hiring process. The OIG took sworn, on-the-record testimony of the subject.

The OIG identified a number of circumstances surrounding the hiring in question that appear to have violated federal hiring regulations and merit system principles. Specifically, the OIG found that the hiring supervisor provided substantial assistance to the applicant during the application process, including giving advance notice of the posting and advice on information to include in the candidate's application. In addition, before the relevant vacancy announcement closed, the subject made several remarks indicating that the applicant would be selected for the position. Further, the subject did not interview any other qualified candidates.

The OIG issued a memorandum report to management on January 12, 2012, describing the results of the inquiry and recommending that OHR provide training to managers on federal hiring regulations and determine whether any corrective action should be taken with respect to those candidates that applied but were not considered for the position. At the end of the reporting period, SEC management action on the OIG's recommendations was pending. The OIG also referred the results of this inquiry to the U.S. Office of Special Counsel, which has the authority to investigate and, where appropriate, prosecute claims of prohibited personnel practices.

### **Prohibited Personnel Practices in Hiring of Senior Officer (PI 10-43)**

The OIG conducted an inquiry into an anonymous complaint alleging that an SEC senior officer in headquarters was preselected for his or her position in violation of federal law and the SEC's internal

merit promotion plan. The complaint further alleged that the vacancy announcement for this position was specifically tailored for the desired candidate and that the candidate was selected without being interviewed. In conducting its inquiry, the OIG reviewed hiring documentation, including the relevant vacancy announcement and candidate list. The OIG also obtained and reviewed e-mails of the selecting official and an OHR staff member who assisted in preparing the relevant posting. In addition, the OIG interviewed staff from OPM to obtain information about hiring regulations. The OIG also took sworn, on-the-record testimony of the selecting official and an OHR staff member familiar with the SEC's merit promotion plan.

The OIG's inquiry identified a number of circumstances surrounding the hiring of the senior officer that appear to substantiate the complaint of improper preselection. Specifically, the OIG found that the decision to hire the senior officer was made before the vacancy announcement was closed and, therefore, before the list of eligible candidates had been generated. The hiring of the senior officer was announced on the same day that the list of eligible candidates was generated and, as a result, candidates other than the senior officer were not given consideration for the position. The OIG also found that the selecting official did not contact or interview any candidates. However, the OIG found no specific evidence that the vacancy announcement was tailored to benefit the senior officer.

The OIG issued a memorandum report to management on December 7, 2011, describing the results of the inquiry and recommending that management (1) provide training to staff to ensure hiring is executed in accordance with the merit system principles, (2) finalize and issue a revised merit promotion plan and post it on the SEC's intranet, (3) institute procedures to ensure the merit promotion plan's documentation requirements are followed, and (4) consider whether corrective action should be taken. In response to the OIG's recommendations,

SEC management instituted new standard operating procedures and scheduled the first audit under the new procedures. At the end of the reporting period, SEC management's response to the other recommendations was pending. The OIG also referred the results of this inquiry to the U.S. Office of Special Counsel, which has the authority to investigate and, where appropriate, prosecute claims of prohibited personnel practices.

### **Violation of the Antideficiency Act Resulting from the Hiring of a Non-U.S. Citizen (PI 11-45)**

The OIG opened this inquiry in July 2011 after receiving information from a headquarters employee that an Antideficiency Act violation had occurred when an SEC division hired a non-U.S. citizen. The Office of General Counsel also asked the OIG to review the circumstances surrounding this hiring and to provide information to assist in determining the party who should be named responsible for the Antideficiency Act violation. In conducting its inquiry, the OIG obtained and reviewed more than 800,000 e-mails of various SEC staff members from the SEC division that hired the non-U.S. citizen, as well as OHR staff familiar with the hiring. The OIG also took sworn, on-the-record testimony of six employees who were involved in hiring the non-U.S. citizen. In addition, the OIG reviewed this employee's personnel file and documents related to the employee's selection.

The OIG's inquiry found that the SEC had unlawfully hired a non-U.S. citizen in violation of the Antideficiency Act, which prohibits the use of government funds exceeding an amount available in an appropriation. A longstanding exemption in appropriations acts that allowed the hiring of non-U.S. citizens from certain "allied countries" was removed by the 2010 Appropriations Act, which was enacted in December 2009. The OIG found that this change had not been adequately communicated to SEC staff involved in the hiring process.

The OIG's inquiry also found that SEC staff were provided inaccurate guidance regarding the permissibility of hiring non-U.S. citizens. Although the non-U.S. citizen's employment was terminated after SEC staff became aware of the violation, the Commission employed this person for approximately 10 months, in violation of the Antideficiency Act.

The OIG issued a memorandum report to management on October 25, 2011, describing the results of the inquiry and recommending that management provide guidance on hiring limitations to all staff involved in the hiring process, institute procedures to ensure that all relevant staff are notified of changes in hiring authority in a timely manner, and finalize and issue a policy regarding the hiring of non-U.S. citizens. In response to the OIG's recommendations, SEC management designated staff responsible for regularly reporting on changes to hiring regulations. At the end of the reporting period, SEC management's response to the OIG's remaining recommendations was still pending. The OIG also referred the results of this inquiry to the Office of the General Counsel for use in determining the officer(s) or employee(s) responsible for the Antideficiency Act violation.

