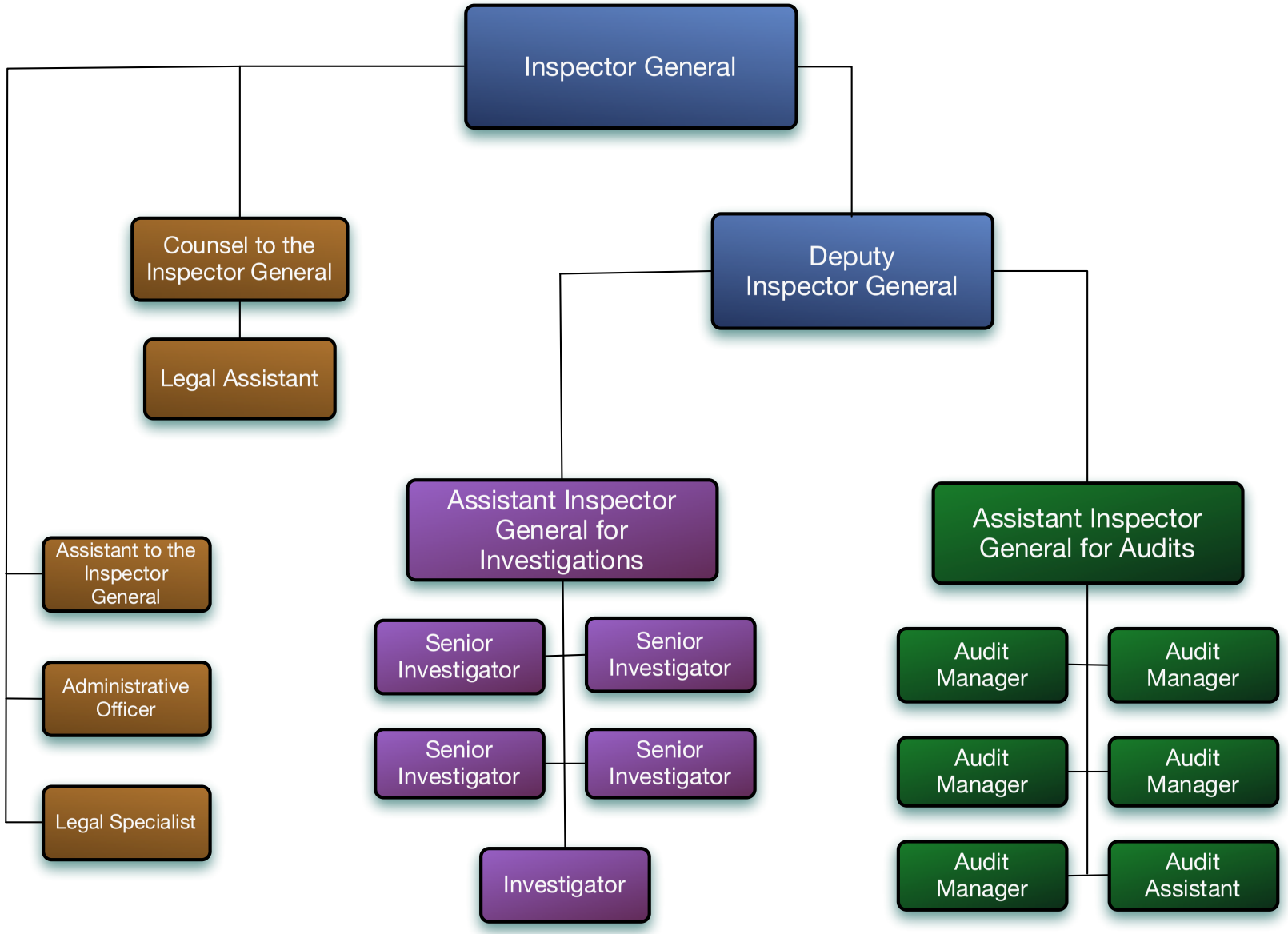
U.S. Securities and Exchange Commission
Office of Inspector General

Semiannual Report to Congress
October 1, 2009 - March 31, 2010

Organizational Chart

Office of Inspector General



October 1, 2009 - March 31, 2010

U.S. Securities and Exchange Commission

OFFICE OF INSPECTOR GENERAL SEMIANNUAL REPORT TO CONGRESS

MISSION

The 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). 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 the Congress fully and currently informed of significant issues and developments.

U.S. Securities and Exchange Commission

SEMIANNUAL REPORT TO CONGRESS

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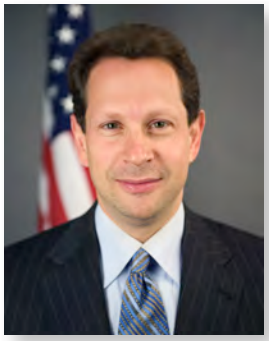

Message from the

Inspector General

I am pleased to present this Semiannual Report to Congress on the activities and accomplishments of the United States Securities and Exchange Commission (SEC) Office of Inspector General (OIG) for the period of October 1, 2009 through March 31, 2010. This report is required by the Inspector General Act of 1978, as amended, and covers the work performed by the OIG during the period indicated.

The audits, evaluations and investigations described in this report illustrate the commitment of the SEC OIG to promote efficiency and effectiveness within the SEC, as well as the tremendous impact that the SEC OIG has had on SEC programs and operations.

During this reporting period, we issued several significant audit and evaluation reports on matters critical to the SEC's programs and operations. We conducted a review of the SEC Office of Compliance Inspections and Examinations' (OCIE's) process for selecting investment advisers and investment companies for examination. This review arose out of our findings in the investigative report finalized during the preceding semiannual reporting period entitled, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme.* This investigation found that the SEC received more than ample information in the form of detailed and substantive complaints over a period of many years to warrant a thorough and comprehensive examination and/or investigation of Bernard Madoff (Madoff) for operating a Ponzi scheme. However, despite three examinations and two investigations of Madoff and his firm, a thorough and competent investigation or examination was not performed, and the SEC never identified the Ponzi scheme that Madoff operated. We further found that although Madoff's firm was required to register with the Commission as an investment adviser in 2006 as a resolution of an SEC enforcement action, in order that Madoff and his firm would be exposed to "extra regulatory scrutiny," OCIE never initiated an examination of Madoff's firm.

Accordingly, we conducted a review to determine OCIE's rationale for not performing this examination of Madoff's investment advisory business and to make recommendations to improve OCIE's process for selecting investment advisers and investment companies for examination. The review found that OCIE assigned Madoff's investment advisory business a rating of "medium risk," based on answers to questions provided on the forms he filed with the SEC. We found this rating to be problematic because Madoff was examined and investigated by OCIE and the Division of Enforcement (Enforcement) repeatedly and found to be operating as an unregistered investment adviser, and OCIE and Enforcement also found that Madoff lied about his advisory role. We further found that failures on the part of Enforcement and OCIE's broker-dealer examination unit to communicate with OCIE's investment adviser unit led to OCIE's failure to conduct an examination of Madoff's advisory business. Our report provided 11 concrete and specific recommendations designed to improve OCIE's process for selecting investment advisers for examination.