### **Possible Violations of Ethical Standards and Conflict of Interest Statute (PI 11-26)**

On March 28, 2011, after being contacted by the SEC Ethics Counsel, the OIG opened a preliminary inquiry into allegations that an SEC employee failed to timely report a spouse's securities holdings, in possible violation of Rule 4401.102 of the SEC's Supplemental Standards of Ethical Conduct. The SEC Ethics Counsel also expressed concerns that the SEC employee might have investigated one or more companies in which the employee had a financial interest due to the spouse's securities holdings, possibly in violation of a federal conflict of interest statute. The OIG was further informed that the employee's spouse had acknowledged the existence

of two securities accounts that the spouse had kept secret from the SEC employee for several years. According to the SEC Ethics Counsel, this disclosure had arisen because the SEC employee was required to confirm all of his or her reportable holdings in the SEC's internal reporting system.

The OIG obtained and searched of over 600,000 e-mails and took the sworn testimony of the SEC employee. Additionally, the OIG interviewed both the SEC's current and former Ethics Counsels. The OIG also reviewed materials necessary to determine whether the SEC employee violated any SEC rules, regulations, and policies, or federal laws, including several hundred pages of account statements and related brokerage information; internal SEC investigative and securities holdings databases; and information provided by the Ethics Office. Finally, the OIG sought the voluntary testimony of the employee's spouse, who declined to testify during the OIG's inquiry.

On March 15, 2012, the OIG issued its memorandum report in this matter. The OIG found that the SEC employee failed to timely file the spouse's securities holdings in certain accounts as required by SEC regulations. However, the OIG also found that once the SEC employee became aware that the spouse had unreported managed accounts, secretly kept without the employee's knowledge, the employee contacted the SEC's Ethics Counsel at that time and arranged for him to advise the spouse directly on the best course of action to be taken. The former Ethics Counsel told the OIG under oath that he advised both parties that the employee should not change any reporting at that time due to anticipated changes in the ethics rules, and the OIG found that they reasonably relied on his advice. The OIG found further that the employee took affirmative steps to report and to remedy the situation by having the spouse meet more recently with the current Ethics Counsel.

In addition, the OIG did not find that the SEC employee's conduct violated a federal conflict-of-interest statute. Finally, the OIG obtained evidence that the SEC employee had a consistent history of conscientiously seeking ethics advice and testified credibly before the OIG about the events that transpired. Accordingly, the OIG did not find a basis for recommending disciplinary action in this matter and referred its report to management for informational purposes.

### **Alleged Improper Award of Sole-Source Contract (PI 11-39)**

The OIG conducted an inquiry into an anonymous complaint regarding a contract that the SEC entered into in May 2011. The complaint alleged that the contract award was inappropriate because it was a sole-source award to a friend of an SEC official's wife, made without the appropriate justification required under the applicable regulations. The complaint further alleged that the SEC official requested that the size of the contract be doubled after it was awarded.

The OIG obtained and reviewed a copy of the contract file from the Office of Acquisitions and obtained and reviewed e-mails of four current SEC employees with knowledge of the relevant facts. The OIG also interviewed four current and former SEC personnel and took sworn testimony of the SEC official referenced in the anonymous complaint.

On March 15, 2012, the OIG issued its memorandum report. The OIG found that the evidence did not substantiate the complaint's allegations regarding the contract award because the contract appeared to comply with the applicable provisions of the FAR governing the award of sole-source contracts to contractors in the Small Business Administration's 8(a) Program for small and disadvantaged businesses. Further, the OIG found that the evidence did not substantiate the complaint's claims regarding the alleged attempt to double the size of the

contract shortly after its award. The OIG also did not find any evidence that the SEC official referenced in the complaint had any inappropriate intent to award the contract to a friend or to increase the size of the contract after its award.

### **Alleged Failure to Pursue Insider Trading Investigation at Headquarters (PI 11-10)**

On December 15, 2010, the OIG opened an inquiry after being contacted by the staff of a U.S. Senator regarding a press report of an FBI investigation of alleged insider trading by third-party consultants for expert network firms, *i.e.*, Wall Street matchmakers that connect large investors with outside experts. The Senator's staff requested that the OIG investigate why no SEC enforcement action had been brought in response to a 2005 referral made by the Senator to the SEC regarding allegations of insider trading by expert network firms outlined in a 2005 newspaper article. The Senator's staff also asked whether the 2010 FBI investigation could have been initiated several years earlier if the SEC had pursued the Senator's 2005 referral.

The OIG conducted an inquiry into this matter and issued its memorandum report on March 15, 2012. The OIG inquiry found that the SEC promptly initiated its investigation into the allegations outlined in a 2005 newspaper article that the Senator had provided to the SEC. Specifically, the inquiry revealed that the SEC had opened a matter under inquiry into the allegations the day after the Senator had referred the article to the SEC.

The OIG inquiry further found that the SEC made efforts to keep the Senator's staff apprised of the ongoing SEC investigation. The OIG inquiry revealed that the SEC conducted an extensive investigation into the allegations raised in 2005, as well as a broader analysis of the links between the pharmaceutical industry and Wall Street research analysts from August 2005 through 2006. The OIG inquiry established that the SEC made many document



requests and conducted interviews. At the outset of the investigation, the SEC sent document requests to five brokerage firms identified by the 2005 newspaper article as having received information from a clinical researcher. In addition, the SEC requested documents and information from the two largest consulting matchmakers. Moreover, the SEC contacted nine pharmaceutical companies with drugs involved in clinical trials that the 2005 newspaper article had identified as being of significant interest to Wall Street, interviewed individuals at each company knowledgeable about the clinical trials, and conducted significant investigative work into how information about these clinical trials reached the marketplace.

The OIG found that the SEC received massive amounts of data, which the staff reviewed and analyzed. While the SEC's investigation uncovered communications between clinical researchers and Wall Street professionals, none of the communications identified by the investigation appear to have conveyed information that was both material and nonpublic. In addition, the SEC's investigation did not uncover any potential illegal trading activity. Despite its extensive investigation into these matters, the SEC did not find evidence supporting a violation of the federal securities laws.

Finally, the OIG inquiry revealed that the 2010 FBI investigation into alleged insider trading by third-party consultants for expert network firms, which was referenced by the Senator's staff, did not involve the subject matter of the SEC's 2005 investigation.

### **Alleged Conflict of Interest, Improper Inducement and Acceptance of a Gift, and Other Ethics Violations (PI 11-53)**

The OIG opened an inquiry after receiving an anonymous complaint through the OIG's SEC Employee Suggestion Program alleging that a branch chief engaged in social activities with a contractor, creating a conflict of interest that impeded his ethical

duty to impartially perform his procurement duties. As a part of its inquiry, the OIG also examined whether the branch chief improperly induced a social invitation from this contractor and whether the branch chief accepted a gift from the contractor that was prohibited, either because the contractor was the branch chief's subordinate or was a prohibited source as defined by applicable ethics rules. Further, the OIG considered whether the branch chief's conduct created an improper appearance. Finally, the OIG reviewed the complaint's claim that the branch chief improperly disclosed nonpublic information about future SEC contracts to employees of companies that were bidding for or had existing SEC contracts.

The OIG took the sworn, on-the-record testimony of four SEC employees or contractors. The OIG also consulted with an Assistant Ethics Counsel, the Ethics Counsel, and a contracting officer. Additionally, the OIG obtained from the contracting officer a report with detailed information about the relevant contracts, the winning quotes for one SEC solicitation, and the notifications sent to unsuccessful bidders for this solicitation. The OIG also obtained and searched approximately 77,000 e-mails during its inquiry.

On March 27, 2012, the OIG issued its memorandum report in this matter. The OIG did not find sufficient evidence to substantiate the allegation that the branch chief's limited socialization with the contractor negatively affected the branch chief's impartial performance of official contract procurement duties. The OIG did find, however, that the branch chief's actions in inducing the contractor to give a social invitation led to the improper appearance that the branch chief used his SEC position to obtain the invitation. The OIG also concluded that the branch chief received a *de minimis* gift from the contractor, who was a prohibited source under the gift rules. Nonetheless, the OIG found that corrective action taken by the branch chief and SEC management was sufficient to remedy any violations

of the gift and appearance rules. Finally, the OIG found no evidence to substantiate the allegation that the branch chief improperly disclosed nonpublic information to vendors about future SEC contracts.

Accordingly, the OIG did not find a basis for recommending disciplinary action against the branch chief, but did recommend that the Ethics Office provide counseling to the branch chief on how to properly deal with appearance and gift acceptance issues in the future. The SEC Ethics Office provided counseling to the branch chief in accordance with the OIG's recommendation prior to the end of the reporting period.

## **CIVIL SETTLEMENT AND GUILTY PLEA ARISING OUT OF OIG INVESTIGATIONS**

### **Settlement With Department of Justice for Violation of Federal Conflict of Interest Statute**

On January 13, 2012, the United States Attorney for the Eastern District of Texas announced a civil settlement reached with the former SEC official in charge of the Enforcement program at the SEC's Fort Worth Regional Office from 1998 through 2005. The agreement alleged that the former official violated 18 U.S.C. § 207, the federal statute prohibiting a former government official from making a communication or appearance before a federal agency concerning a particular matter in which the official participated personally and substantially while serving the government. As part of this agreement, the former official agreed to pay a \$50,000 civil fine, the maximum fine for violating this statute.

The settlement with the former official arose from facts uncovered during an OIG investigation into the SEC's failure to bring an enforcement action against Robert Allen Stanford or his companies (Stanford) for several years after receipt of numerous complaints that Stanford was operating a Ponzi scheme. In the report of investigation issued on

March 31, 2010, the OIG uncovered evidence that the former official, who played a significant role in multiple decisions over several years that quashed investigations of Stanford, sought to represent Stanford on three separate occasions after he left the SEC to enter private practice. The evidence obtained by the OIG also showed that the former SEC official actually represented Stanford for a brief period in 2006 and communicated with an SEC attorney about the matter before the SEC Ethics Office informed the former official that it was improper for him to represent Stanford. Subsequent to the issuance of its report of investigation, the OIG provided its full cooperation to DOJ in support of the efforts that resulted in this settlement.

The full press release discussing the settlement can be found at [http://www.sec-oig.gov/Reports/Other/SEC\\_OIG\\_PressRelease\\_1\\_13.pdf](http://www.sec-oig.gov/Reports/Other/SEC_OIG_PressRelease_1_13.pdf).

### **Guilty Plea to Felony Fraud**

On March 24, 2012, a former SEC employee pled guilty in District of Columbia Superior Court to one count of first degree felony fraud. The guilty plea arose out of an investigation that was conducted jointly by the SEC OIG, the District of Columbia OIG, and the U.S. Office of Personnel Management OIG.

The evidence obtained during the joint investigation showed that throughout a five-year period the former employee had repeatedly submitted false income information to various District of Columbia agencies in order to obtain benefits to which the former employee was not entitled. As a consequence of these false statements, the former employee fraudulently obtained benefits worth approximately \$30,000 from District of Columbia benefit programs over this five-year period. The investigation also revealed that the employee had submitted numerous false claims to the federal flexible spending account program. Sentencing in the matter was scheduled for April 2012.

## **PENDING INVESTIGATIONS**

As of March 31, 2012, the OIG had ten pending investigations. These included investigations into allegations of privacy violations related to an SEC contract, assault and building security violations,

favoritism in hiring and retaliation, conflict of interest, misuse of government resources to falsify documents, waste and mismanagement, and computer security violations. The OIG also had 58 pending inquiries at the end of the reporting period.