We also conducted an assessment of the SEC's program for awarding bounties to persons who provide information on insider trading violations. Our assessment found that although the SEC has had a bounty program in place for more than 20 years for rewarding whistleblowers who provide insider trading tips and complaints that lead to a successful enforcement action, there have been very few payments made under this program. We also found that the SEC bounty program is not widely recognized inside or outside the Commission. Additionally, while the Commission recently asked for expanded authority from Congress to reward whistleblowers who bring forward substantial evidence about significant federal securities law violations other than insider trading violations, we found that the current SEC bounty program is not fundamentally well-designed to be successful. Our report included nine recommendations designed to ensure the Commission has a fully-functioning and effective bounty/whistleblower program as the Commission's authority to award bounties is potentially expanded.

In addition, we conducted audits of the Commission's management of interagency acquisition agreements (IAAs) and identified 23 IAAs, totaling approximately $6.9 million, for which the period of performance had expired but the IAAs were not closed out and the remaining funds had not been deobligated. We also issued four audit or evaluation reports relating to information technology (IT) at the SEC, including an audit of the process and structure for the approval and oversight of IT investment projects and three reports prepared pursuant to the Federal Information Security Management Act of 2002.

On the investigative side, we completed 13 investigative reports on a myriad of complex and critical issues. We concluded a nearly six-month investigation of the SEC's investigations and examinations regarding accused Ponzi scheme operator Robert Allen Stanford in an effort to determine whether the SEC was aware of Stanford's alleged Ponzi scheme prior to 2006. In this investigation, we conducted 51 testimonies and interviews of 48 individuals with knowledge of facts or circumstances surrounding the SEC's examinations and/or investigations of Stanford and his companies and searched approximately 2.7 million e-mails. On March 31, 2010, we issued an investigative report that found that the SEC's Fort Worth office was aware since 1997 that Stanford was likely operating a Ponzi scheme. We found that over the next eight years, the SEC's Fort Worth Examination group conducted four examinations of Stanford's operations, finding in each examination that the certificates of deposit issued by the Antiguan-based Stanford International Bank could not have been "legitimate," and that it was "highly unlikely" that the returns Stanford claimed to generate could have been achieved with the purported conservative investment approach. Moreover, we found that while the Fort Worth Examination group made multiple efforts after each examination to convince the Fort Worth Enforcement group to open and conduct an investigation of Stanford, no meaningful effort was made by the Fort Worth Enforcement group to begin to investigate the potential fraud until late 2005.

We also conducted a comprehensive investigation of allegations that a large and well-connected company used its influence with the SEC to punish a rival who had made negative statements about the company in a speech. In this investigation, we found that serious and credible allegations against this company were not initially investigated, and instead the company was

able to successfully lobby the SEC to look into allegations against its rival without any specific evidence of wrongdoing on his part.

We also concluded investigations regarding the SEC's failure to timely investigate very serious allegations of financial fraud, the unauthorized disclosure of non-public information obtained from a Commission database, whistleblower allegations that an SEC contractor fraudulently obtained award fees, abusive behavior on the part of a current SEC employee, and misuse of government resources, among others.

I am very proud of the accomplishments of this Office during the past six months that have been achieved with a very small staff. Particularly, during these turbulent financial times, I believe that the work of the Office has been critical in providing the Commission, the United States Congress, and the public with valuable information about the regulation of the financial markets, and we intend to continue this important work in the future.

H. David Kotz
Inspector General

SEMIANNUAL REPORT TO CONGRESS

MANAGEMENT AND ADMINISTRATION

AGENCY OVERVIEW

The United States Securities and Exchange Commission's (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 that includes more than 35,000 registrants, including about 12,000 public companies, more than 11,000 investment advisers, about 8,000 mutual funds, and about 5,500 broker-dealers, as well as national securities exchanges and self-regulatory organizations, transfer agents, the Municipal Securities Rulemaking Board, the Public Company Accounting Oversight Board, alternate trading systems, and credit rating agencies.

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 16 functional offices. The Commission's Headquarters is located in Washington, D.C., and there are 11 Regional Offices located throughout the country. As of September 30, 2009, the SEC had 3,642 full-time equivalents (FTEs), consisting of 3,584 permanent and 58 temporary FTEs.

OIG STAFFING

During the reporting period, the OIG added several new auditors, investigators, and administrative staff, thereby further increasing its capacity to conduct its oversight responsibilities.

In October 2009, Craig Welter joined the OIG as a Senior Investigator. Prior to joining the OIG, Mr. Welter was Senior Counsel in the SEC's Division of Enforcement, where he investigated potential violations of the federal securities laws for nine years. During this time, Mr. Welter also served on detail from the SEC as a Special Assistant United States Attorney for the United States Attorney's Office for the Eastern District of Virginia. Before joining the SEC, Mr. Welter worked as an attorney in the United States Office of Special Counsel's Prosecution Division, where he investigated allegations of fraud, gross mismanagement, and violations of federal law by federal agencies and employees. Mr. Welter is a 1994 graduate of Duke University, where he received a Bachelor of Arts degree *cum laude* in Economics. He received his Juris Doctor degree from the William & Mary Law School in 1997.

In January 2010, Anthony Barnes joined the OIG as an Audit Manager. Mr. Barnes comes to us from PricewaterhouseCoopers LLP, where he served as a Senior Associate in the Assurance practice, primarily performing financial statement and internal control audits. Mr. Barnes joined PricewaterhouseCoopers LLP in 2004 and worked in the Financial Services - Banking and Capital Markets practice. Mr. Barnes is a graduate of the University of Alabama at Birmingham, where he received both his Bachelor and Masters in Accounting. Mr. Barnes is a Certified Public Accountant (CPA) and member of the American Institute of Certified Public Accountants (AICPA).

In March 2010, Julie Marlowe joined the OIG as an Audit Manager. Ms. Marlowe comes to us from KPMG, LLP, where she spent seven and a half years managing financial statement audits, statutory audits, Office of Management and Budget (OMB) Circular A-133 audits, and benefit plan audits of various healthcare and not-for-profit entities. While at KPMG, LLP, Ms. Marlowe provided guidance and technical updates to her clients regarding various accounting boards and standards, including the Financial Accounting Standards Board, the Governmental Accounting Standards Board, Generally Accepted Accounting Principles, and Statutory Accounting Principles. She also managed various audits for a number of entities, including healthcare systems, charitable organizations, healthcare insurance companies, a trade association, and a university. Ms. Marlowe is a graduate of the College of Notre Dame of Maryland, where she received her Bachelor of Arts degree *magna cum laude* in Accounting and Finance with a minor in Mathematics. She is a CPA in the District of Columbia, Maryland and Virginia, and a member of the AICPA and the Maryland Association of Certified Public Accountants.

The OIG also created new contract positions of legal specialist to assist the investigative function and audit assistant to assist our audit function. In January 2010, Cheryl Amitay joined the OIG as the legal specialist. Ms. Amitay comes to us from the private sector, having served as Assistant Vice President and Counsel at First American Corporation for over a decade, where she managed large scale commercial transactions and advised corporate clients and financial institutions. Prior to this, she served as Special Counsel for Legislative and Public Affairs for a criminal law association. Ms. Amitay is a 1989 graduate of Brown University, where she received her Bachelor of Arts degree with dual majors in political science and cultural anthropology. Ms. Amitay received her Juris Doctor degree from the University of Maryland in 1997, where she earned Corpus Juris Secundum and legal writing awards.

In February 2010, Brenda Eberle joined the OIG as an audit assistant. Before joining the OIG staff, Ms. Eberle worked as a full charge bookkeeper while attending college. She is currently pursuing her Bachelors of Science degree in accounting with Colorado Technical University online.

The OIG also obtained the services of two investigators on detail to assist with the increasing number of complaints it has been receiving. In November 2009, Bonnie C. Dailey joined the OIG on detail from the Office of Investor Education and Advocacy (OIEA). In OIEA, Ms. Dailey served as Senior Counsel, where she provided assistance and guidance to investors and securities professionals regarding federal securities law issues. Ms. Dailey joined the SEC in 2000 as a Branch Chief in the Office of Compliance Inspections and Examinations (OCIE). Prior to joining the SEC, Ms. Dailey was a securities regulatory attorney with Edwards & Angell, LLP, where she represented broker-dealers, investment advisers, investment companies, banks and insurance companies in securities regulatory matters. Ms. Dailey received her Bachelor of Arts degree from the University of Michigan and her Juris Doctor degree from Loyola University of Los Angeles Law School. Ms. Dailey has over 30 years of securities industry experience, beginning as a registered representative with Merrill Lynch in 1976.

In March 2010, Juliet D. Gardner joined the OIG on detail from OIEA as well. Ms. Gardner served as Senior Counsel in the Investor Assistance Group of OIEA, where she responded to a broad range of contacts from investors and securities industry professionals worldwide and analyzed incoming tips for potential referral to other SEC divisions and offices. Ms. Gardner began her legal career at the SEC in 1996, in the Division of Enforcement, where she investigated allegations of market manipulation, insider trading, financial fraud, and securities offering fraud. Ms. Gardner is a 1991 graduate of Wittenberg University, where she received a Bachelor of Arts degree in Political Science. Ms. Gardner received her Juris Doctor degree *cum laude* from Marquette University in 1996.

In addition, Heidi L. Steiber, who had worked for the OIG in the previous semiannual reporting period on detail from the Office of General Counsel (OGC) to assist in the OIG's investigation of Bernard L. Madoff's Ponzi scheme, officially joined the OIG as a Senior Investigator in October 2009. In the OGC, Ms. Steiber served as Senior Counsel in the Legal Policy Group and, prior to that, as a litigation associate in the securities enforcement group of the law firm of Mayer Brown LLP. She received a Bachelor of Arts degree from Boston University in 1995, a Masters degree from Harvard University in 1997, and her Juris Doctor degree from Cornell Law School in 2002.

Office of Inspector General

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CONGRESSIONAL AND OTHER RELATED BRIEFINGS AND REQUESTS

During the reporting period, the OIG continued to keep the Congress fully and currently informed of the OIG's investigations, audits and other activities, as well as suggestions for legislative improvements, through numerous written and telephonic communications. As discussed in the Review of Legislation and Regulations section of this report, the OIG provided comments to Congressional Committees on specific legislative provisions that would impact the SEC and the SEC OIG, along with other Inspectors General. The OIG also communicated with individual members of Congress and their staff to apprise them of the status of investigations or inquiries that were of interest to these members' constituents. Further, the SEC Inspector General also met with other commissions and agencies, including the Financial Crisis Inquiry Commission and the Government Accountability Office.

Specifically, on October 29, 2009, the Inspector General provided a letter to the Honorable Christopher J. Dodd (D-Connecticut), Chairman of the U.S. Senate Committee on Banking, Housing and Urban Affairs, in which the Inspector General set forth several recommendations that would require action by Congress. This letter was provided to follow up on a request made by Senator Dodd during the Inspector General's testimony at a September 10, 2009 hearing entitled, "Oversight of the Securities and Exchange Commission's Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance." In his letter, the Inspector General made the following specific recommendations:

(1) Extend the regulatory jurisdiction of the Public Company Accounting Oversight Board to audit reports prepared by a domestic registered or public accounting firm regarding

issuers, broker-dealers, investment advisers and any companies subject to U.S. securities laws, to allow for increased oversight of these accounting firms and reduce the risks associated with unknown accounting firms.

(2) Amend the Investment Adviser Acts of 1940, 15 U.S.C. § 80b-1, *et seq.*, to require the use of independent custodians in a manner similar to the requirement found in Section 17(f) of the Investment Company Act of 1940, 15 U.S.C. § 80a-17(f), to close an existing loophole that results in the exclusion of hedge funds from the requirement to use independent custodians.

(3) Impose a requirement of certification by senior officers of registered investment advisers that they have conducted adequate due diligence in connection with investments, and apply this certification requirement to all funds of hedge funds.

(4) Amend the Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.*, to authorize the SEC to award a bounty for information leading to the recovery of a civil penalty from any violator of the federal securities laws, not simply insider trading violators.

The full text of the Inspector General's letter is available on the OIG's website at http://www.sec-oig.gov/Reports/Other/Kotz_LegislativeRecommendationsforBankingCommittee.PDF.

On December 17, 2009, the Inspector General and an OIG expert consultant, Professor Albert S. (Pete) Kyle, Ph.D., provided an extensive several-hour briefing to the newly-created Financial Crisis Inquiry Commission (FCIC). The FCIC was created pursuant to Public Law No. 111-21, the Fraud Enforcement and Recovery Act of 2009, and was established to examine the causes, both domestic and global, of the current financial and economic crisis in the United States. Attending the briefing on behalf of the FCIC were Thomas Greene, Executive Director; Thomas Krebs, Assistant Director and Deputy General Counsel; Bradley Bondi, Assistant Director and Deputy General Counsel; Martin Biegelman, Assistant Director; Thomas Borgers, Senior Investigator; and Scott Ganz, Special Assistant to the Vice Chairman. During this briefing, the FCIC staff sought information from the Inspector General and OIG expert for use in their broad analysis of the causes of the financial crisis.