## Review of Legislation and Regulations

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**D**uring the semiannual reporting period, the OIG reviewed legislation and proposed and final rules and regulations relating to the programs and operations of the SEC, pursuant to section 4(a)(2) of the Inspector General Act, as amended.

In particular, the OIG conducted a follow-up review of the cost-benefit analyses performed by the SEC in connection with rulemaking initiatives undertaken pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and issued a report on the results of this follow-up review on January 27, 2011 (Report No. 499). Specifically, the OIG's follow-up review focused on the cost-benefit analyses prepared by the SEC for the following five Dodd-Frank Act regulatory initiatives:

- Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6010 (January 25, 2011) (to be codified at 17 C.F.R. parts 229, 240, and 249)
- Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4489 (January 20, 2011) (to be codified at 17 C.F.R. parts 229, 232, 240, and 249)
- Issuer Review of Assets in Offerings of Asset-Backed Securities, 76 Fed. Reg. 4231 (January

20, 2011) (to be codified at 17 C.F.R. parts 229 and 230)

- Reporting of Security-Based Swap Transaction Data, 75 Fed. Reg. 64643 (interim final temporary rule, October 13, 2010) (to be codified at 17 C.F.R. part 240)
- Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75208 (proposed November 19, 2010) (to be codified at 17 C.F.R. parts 240 and 242)

During the follow-up review, the OIG also examined, as appropriate, the following six Dodd-Frank Act rulemakings, which it had initially assessed during the prior semiannual reporting period:

- Credit Risk Retention, 76 Fed. Reg. 24090 (proposed March 31, 2011) (to be codified at 17 C.F.R. part 246)
- Clearing Agency Standards for Operation and Governance, 76 Fed. Reg. 14472 (proposed March 3, 2011) (to be codified at 17 C.F.R. part 240)
- Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948 (proposed February 2, 2011) (to be codified at 17 C.F.R. parts 240, 242 and 249)
- Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators

and Commodity Trading Advisors on Form PF, 76 Fed. Reg. 8068 (proposed January 26, 2011) (to be codified at 17 C.F.R. parts 275 and 279)

- Registration of Municipal Advisors, 76 Fed. Reg. 824 (proposed December 20, 2010) (to be codified at 17 C.F.R. parts 240 and 249)
- Conflict Minerals, 75 Fed. Reg. 80948 (proposed December 15, 2010) (to be codified at 17 C.F.R. parts 229 and 249)

To assess the adequacy of the cost-benefit or economic analyses performed by the SEC in connection with the aforementioned rulemakings, the OIG reviewed and analyzed the relevant requirements of the Paperwork Reduction Act, 44 U.S.C. § 3501 et seq.; the Regulatory Flexibility Act, 5 U.S.C. § 601 et seq.; the National Securities Market Improvement Act of 1996 (which amended the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, and the Investment Company Act of 1940); Executive Order 12866, Regulatory Planning and Review, 58 Fed. Reg. 51735, (September 30, 1993); Executive Order 13563, Improving Regulation and Regulatory Review, 76 Fed. Reg. 3821 (January 18, 2011); and Office of Management and Budget Circular A-4, Regulatory Analysis (September 17, 2003).

The OIG also reviewed statutes, rules, and regulations, and their impact on Commission programs and operations, within the context of other reviews, audits, and investigations conducted during the reporting period. For example, in the OIG's audit of the SEC's use of justifications and approvals in sole-source contracting (Report No. 507, issued March 28, 2012), the OIG reviewed and analyzed Federal Acquisition Regulation (FAR) Subpart 6.3, which prescribes the policies and procedures that must be applied when contracts are not awarded under full and open competition. During its audit, the OIG also reviewed the SEC's internal policies and procedures pertaining to justifications and approvals for other than full and open competition and found

that the SEC's administrative regulation on the use and preparation of justifications and approvals, SECR 10-21, "Restricting Competition for SEC Acquisitions," had been removed from the SEC's intranet site and was under review. In its report, the OIG recommended that the SEC's Office of Acquisitions publish comprehensive policies and procedures governing the justification and approval process at the Commission.

Similarly, during the OIG's audit of the SEC's controls over government-furnished equipment and contractor-acquired property (Report No. 503, issued March 28, 2012), the OIG reviewed the requirements of FAR Part 45 concerning government property. The OIG also examined during this audit the SEC's administrative regulation on the agency's property management program, SECR 9-2, and found that it did not address government-furnished property other than by noting that government-furnished property used by a contractor off-site was governed by the FAR. In addition, the OIG reviewed SECR 9-3 regarding reports of survey for SEC property and found that it did not discuss which specific SEC property was designated as government-furnished property. The OIG recommended that the Office of Administrative Services, in conjunction with the Office of Information Technology, revise both SECR 9-2 and SECR 9-3 to clearly define what property is designated as government-furnished property and to identify the particular circumstances needed to meet the requirements of FAR Part 45.

During an investigation completed during the reporting period into an allegation of an improper personal services contract (Report No. OIG-569, issued March 29, 2012), the OIG reviewed and analyzed the FAR provision concerning personal service contracts, 48 C.F.R. § 37.104, as well as the Anti-deficiency Act prohibition on employing personal services, 31 U.S.C. § 1342. In another investigation completed during the reporting period into an allegation involving the destruction of investigative

records by the Division of Enforcement (Report No. OIG-567, issued October 5, 2011), the OIG reviewed and analyzed the requirements of various pertinent statutes and regulations. In particular, the OIG examined the regulations promulgated by the National Archives and Records Administration concerning the unlawful or accidental removal, defacing, alteration, or destruction of federal government records.