The focus of the Inspector General's briefing of the FCIC staff concerned the OIG's audit report entitled, *SEC's Oversight of Bear Stearns and Related Entitles: The Consolidated Supervised Entity (CSE) Program*, issued on September 25, 2008. The specific topics addressed included: (1) additional information about the findings and recommendations contained in the OIG's audit report; (2) how the SEC oversaw the CSE program; (3) the awareness on the part of the SEC of risk management and other concerns at Bear Stearns prior to its collapse in March 2008; (4) the relationship between SEC officials and Bear Stearns executives; (5) the SEC's oversight of CSEs other than Bear Stearns; (6) the authority of the SEC with respect to the voluntary nature of the CSE program; and (7) lessons learned from the collapse of Bear Stearns.

On March 8, 2010, the SEC Inspector General participated in a half-day meeting between the Government Accountability Office (GAO) and the Council of the Inspectors General for Integrity and Efficiency (CIGIE). The purpose of the meeting was to coordinate various ongoing activities of the GAO and the CIGIE. Specific topics discussed included, among others:

GAO's list of high-risk areas as of March 2010, including modernizing the outdated U.S. financial regulatory system; cross-cutting CIGIE reviews and projects; GAO's mandate to eliminate duplicative and wasteful spending pursuant to Public Law No. 111-139, the Statutory Pay-As-You-Go Act of 2010; updates on GAO's strategic plan and CIGIE activities; and ways to enhance GAO/Inspector General relationships.

ADVICE AND ASSISTANCE PROVIDED TO THE AGENCY

During this semiannual reporting period, the OIG provided advice and assistance to SEC management on numerous issues that were brought to the OIG's attention during the course of audits and investigations conducted by the Office and otherwise. This advice was conveyed through written communications, as well as in meetings and conversations with agency officials. The advice provided included comments on draft policies and procedures and suggestions for improvements in existing policies and procedures.

Employee Recognition Program and Grants of Employee Awards

In the course of an inquiry conducted by the OIG (PI 09-07), which is described more fully in the Inquiries Conducted subsection of this semiannual report, the OIG found that inscribed glass blocks purchased by a former Regional Office Director using office supply funds, and given as employee awards, were not issued pursuant to an agency-sponsored awards program. The OIG determined that the absence of clear criteria to serve as the basis for making such awards could lead to an appearance of impropriety on the part of the manager making the award and a perception of unfairness or favoritism on the part of other staff. The OIG's inquiry also disclosed that the SEC's Executive Director had incorrectly advised the former Regional Office Director that appropriated funds could be used to purchase parking spaces to be given as employee awards, although this option was not ultimately pursued.

The OIG also learned during its inquiry that the SEC's internal policies and procedures authorizing the agency's Employee Recognition Program (ERP) had not been revised or updated in more than 15 years, were not posted on the SEC's Intranet site and were outdated in many respects. The OIG's inquiry also found that the use of the supplies Budget Object Class (BOC) to purchase the inscribed glass blocks was not proper, and that the SEC's practice of using more than one BOC for non-monetary employee awards was contrary to the Government Accountability

Office's rules and could lead to confusion and a lack of transparency.

In order to address the deficiencies identified in its inquiry, the OIG issued an investigative memorandum to management on March 10, 2010. Therein, the OIG recommended that the agency: (1) review and update the internal policies and procedures for the ERP and post the revised policies and procedures to the SEC's Intranet site; (2) ensure the revised ERP policies and procedures specifically address whether informal recognition awards and honorary awards in addition to the existing annual awards are authorized and, if so, what criteria, standards and approval are pertinent to such awards; (3) ensure that the revised ERP policies and procedures make clear that appropriated funds may not be used to pay for employee parking as an award; (4) review the various BOCs that are currently used for non-monetary employee awards, select the most apposite BOC, and ensure that all properly-authorized non-monetary employee awards are charged to that BOC; and (5) approve requests to use appropriated funds for non-monetary employee awards only after ensuring that an authorized officer of the agency has approved such awards in accordance with statutory and regulatory authority. Management action on the OIG's recommendations was pending as of the end of the semiannual reporting period.

Access Card Readers in Regional Offices

The OIG had received numerous allegations that senior managers in an SEC Regional Office were frequently absent from the office for several hours a day over an extended period of time. In an attempt to determine the veracity of these allegations, the OIG sought documentation of the managers' arrival and departure times. The OIG learned, however, that this particular Regional Office, as well as most other SEC Regional Offices, did not have systems in place to identify both entry and exit times of employees. The OIG found that only the SEC Headquarters and the New York Regional Office are equipped with systems that fully capture building entry and exit times. The OIG determined that the lack of access card readers or other devices that would capture full employee entry and exit information could limit OIG efforts to investigate allegations concerning time and attendance abuse or other employee misconduct, and noted that such information had been instrumental in similar cases investigated by the OIG at SEC Headquarters in the past.

In order to advise management of its concerns, the OIG issued an investigative memorandum to management on February 22, 2010. In its memorandum, the OIG recommended that access card readers or other devices to capture building entry and exit information, similar to those currently utilized at SEC Headquarters and the New York Regional Office, be installed in every Regional Office in order that allegations of time and attendance abuse or other law enforcement concerns may be adequately investigated and addressed. As of the end of the semiannual reporting period, management had not yet implemented the OIG's recommendation.

Regulation on Management and Protection of Privacy Act Records and Other Personally Identifiable Information

The OIG reviewed and provided written comments to the Office of Information Technology (OIT) on a draft of SEC Regula-

tion 24-08, "Management and Protection of Privacy Act Records and other Personally Identifiable Information." In those comments, the OIG requested that OIT provide certain clarifying information concerning an attachment to the draft regulation, entitled "Rules of Conduct." The OIG further recommended appropriate revisions to the language contained in the draft regulation regarding the penalties for non-compliance with the policy. Finally, the OIG's comments sought clarification regarding certain language contained in the section of the draft regulation regarding effective dates. In response to the OIG's comments, the OIT provided the requested clarifications and made appropriate changes to the draft regulation. Issuance of the final regulation was pending as of the end of the semiannual reporting period.

Warning Banner for New Employee Financial Reporting System

During the reporting period, the SEC's Office of General Counsel (OGC) requested that the OIG review and provide comment on a warning banner that had been drafted for the new SEC employee financial reporting system, the Ethics Program System (EPS). The EPS was implemented in response to an OIG report of investigation issued on March 3, 2009. The OIG's report found suspicious activity, appearances of improprieties, and evidence of possible trading on non-public information on the part of two Enforcement attorneys. The Report further found that the SEC had essentially no compliance system in place to ensure that Commission employees, who have tremendous amounts of non-public information at their disposal, did not engage in insider trading. Accordingly, the report made 11 specific recommendations designed to ensure adequate monitoring of employee securities transactions, including that the agency institute an integrated, computerized system for the tracking and reporting of such transactions. In the comments provided to OGC regarding the draft EPS warning banner, the OIG provided suggested revisions to the draft language, and those suggestions were incorporated into the final system warning banner.