Finally, in connection with the preparation of the Inspector General's report for fiscal year 2011 on the SEC's compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA), Public Law 111-204, the OIG reviewed and analyzed the requirements of IPERA. The review focused on the requirement in section 3 of IPERA that the inspector general of each agency prepare an annual report on the agency's compliance with the act.

# MANAGEMENT DECISIONS

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## **STATUS OF RECOMMENDATIONS WITH NO MANAGEMENT DECISIONS**

Management decisions have been made on all audit reports issued before the beginning of this reporting period.

## **REVISED MANAGEMENT DECISIONS**

No management decisions were revised during the period.

## **AGREEMENT WITH SIGNIFICANT MANAGEMENT DECISIONS**

The Office of Inspector General agrees with all significant management decisions regarding audit recommendations.

## **INSTANCES WHERE INFORMATION WAS REFUSED**

During this reporting period, there were no instances where information was refused.

## TABLES

**Table 1. List of Reports: Audits and Evaluations**

Audit/Evaluation Number	Title	Date Issued
499	Follow-Up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings	1/27/12
500	Assessment of SEC's System and Network Logs	3/16/12
501	2011 Annual FISMA Executive Summary Report	2/02/12
503	SEC's Controls Over Government Furnished Equipment and Contractor Acquired Property	3/28/12
507	SEC's Use of Justifications and Approvals in Sole-Source Contracting	3/28/12

**Table 2. Reports Issued with Costs Questioned or Funds Put to Better Use (Including Disallowed Costs)**

	Number of Reports	Value
A. Reports issued prior to this period for which no management decision had been made on any issue at the commencement of the reporting period	4	\$266,773.24
For which some decisions had been made on some issues at the commencement of the reporting period	1	\$556,811,589.00
B. Reports issued during this period	0	\$0.00
<i>Total of Categories A and B</i>	5	\$557,078,362.24
C. For which final management decisions were made during this period	5	\$557,078,362.24
D. For which no management decisions were made during this period	0	\$0.00
E. For which management decisions were made on some issues during this period	0	\$0.00
<i>Total of Categories C, D, and E</i>	5	\$557,078,362.24



**Table 3. Reports with Recommendations on which Corrective Action has not been Completed**

Recommendations Open 180 days or more

Report Number and Title	Issue Date	Summary of Recommendations
439—Student Loan Program	3/27/2008	In consultation with the National Treasury Employees Union, develop a detailed distribution plan.
460—Management and Oversight of Interagency Acquisition Agreements (IAAs) at the SEC	3/26/2010	Promptly identify all IAAs that have expired and have not been closed, and deobligate any funds that remain on the expired agreements.
		Take action to close the IAAs identified for which the performance period expired and deobligate the \$6.9 million in unused funds that remain on the IAAs, in accordance with the appropriate close-out procedures.
474—Assessment of the SEC’s Bounty Program	3/29/2010	Develop a communication plan to address outreach to both the public and SEC personnel regarding the SEC bounty program, which includes efforts to make information available on the SEC’s intranet, enhance information available on the SEC’s public website, and provide training to employees who are most likely to deal with whistleblower cases.
		Examine ways in which the Commission can increase communications with whistleblowers by notifying them of the status of their bounty requests without releasing nonpublic or confidential information during the course of an investigation or examination.
		Require that a bounty file (hard copy or electronic) be created for each bounty application, which should contain at a minimum the bounty application, any correspondence with the whistleblower, documentation of how the whistleblower’s information was utilized, and documentation regarding significant decisions made with regard to the whistleblower’s complaint.
		Incorporate best practices from the Department of Justice (DOJ) and the Internal Revenue Service (IRS) into the SEC bounty program with respect to bounty applications, analysis of whistleblower information, tracking of whistleblower complaints, recordkeeping practices, and continual assessment of the whistleblower program.
		Set a timeframe to finalize new policies and procedures for the SEC bounty program that incorporate the best practices from DOJ and IRS, as well as any legislative changes to the program.

**Table 3. Reports with Recommendations, continued**

Recommendations Open 180 days or more

Report Number and Title	Issue Date	Summary of Recommendations
480—Review of the SEC’s Section 13(f) Reporting Requirements	9/27/2010	Update Form 13F to a more structured format, such as Extensible Markup Language (XML), to make it easier for users and researchers to extract and analyze Section 13(f) data.
481—The SEC’s Implementation of and Compliance with Homeland Security Presidential Directive 12 (HSPD-12)	3/31/2011	Develop policies and procedures for determining the eligibility of contractors requiring temporary access to the SEC’s facilities and information systems.
		Promptly deploy appropriate technology (e.g., laptops with internal card readers, keyboards with card readers, or external card readers) to employees and contractors who do not have card readers.
482—Oversight of and Compliance with Conditions and Representations Related to Exemptive Orders and No-Action Letters	6/29/2011	Develop processes, including written policies and procedures, regarding reviewing for compliance with conditions and representations in exemptive orders and no-action letters issued to regulated entities on a risk basis.
		Develop and implement processes to consolidate, track, and analyze information regarding exemptive orders and no-action letters issued to regulated entities, and document these processes in written policies and procedures.
		In plans for implementing Section 965 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, develop procedures to coordinate examinations with those conducted by the Office of Compliance Inspections and Examinations and, as appropriate, include provisions for reviewing for compliance with the conditions in exemptive orders and representations made in no-action letters on a risk basis.
		In connection with monitoring efforts, include compliance with the conditions and representations in significant exemptive orders and/or no-action letters issued to regulated entities as risk considerations.
		In connection with compliance efforts, include compliance with the conditions and representations in significant exemptive orders and/or no-action letters issued to regulated entities as risk considerations.