Office of Inspector General

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AUDITS AND EVALUATIONS

OVERVIEW

The 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 that are received from Congress, internal SEC staff, the Government Accountability Office, 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 is measurable, and testing internal controls are 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 that are conducted 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 the 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 the SEC's 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. The Office of Audits' evaluations are conducted in accordance with OIG policy, Yellow Book non-audit service standards and guidance issued by the CIGIE.

Peer Reviews

The OIG community conducts peer reviews of audit and investigative functions to ensure quality programs. During this reporting period, another OIG reported on its review of our audit function, and we performed a review of another OIG's audit function.

External Peer Review of the SEC OIG's Audit Operations by the Corporation for Public Broadcasting OIG

The Corporation for Public Broadcasting (CPB) OIG conducted a peer review of our audit operations in accordance with generally accepted government auditing standards (GAGAS) and the guidelines established by the CIGIE. Under GAGAS, audit organizations that conduct audits or attestations in accordance with those standards must have an appropriate system of quality control and undergo external peer reviews at least once every three years. The CPB OIG issued its report on the SEC OIG's audit operations in January 2010. This report concluded that our system of quality control for the audit function was designed to meet the requirements of the quality control standards established by the Comptroller General of the United States in all material respects and awarded the SEC OIG the highest possible peer review rating, *i.e.*, a rating of "pass."

Peer Review of National Credit Union Administration's Office of Inspector General

During this reporting period, our Office of Audits began to conduct an external peer review of the audit activities of the National Credit Union Administration (NCUA) OIG. The objective of this external peer review is to determine whether, for the period under review, NCUA OIG audit organization's system of quality control was suitably designed to provide a reasonable assurance of conforming to GAGAS and to determine whether the audit organization complied with its quality control system.

We commenced a review of the NCUA OIG audit organization and the design of its system of quality control to assess the risks implicit in its audit function. Based on our assessments, we selected for review audits conducted under GAGAS by the NCUA OIG that were completed during the period from April 1, 2008 to October 30, 2009. In the course of our review, we examined supporting documentation, conducted interviews, and tested the adequacy of the design of the quality control system to provide reasonable assurance of compliance with GAGAS. Also, we tested compliance with the audit organization's system of quality control to the extent appropriate. Additionally, we reviewed NCUA OIG's monitoring of an engagement performed by an Independent Public Accountant (IPA), in which the IPA served as the principal auditor. We intend to complete this review and issue a report of our findings during the next semiannual reporting period.

AUDITS AND EVALUATIONS CONDUCTED

Review of the Commission's Processes for Selecting Investment Advisers and Investment Companies for Examination (No. 470)

Background

On August 31, 2009, the OIG issued an investigative report entitled, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme*, Report No. 509. The investigation found that the SEC received more than ample information in the form of detailed and substantive complaints over a period of many years to warrant a thorough and comprehensive examination and/or investigation of Bernard Madoff (Madoff) and Bernard Madoff Investment Securities, LLC (BMIS) for operating a Ponzi scheme. However, despite three examinations and two investigations of Madoff and BMIS, a thorough and competent investigation or examination was not performed, and the SEC never identified the Ponzi scheme that Madoff operated.

The first Enforcement investigation and first examination were conducted in 1992 after the SEC received information that led it to suspect that Avellino & Bienes, a firm for which Madoff was managing money, was selling unregistered securities and conducting a Ponzi scheme. The SEC's investigation focused on Avellino & Bienes and did not investigate the possibility that Madoff was the one who was in fact operating the Ponzi scheme.

In 2004 and 2005, the SEC's examination office, the Office of Compliance Inspections and Examinations (OCIE), conducted two parallel cause examinations of BMIS. These examinations were conducted by OCIE's broker-dealer examination unit, rather than its investment adviser unit, notwithstanding the fact that many of the issues in the complaints that precipitated the examinations related to BMIS's investment adviser operations. During the 2004 examination, the examiners raised the issue of whether BMIS was acting as an unregistered investment adviser. A member of the examination team drafted a memorandum about whether BMIS met the definition of investment adviser, but the memorandum was never finalized, and the team did not pursue or resolve the issue of BMIS's investment adviser status. Similarly, in the 2005 examination, examiners began researching the issue of whether Madoff should be registered as an investment adviser due to his investment discretion over certain hedge fund accounts, but the investment adviser registration issue was not pursued or resolved.

Enforcement formally opened an investigation of BMIS in January 2006, based upon a detailed complaint that Harry Markopolos (Markopolos), an independent fraud investigator, provided to Enforcement in 2005. Although Markopolos' complaint focused on why Madoff's returns could not be legitimate, the Enforcement team investigating Markopolos' complaint decided to open the matter to investigate (1) whether BMIS, a registered broker-dealer, provided investment advisory services to large hedge funds in violation of the registration requirements of the Investment Advisers Act of 1940 (the Advisers Act), and (2) whether BMIS engaged in any fraudulent activities in connection with these services. During Enforcement's investigation, the staff learned from an OCIE examiner that in the 2005 examination of BMIS by OCIE's broker-dealer examination staff, Madoff failed to disclose to the staff both the nature of the trading conducted in the hedge fund accounts and also the number of such accounts at BMIS. When closing its investigation in 2007, the Enforcement staff stated that they found "that BMIS acted as an [unregistered] investment adviser to certain hedge funds, institutions, and high net worth individuals in violation of the registration requirements of the Advisers Act." The Enforcement staff also found that Madoff's largest hedge fund client, Fairfield Greenwich Group (FGG), "did not adequately disclose to its investors [BMIS's] advisory role and merely described [BMIS] as an executing broker to FGG's accounts."

As a result of this investigation and discussions with SEC staff, BMIS registered with the Commission as an investment adviser. BMIS filed Part 1 of its Form ADV with the Commission on August 25, 2006, and its registration as an investment adviser became effective on September 12, 2006. Further, FGG revised its disclosures to investors to reflect BMIS's advisory role. The Enforcement staff stated that BMIS's investment adviser registration was a "good result" because it would expose Madoff and his firm to "extra regulatory scrutiny." They further noted that BMIS's agreement to register as an investment adviser was "a positive development for law enforcement" because, *inter alia*, BMIS would "be subject to continued on-site inspections." However, we found that until Madoff confessed to operating a Ponzi scheme in December 2008, OCIE never initiated an investment adviser examination of BMIS, even after BMIS was forced to finally register as an investment advisor in August 2006. We conducted this review to determine OCIE's rationale for not performing an examination of BMIS's investment advisory business soon after the firm registered as an investment adviser in 2006, and to make recommendations to improve OCIE's process for selecting investment advisers and investment companies for examination.

Results

The OIG's review found that OCIE assigns each registered investment adviser a "low," "medium," or "high" risk rating, which is initially based on each adviser's response to certain questions in Part 1 of the Uniform Application for Investment Adviser Registration (Form ADV). When BMIS registered as an investment adviser in 2006, BMIS was classified as "medium risk," based on its answers to the questions provided on its Form ADV Part 1. BMIS filed two subsequent Form ADVs in 2007 and 2008. Each of the three Form ADVs received by the Commission resulted in BMIS being assigned a "medium risk" designation in 2006, 2007 and 2008. We found that only firms categorized as "high risk" trigger routine OCIE examinations within three years of receiving the "high risk" rating.

To ascertain the Form ADV rating, OCIE uses an algorithm to calculate a numeric score for each firm based on certain affiliations, business activities, compensation arrangements, and other disclosure items that could pose conflicts of interest. Although the risk algorithm allows OCIE to determine an investment adviser's relative risk profile, in the absence of an examination risk rating, it is potentially limited because it does not measure the effectiveness of the investment adviser's compliance controls, which are designed to mitigate conflicts of interest or other risks that could harm investors.

OCIE may also develop a risk rating for an investment adviser based upon information obtained through an examination. The examination rating is weighted more heavily than the Form ADV rating since it is based upon more complete information. However, because OCIE's investment adviser unit never conducted a formal examination of BMIS's investment advisory business, notwithstanding the fact that OCIE's broker-dealer unit and Enforcement analyzed numerous aspects of BMIS's advisory business during their examinations and investigations, OCIE never developed a risk rating of BMIS based on an OCIE examination. Therefore, OCIE's rating of BMIS was "medium" – the same as BMIS's Form ADV rating.

Our review found this rating problematic because BMIS was examined and investigated by OCIE and Enforcement repeatedly and found to be operating as an (unregistered) investment adviser, and OCIE and Enforcement found that Madoff lied about BMIS's advisory role. We also found that BMIS's registration as an investment adviser was prompted by an Enforcement investigation, which should have automatically led to BMIS receiving an initially higher risk rating than it would have received had its registration not been a condition of Enforcement closing its investigation. Moreover, findings from OCIE's prior cause examinations of BMIS and Enforcement's investigations involving BMIS should have prompted OCIE to question BMIS's "medium" Form ADV rating.

Enforcement stated that BMIS's investment adviser registration was a "good result" because it would expose Madoff and his firm to "extra regulatory scrutiny." However, there is no indication that anyone on the Enforcement staff ever suggested that OCIE's investment adviser examination staff conduct a cause examination of BMIS. We found this fact to be troubling because the Enforcement investigation (which included the assistance of an OCIE broker-dealer examiner) revealed that Madoff did not fully disclose either the nature of the trading BMIS conducted in hedge fund accounts or the number of such accounts at BMIS, BMIS commingled billions of dollars of equities among its investment advisory accounts and with its broker-dealer proprietary account, and the investor disclosures of BMIS's largest hedge fund client did not adequately describe BMIS's advisory role. As some of the problems identified in Enforcement's investigation related to BMIS's investment advisory operations, we found that both Enforcement and OCIE's broker-dealer examination staff should have immediately notified OCIE's investment adviser examination unit. We further concluded that at this point, OCIE should have immediately scheduled a cause examination.

Our review further found that Enforcement's and OCIE's broker-dealer examination unit's failures to communicate with OCIE's investment adviser unit led to OCIE's failure to conduct an examination of BMIS's advisory business. An OCIE branch chief testified that BMIS might have been subject to a "cause exam" immediately after it registered

had the investment adviser examination staff been informed that Madoff had made misrepresentations to Enforcement and OCIE broker-dealer examination staff.

We also found that OCIE's risk rating process did not adequately weigh an investment adviser's level of assets under management and the number of clients that receive investment advisory services. We believe that advisers with more assets under management and more clients who receive advisory services should receive progressively higher risk scores.

As part of our review, we conducted an analysis of BMIS's 2006, 2007 and 2008 filings and found that had BMIS provided accurate information on its Form ADVs, it may have been classified as a "high risk" adviser and, therefore, been subject to a routine OCIE examination within three years of receiving a "high risk" rating. We found numerous lies and misrepresentations in Part 1 of BMIS's Form ADV of which OCIE should have been aware because of the examinations it conducted of BMIS. We found that Madoff, on behalf of BMIS, lied about the number of firms he solicited, the number of clients to whom he provided services, the types of clients he had, the amount of BMIS's assets, whether he had discretionary authority to determine the broker or dealer to be used for a purchase or sale of securities for a client's account, whether he had compensated any firms for client referrals and whether any firms had custody of his advisory clients' securities. In fact, nearly every substantive answer he gave on Part 1 of his Form ADV was a lie and, in nearly every case, OCIE's previous examinations of Madoff had revealed that Madoff's answers were false. Moreover, had OCIE utilized the information the SEC gathered from the examinations and investigations of BMIS in assigning risk weighting to BMIS's answers and, thus, graded it on accurate information, BMIS's score would have been significantly higher. In that scenario, BMIS should have been subject to the three-year cycle for a firm rated as "high" risk.

Our review also found that Form ADV has not been substantively updated since 2000, when it was first required to be filed electronically with the Commission. We believe that OCIE could identify additional risk factors if registrants were required to include in Form ADV detailed information about the hedge funds they advise, including the hedge funds' performance and auditor. Further, Form ADV should require a hedge fund's auditor to file its opinion with the Commission. Further, we found that until 2000, investment advisers were required to file Parts 1 and II of Form ADV with the Commission in hard copy. Part II of ADV was required to be filed with the SEC until 2000 when the Commission adopted new rules under the Advisers Act requiring that registered advisers make filings with the Commission electronically through an electronic filing system known as the Investment Adviser Registration Depository (IARD) system. At that time, the Commission exempted advisers from submitting Part II to the Commission because the IARD system was not ready to accept those filings. The exemption was intended to be temporary, but nine years later, investment advisers are still not required to file Part II of their Form ADV electronically or even file a paper copy with the Commission, absent a specific request from the Commission. Instead, investment advisers need only retain a copy of Part II of their Form ADV in their files. Currently, Part II is deemed to be "filed" with the SEC when advisers update the form and place a copy in their files.

We found that considering Form ADV Part II to be "filed" with the Commission when an adviser places it in a filing cabinet is an inadequate procedure and concluded that Part II of Form ADV should be electronically filed with the Commission. This document provides pertinent disclosures about an investment adviser's advisory services, fees, types of clients, types of investments on which the adviser offers advice, other business activities, affiliates, conditions for managing accounts, and compensation information, among other things.