**Table 3. Reports with Recommendations, continued**

Recommendations Open 180 days or more

Report Number and Title	Issue Date	Summary of Recommendations
485—Assessment of the SEC’s Privacy Program	9/29/2010	Evaluate risk assessment processes for scoring risk to ensure that the Office of Information Technology adequately weighs all appropriate factors, including the identification of risk levels by vendors.
		Implement an agency-wide policy regarding shared folder structure and access rights, ensuring that only the employees involved with a particular case have access to that data. If an employee backs up additional information to the shared resources, only the employee and his or her supervisor should have access.
		Ensure personal storage tab (PST) files are saved to a protected folder.
		Provide Commission staff training on handling, disposal, and storage of portable media storage devices.
489—2010 Annual FISMA Executive Summary Report	3/3/2011	Complete a logical access integration of the HSPD-12 card no later than December 2011, as reported to the Office of Management and Budget on December 31, 2010.
491—Review of Alternative Work Arrangements, Overtime Compensation, and COOP-Related Activities at the SEC	9/28/2011	Take necessary actions to ensure that employees do not work unauthorized alternative work schedules, including required revisions to the collective bargaining agreement and steps to ensure that all Commission managers and staff are fully informed about which alternative schedules are authorized.
		Provide comprehensive training to all employees and managers on all available alternative work schedule programs. This training should be provided to all new employees during employee orientation and to all employees and managers whenever significant changes to policy occur, such as upon completion of the Human Capital Directive or adoption of a new collective bargaining agreement.
		Make up-to-date information on alternative work schedules and policy available to all employees on the SEC intranet site and periodically notify employees of its availability and location.
		In developing the new Human Capital Directive, work with the National Treasury Employees Union to determine whether additional alternative work schedules, such as the gliding, variable day, variable week, three-day workweek, and Maxiflex options described in the Office of Personnel Management Handbook on Alternative Work Schedules, should be adopted as options for SEC employees.

**Table 3. Reports with Recommendations, continued**

Recommendations Open 180 days or more

Report Number and Title	Issue Date	Summary of Recommendations
		Include in the new Human Capital Directive clear, up-to-date information on the laws, policies, guidelines, and procedures related to credit hours, compensatory time off, payment for overtime worked, and voluntary and uncompensated services.
		Negotiate revisions to the language in the collective bargaining agreement between the Commission and the National Treasury Employees Union with respect to the use of credit hours by employees working conforming schedules, ensuring that the revised language conforms with applicable law.
		Institute appropriate controls to ensure that senior officers do not receive compensatory time off.
		Consult with the Office of the General Counsel and the Office of Personnel Management to determine whether the SEC should adopt an official policy that addresses whether senior officers are permitted to earn credit hours.
		Provide comprehensive telework training sessions to SEC employees that address, among other things, telework tools; policies and procedures for discontinuing telework; what happens when an employee is promoted, reassigned, or detailed; duty station policy; employee availability during telework; employee personal computer usage; mandatory telework-related forms; office supplies and equipment; and protection of government records.
		Provide comprehensive telework training sessions to SEC managers that address, among other things, telework tools, policies and procedures related to managers' approval and denial of employee telework, managers' right to direct employees to report to work on their telework day, and managers' ability to suspend or terminate telework.
		Require training and recertification for current teleworkers and managers of teleworkers at least every two years.
		Develop goals and objectives for accomplishing the work listed in the telework program work plan for fiscal year 2011 and for increasing telework participation by SEC employees.
		Establish a process to monitor progress in meeting the Commission's telework-related goals and objectives. If the goals and objectives are not being met, take action to identify and eliminate barriers to meet the goals and objectives.

**Table 3. Reports with Recommendations, continued**

Recommendations Open 180 days or more

Report Number and Title	Issue Date	Summary of Recommendations
		Require all mission-essential personnel to enter into telework agreements that specifically allow them to conduct their continuity of operations responsibilities and the mission-essential functions they will perform during emergencies or agency closures.
		Require mission-essential personnel who have telework agreements to telework periodically to practice their assigned mission-essential and primary mission-essential functions.
		Update the continuity communications section of the SEC’s continuity of operations plans and expand it to expressly address conducting essential functions by telework consistent with governing Federal Emergency Management Agency and Office of Personnel Management directives, and the SEC Collective Bargaining Agreement. It should include subsections addressing telework capability, training staff to telework effectively, and exercising agency telework competence as detailed in the Commission’s Pandemic Influenza Preparedness Plan.
		Instruct regional office directors to revise their regional office continuity of operations plans to address all the essential elements of viable continuity capability specified by the Federal Emergency Management Agency, and establish timelines and submission criteria for the revised plans.
		Instruct the directors of the appropriate regional offices to include in their continuity of operations plans strategies for supporting headquarters essential functions during devolution of control.
		Perform server stress tests that incorporate a variety of applications used with remote access.
492—Audit of SEC’s Employee Recognition Program and Recruitment, Relocation, and Retention Incentives	8/2/2011	At least annually provide information to SEC supervisors on relevant parts of the SEC award program, including (1) types of awards available and procedures for nominating employees for awards, (2) appropriate types of division- and office-level awards for peer recognition, and (3) successful award practices.*

\* This recommendation had not been closed by the end of the semiannual reporting period, although management had submitted documentation of completed corrective action and, after the end of the reporting period, the OIG determined that the recommendation should be closed.