Finally, our review found that OCIE internal documentation identified a risk that hedge fund custodian statements could be fictitious and the assets may not be verifiable. Another risk identified was that since investment advisers are not required to file Part II of Form ADV with the Commission, the SEC does not receive important information regarding potential conflicts of interest involving investment advisers. While these issues have been recognized, we found that they have not been resolved.

Recommendations

The OIG issued its final report of the results of the review on November 19, 2009. The report included 11 recommendations designed to improve OCIE's process for selecting investment advisers and investment companies for examination. These recommendations were as follows:

(1) OCIE should implement a procedure requiring, as part its process for creating a risk rating for an investment adviser, that OCIE staff perform a search of Commission databases containing information about past examinations, investigations, and filings related to the investment adviser.

(2) OCIE should change the risk rating of an investment adviser based on pertinent information garnered from all Commission divisions and offices, including information from OCIE examinations and Enforcement investigations, regardless of whether the information was learned during an examination conducted to look specifically at a firm's investment advisory business.

(3) Enforcement and OCIE should establish and adhere to a joint protocol providing for the sharing of all pertinent information (*e.g.*, securities laws violations, disciplinary history, tips, complaints and referrals) identified during the course of an investigation or examination or otherwise.

(4) OCIE should establish a procedure to thoroughly evaluate negative information it receives about an investment adviser and use this information to determine when it is appropriate to conduct a cause examination of an investment adviser.

(5) When OCIE becomes aware of negative information pertaining to an investment adviser, it should examine the investment adviser's Form ADV filings, and document and investigate discrepancies existing between the adviser's Form ADV and information OCIE previously learned about the registrant.

(6) OCIE should establish a procedure to thoroughly evaluate an investment adviser's Form ADV when it becomes aware of issues or problems with an investment adviser, and should initiate appropriate action such as commencing a cause examination.

(7) OCIE should re-evaluate the point scores it assigns to advisers based on their reported assets under

management and assign progressively higher risk weightings to firms that have greater assets under management.

(8) OCIE should re-evaluate the point scores that it assigns to firms based upon their reported number of clients to which they provide investment advisory services and assign progressively higher risk weightings to firms that serve a large number of clients.

(9) A Commission rulemaking should be instituted that would require additional information to be reported as part of Form ADV.

(10) The proposed rule providing for Amendments to Form ADV should be finalized.

(11) OCIE should develop and adhere to policies and procedures for conducting third party verifications, such that OCIE verifies the existence of assets, custodian statements, and other relevant criteria.

Management agreed with all 11 recommendations in this report. We encouraged OCIE to take immediate steps to implement the recommendations and plan to conduct a follow-up audit to determine whether the changes to OCIE's operations are having the desired and appropriate effect.

Assessment of the SEC's Bounty Program (No. 474)

Background

The OIG conducted an assessment of the SEC's program for awarding bounties to persons who provide information on insider trading violations (bounty program) as a result of an issue that was identified during the OIG's investigation into the SEC's examinations and investigations of Bernard L. Madoff and related entities, OIG Report of Investigation entitled, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme,* Report No. 509, August 31, 2009. We conducted our review during December 2009 and January 2010.

The primary objectives of the review were to:

- assess whether necessary management controls have been established and operate effectively to ensure bounty applications are routed to appropriate personnel and are properly processed and tracked; and

- determine whether other government agencies with similar programs have best practices that could be incorporated into the SEC bounty program.

Section 21A(e) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78u-1(e), authorizes the SEC to award a bounty to a person who provides information leading to the recovery of a civil penalty from an insider trader, from a person who tipped information to an insider trader, or from a person who directly or indirectly controlled an insider trader. All bounty determinations, including whether, to whom, or in what amount to make payments, are within the sole discretion of the SEC. However, the total bounty may not currently exceed ten percent of the amount recovered from a civil penalty pursuant to a court order.

The SEC recently sent to Congress proposed legislation to expand its authority to permit bounties for any judicial or administrative action brought by the Commission under the federal securities laws that results in monetary sanctions exceeding $1,000,000. The

proposed legislation was included in the Investor Protection Act of 2009 (H.R. 3817), which was introduced in the U.S. House of Representatives on October 15, 2009, by Congressman Paul Kanjorski (D-Pennsylvania) and referred to the House Committee on Financial Services. Variations of this legislation are being considered by both the U.S. House of Representatives and U.S. Senate.

Results

Although the SEC has had a bounty program in place for more than 20 years for rewarding whistleblowers who provide insider trading tips and complaints that lead to a successful enforcement action, the OIG review found that there have been very few payments made under this program. Likewise, the Commission has not received a large number of applications from individuals seeking bounties over this 20-year period. We also found that the program is not widely recognized inside or outside the Commission. Additionally, while the Commission recently asked for expanded authority from Congress to reward whistleblowers who bring forward substantial evidence about significant federal securities law violations other than insider trading violations, we found that the current SEC bounty program is not fundamentally well-designed to be successful.

More specifically, the OIG found that improvements are needed to the bounty application process to make it more user-friendly and help ensure that bounty applications provide detailed information regarding the alleged securities law violations. The OIG also found that the criteria for judging bounty applications are broad and the SEC has not put in place internal policies and procedures to assist staff in assessing contributions made by whistleblowers and making bounty award determinations. Additionally, the OIG found that the Commission does not routinely provide status reports to whistleblowers regarding their bounty applications, even if a whistleblower's information led to an investigation. Moreover, we found that once bounty applications are received by the SEC and forwarded to appropriate staff for review and further consideration, they are not tracked to ensure they are timely and adequately reviewed. Lastly, the OIG found that files regarding bounty referrals did not always contain complete documentation, such as a copy of the bounty application, a memorandum sent to the whistleblower to acknowledge receipt of the application, and a referral memorandum showing the division or office and official to whom the bounty application was referred for further consideration.

Recommendations

The OIG issued a report summarizing the results of its review on March 29, 2010. The report included nine recommendations designed to ensure the Commission has a fully-functioning bounty/whistleblower program in place as the Commission's authority to award bounties is potentially expanded.

The report's recommendations were as follows:

(1) The Division of Enforcement (Enforcement) should develop a communication plan to address outreach to both the public and SEC personnel regarding the SEC's bounty program.

(2) Enforcement should develop and post a bounty application form to its public website that asks the whistleblower to provide certain pertinent information.

(3) Enforcement should establish policies on when to follow up with whistleblowers who submit bounty applications to clarify information in those applications and to obtain readily-available supporting documentation prior to making a decision as to whether a whistleblower's complaint should be further investigated.

(4) Enforcement should develop specific criteria for recommending the award of bounties, including a provision that where a whistleblower relies partially upon public information, such reliance will not preclude the individual from receiving a bounty.