**Table 3. Reports with Recommendations, continued**

Recommendations Open 180 days or more

Report Number and Title	Issue Date	Summary of Recommendations
		Provide formal training on revised policies and procedures and issue information notices to supervisors and employees as needed to reflect changes in practices and policies.
		Develop and implement a mechanism to reward employees for superior or meritorious performance within their job responsibilities through lump-sum performance awards.
		Re-examine budgeted amounts for recruitment, relocation, and retention incentives to ensure that sufficient funds are available, and make supervisors aware of available funding so they can effectively use incentives to recruit and retain needed talent.*
		Consider ways that, as part of the Employee Recognition Program, the Office of Human Resources may be able to provide awards to employees for adopted suggestions submitted to the OIG's suggestion program.*
493—OCIE Regional Offices' Referrals to Enforcement	3/30/2011	Continue efforts to establish a complete interface between the Super Tracking and Review System or its equivalent, the Hub, and the Tips, Complaints, and Referrals system.
495—SEC's Oversight of the Securities Investor Protection Corporation's (SIPC) Activities	3/30/2011	Determine whether to request that Congress modify the Securities Investor Protection Act (SIPA) to allow bankruptcy judges who preside over SIPA liquidations to assess the reasonableness of administrative fees in all cases where administrative fees are paid by SIPC.
		Utilize more effective methods to communicate with investors in case of the failure of broker-dealers, such as notifying investors of the status of the Commission's efforts throughout the liquidation process or designating an employee, as appropriate, who can communicate directly with investors on matters unique to each liquidation case.
497—Assessment of SEC's Continuous Monitoring Program	8/11/2011	Review the Commission's Microsoft Active Directory settings and make the necessary changes to ensure that password policy requirements, as documented in the applicable Implementing Instruction, are strictly enforced for both on-site and remote users and that the documented password structure set forth in policy is strictly enforced.
		Ensure that security controls configurations that are applied in the production environment are identical with those applied in the testing environment.

\* This recommendation had not been closed by the end of the semiannual reporting period, although management had submitted documentation of completed corrective action and, after the end of the reporting period, the OIG determined that the recommendation should be closed.

**Table 3. Reports with Recommendations, continued**

Recommendations Open 180 days or more

Report Number and Title	Issue Date	Summary of Recommendations
		Develop and implement written procedures to ensure consistency in the Commission’s production and testing environments. These procedures should detail the software and hardware components in both environments and specify the actions required to maintain consistent environments.
		Complete and finalize written server and storage log management policies and procedures that fully document the roles and responsibilities for log capture, management, retention and separation of duties
		Analyze the level of criticality of the Commission data and the needs and wants of its customers, and establish an appropriate backup retention period based on the results of the analysis and that meets the requirements of the Commission.
		Ensure that tapes are handled appropriately.
		Perform periodic audits of separated/terminated employees and contractors to ensure that all account termination notices were received and the appropriate accounts deactivated in a timely manner.
PI-09-05—SEC Access Card Readers in Regional Offices	2/22/2010	Ensure, on a Commission-wide basis, that all regional offices are capable of capturing and recording building entry and exit information of Commission employees.
PI-09-07—Employee Recognition Program and Grants of Employee Awards	3/10/2010	Ensure the revised Employee Recognition Program regulation and/or policy specifically addresses whether informal recognition awards are authorized and, if so, what criteria, standards, and approvals pertain.
ROI-491—Allegation of Fraudulently Obtained Award Fees	3/29/2010	Make efforts to recapture a portion of additional award fees a contractor obtained based on potentially inaccurate data.
ROI-505—Failure to Timely Investigate Allegations of Financial Fraud	2/26/2010	Ensure as part of changes to complaint handling system that databases used to refer complaints are updated to accurately reflect status of investigations and identity of staff.
		Ensure as part of changes to case-closing system that cases that are not actively being investigated are closed promptly.*

\* This recommendation had not been closed by the end of the semiannual reporting period, although management had submitted documentation of completed corrective action and, after the end of the reporting period, the OIG determined that the recommendation should be closed.

**Table 3. Reports with Recommendations, continued**

Recommendations Open 180 days or more

Report Number and Title	Issue Date	Summary of Recommendations
		Ensure as part of changes to case-closing system that Enforcement staff members have access to accurate information about the status of investigations and staff requests to close investigations.*
		Ensure as part of changes to case-closing system that staff at all levels are appropriately trained in case-closing procedures.*
ROI-540—Investigation of Possible Violation of Conflict of Interest Restrictions	1/25/2011	Rectify the on-line recusal database’s inability to store certain information entered on the applicable form.*
		Seek modification from the U.S. Office of Government Ethics of the blanket exemption for SK employees from the one-year cooling-off ban.
		Designate an administrative contact to maintain a list of specific matters from which senior officers are recused.
ROI-544—Failure to Complete Background Investigation Clearance Before Giving Access to SEC Buildings and Computer Systems	1/20/2011	Take immediate measures to determine whether every OIT employee and contractor has been properly cleared by a background investigation and issued an official SEC badge.
		Issue a directive ending the practice of allowing contractors (or others) to begin work of any kind before being cleared in a proper background investigation and being issued an official SEC badge.
ROI-551—Allegations of Unauthorized Disclosures of Non-Public Information During SEC Investigations	3/30/2011	Employ technology that will enable the agency to maintain records of phone calls made from and received by SEC telephones.
ROI-560—Investigation of Conflict of Interest Arising from Former General Counsel’s Participation in Madoff-Related Matters	9/16/2011	Reconsider position that net equity for Madoff customer claims be calculated in constant dollars by conducting a re-vote, and advise the bankruptcy court of its results.

\* This recommendation had not been closed by the end of the semiannual reporting period, although management had submitted documentation of completed corrective action and, after the end of the reporting period, the OIG determined that the recommendation should be closed.



**Table 4. Summary of Investigative Activity**

Cases	Number
Cases Open as of 9/30/2011	11
Cases Opened during 10/1/2011–3/31/2012	6
Cases Closed during 10/1/2011–3/31/2012	7
Total Open Cases as of 3/31/2012	10
Referrals to Department of Justice for Prosecution	2
Prosecutions	1
Convictions	1
Referrals to Agency for Disciplinary Action/Other Action	7

  

Preliminary Inquiries	Number
Inquiries Open as of 9/30/2011	74
Inquiries Opened during 10/1/2011–3/31/2012	28
Inquiries Closed during 10/1/2011–3/31/2012	44
Total Open Inquiries as of 3/31/2012	58
Referrals to Agency for Disciplinary Action	2

  

Disciplinary Actions (including referrals made in prior periods)	Number
Removals (including resignations and retirements)	3
Demotions/Suspensions	2
Reprimands	0
Warnings/Other Actions	10

**Table 5. Summary of Complaint Activity**

Complaints Received During the Period	Number
Complaints Pending Disposition at the Beginning of Period	7
Hotline Complaints Received	133
Other Complaints Received	120
Total Complaints Received	253
Complaints on which a Decision was Made	259
Complaints Awaiting Disposition at End of Period	1

  

Dispositions of Complaints During the Period	Number
Complaints Resulting in investigations	5
Complaints Resulting in Inquiries	28
Complaints Referred to OIG Office of Audits	3
Complaints Referred to Other Agency Components	164
Complaints Referred to Other Agencies	10
Complaints Included in Ongoing Investigations or Inquiries	13
Response Sent/Additional Information Requested	28
No Action Needed	10

**Table 6. References to Reporting Requirements of the Inspector General Act**

The Inspector General Act of 1978, as amended, specifies reporting requirements for semiannual reports to Congress. The requirements are listed below and indexed to the applicable pages.

Section	Inspector General Act Reporting Requirement	Pages
Section 4(a)(2)	Review of Legislation and Regulations	45–47
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	14–24; 30–43
Section 5(a)(2)	Recommendations for Corrective Action	14–24; 30–43
Section 5(a)(3)	Prior Recommendations for Corrective Action Not Yet Completed	50–57
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	59
Section 5(a)(5)	Summary of Instances Where Information was Unreasonably Refused or Not Provided	48
Section 5(a)(6)	List of OIG Audit and Evaluation Reports Issued During the Period	49
Section 5(a)(7)	Summary of Significant Reports Issued During the Period	14–24; 30–43
Section 5(a)(8)	Statistical Table on Management Decisions with Respect to Questioned Costs	49
Section 5(a)(9)	Statistical Table on Management Decisions on Recommendations That Funds Be Put to Better Use	49
Section 5(a)(10)	Summary of Each Audit, Inspection or Evaluation Report Over Six Months Old for Which No Management Decision has been Made	48
Section 5(a)(11)	Significant Revised Management Decisions	48
Section 5(a)(12)	Significant Management Decisions with Which the Inspector General Disagreed	48
Section 5(a)(14)	Appendix of Peer Reviews Conducted by Another OIG	61

## APPENDIX A. Peer Reviews of OIG Operations

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### **PEER REVIEW OF THE SEC OIG'S AUDIT OPERATIONS**

During the semiannual reporting period, the SEC OIG did not have an external peer review conducted of its audit operations. Peer reviews of OIG audit operations are required to be conducted every three years. The most recent peer review of the SEC OIG's audit operations was conducted by the Corporation for Public Broadcasting (CPB) OIG. The CPB OIG issued its report on the SEC OIG's audit operations in January 2010. This report concluded that the SEC OIG's system of quality for its audit function was designed to meet the requirements of the quality control standards established by the U.S. Comptroller General in all material respects. The report is available on the SEC OIG's website at [http://www.sec-oig.gov/Reports/Other/CPB\\_Peer-ReviewSEC.pdf](http://www.sec-oig.gov/Reports/Other/CPB_Peer-ReviewSEC.pdf).

### **PEER REVIEW OF THE SEC OIG'S INVESTIGATIVE OPERATIONS**

During the semiannual reporting period, the SEC OIG did not have an external peer review of its investigative operations. Peer reviews of Designated Federal Entity OIGs, such as the SEC OIG, are conducted on a voluntary basis. The most recent peer review of the SEC OIG's investigative operations was conducted by the U.S. Equal Employment Opportunity Commission (EEOC) OIG. The EEOC OIG issued its report on the SEC OIG's investigative operations in July 2007. This report concluded that the SEC OIG's system of quality for the investigative function conformed to the professional standards established by the President's Council on Integrity & Efficiency and the Executive Council on Integrity & Efficiency (now the Council of the Inspectors General on Integrity & Efficiency).

## OIG CONTACT INFORMATION

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Help ensure the integrity of SEC operations. Report to the OIG suspected fraud, waste or abuse in SEC programs or operations as well as SEC staff or contractor misconduct. Contact the OIG by:

PHONE                                      Hotline                      877.442.0854  
Main Office                      202.551.6061

WEB-BASED HOTLINE                      [www.sec-oig.gov/ooi/hotline.html](http://www.sec-oig.gov/ooi/hotline.html)  
COMPLAINT FORM

FAX    202.772.9265

MAIL    Office of Inspector General  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

EMAIL    [oig@sec.gov](mailto:oig@sec.gov)

*Information received is held in confidence upon request. While the OIG encourages complaints to provide information on how they may be contacted for additional information, anonymous complaints are also accepted.*

Additional copies of this report may be obtained by contacting the  
Office of Inspector General at 202.551.6061  
The report is also available on the Inspector General's website at [www.sec-oig.gov](http://www.sec-oig.gov).