(5) Enforcement, in conjunction with the Office of General Counsel, should examine ways in which the Commission can increase communications with whistleblowers by notifying them of the status of their bounty requests without releasing non-public or confidential information during the course of an investigation or examination.

(6) Enforcement should develop a plan to incorporate controls for tracking tips and complaints from whistleblowers seeking bounties into the development of its processes and systems for other types of tips, complaints and referrals.

(7) Enforcement should require that a bounty file (hard copy or electronic) be created for each bounty application.

(8) Enforcement should 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.

(9) Enforcement should 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.

Management concurred with all of the report's recommendations and indicated that Enforcement has already begun to take steps to correct the identified deficiencies.

Management and Oversight of Interagency Acquisition Agreements at the SEC (No. 460)

Background

The OIG conducted an audit of the Commission's management of interagency acquisition agreements (IAAs) as part of its annual audit plan. The audit objectives were to: (1) evaluate the SEC's processes and procedures to approve, obtain, monitor, and close IAAs; (2) assess compliance with governing federal and Commission regulations and policies; and (3) determine whether opportunities existed for the SEC to save costs associated with IAAs.

Federal government agencies use IAAs to obtain goods or services from or through other federal agencies. Agencies may place orders directly against another agency's contract (a direct acquisition), or have another agency award and administer the contract on its behalf (an assisted acquisition). The SEC enters into many types of IAAs, including IAAs for administrative support services, employee payroll services, paralegal services, transit subsidy distributions, and financial statement audit and human capital management assistance services.

The authority for federal agencies to obtain goods and services from each other is de-

rived from various statutes. In the absence of specific statutory authority, the Economy Act (31 U.S.C. §§ 1535, 1536) provides general authority for interagency acquisitions. More specific authorities for such acquisitions include: the Government Employees Training Act (5 U.S.C. Chapter 41), which allows agencies to obtain training and related assistance from other government agencies and the Office of Personnel Management; the Clinger-Cohen Act of 1996, which authorizes information technology purchases; and 40 U.S.C. § 501, which relates to services for executive agencies granted to the Administrator of General Services.

A major difference between Economy Act and non-Economy Act IAAs pertains to the deobligation of funds. For Economy Act acquisitions, obligated funds must be deobligated to the extent the funds have not been used to place orders for goods or services before the end of the period of availability for the funds (unless "no-year" funds were obligated). This deobligation requirement also does not apply to interagency agreements based on statutory authority other than the Economy Act.

The Office of Acquisitions (AO) of the SEC's Office of Administrative Services (OAS) oversees the Commission's contracts and interagency acquisitions. OA includes four branches, consisting of a newly-established Policy, Oversight and Acquisitions Program branch and three Operations Contract branches. The responsibilities of staff in OA's Operations Contract branches include signing IAA documents to obligate funding, resolving issues regarding acquisitions, and ensuring agreements are properly closed out after the period of performance expires.

SEC's divisions and offices initiate IAAs by contacting another government agency directly to discuss needed requirements, terms and conditions, or by submitting a requirement to OA. If an SEC division or office contacts another government agency directly, the SEC division or office that is requesting the services must provide OA with the purchase requisition, the unsigned IAA agreement form, the statement of work (SOW), and the terms and conditions of the agreement. If OA initiates the IAA, the requesting division or office must send the SOW to OA, and OA then contacts the other government agency to establish the terms and conditions of the IAA. If OA and the servicing agency approve the agreement, representatives of both agencies sign the IAA form. The servicing agency then establishes payments for the IAA through the Interagency Payment and Collection (IPAC) system. OA uses the signed IAA agreement order to obligate funding for the acquisition by inputting required information into the Commission's financial accounting system.

Results

The OIG's audit found that OA can improve its processes and procedures regarding IAAs in a variety of ways, including improving the tracking of IAAs, developing policies and procedures governing IAAs, deobligating funding on expired IAAs, updating IAA forms to include current information requirements, improving cost estimates, and ensuring that statements of work are prepared according to applicable requirements.

The OIG found that OA is currently unable to track its universe of IAAs, and the incomplete list of IAAs provided by OIA contained numerous errors. The audit discovered that OA currently lacks a centralized method that accurately tracks all of the SEC's IAAs, although OA is in the process of implementing an automated procurement tracking system. We also found that IAAs were not always

clearly identified as such, thus hampering OA's ability to track them appropriately.

Specifically, during our audit, we asked OA to provide us with the universe of IAAs that were open, or for which the period of performance ended during Fiscal Years (FYs) 2007 - 2009. Although OA provided us with a list of 133 IAAs totaling approximately $234 million in estimated costs, the complete universe of IAAs could not be confirmed, and the list provided was incomplete and contained erroneous information. Thus, OA officials could not identify the total number or dollar amount of the Commission's IAAs with certainty.

Moreover, our review of the 133 IAAs OA identified on the list provided to us revealed the following deficiencies:

- the period of performance was missing for 63 IAAs;
- the amount obligated amounts was missing for 50 IAAs;
- the IAA status was missing for 49 IAAs; and
- the statutory authority was missing for 48 IAAs.

Further, four IAAs were inaccurately identified on OA's list of IAAs as "expired" when, in fact, according to the IAAs themselves, the period of performance had not ended. Due to the number of errors found on OA's list of IAAs, our audit determined that the IAA list was unreliable and did not provide OA with accurate information that could be used to make decisions regarding IAAs.

In addition, the OIG's audit found that OA lacks written internal policies and procedures for administering and overseeing IAAs. For example, OA has no SEC-specific written policies and procedures regarding:

- providing a specific, definite and clear description of products or services;
- ensuring that statements of work for assisted interagency acquisitions meet the applicable requirements;
- ensuring the reasonableness of interagency acquisition costs;
- including the appropriate information in interagency acquisition files;
- recording and maintaining complete information on interagency acquisitions; and
- closing expired interagency acquisitions.

We also found that OA has no written policies and procedures to implement the applicable provisions of the Federal Acquisition Regulation (FAR), the U.S. Department of Treasury Financial Manual (TFM) Bulletin No. 2007-03, or the OMB's Office of Federal Procurement Policy (OFPP) guidance on interagency acquisitions. Further, OA's IAAs do not undergo any legal review, and OA has not formulated policies regarding SEC oversight of IAAs. Nor has OA performed risk assessments of its interagency acquisition function.

Significantly, during our audit we identified 23 IAAs, totaling approximately $6.9 million, for which the period of performance had expired, yet the IAAs were not closed out and the funds that remained on the IAAs were not deobligated. This $6.9 million represents funds that were unable to be used by the Commission because they had not been deobligated. We found that $5.3 million of this $6.9 million was attributable to a single IAA with the General Services Administration (GSA), for which the period of performance

had ended on September 30, 2008. Effective monitoring on the part of OA for this single IAA would have resulted in $5.3 million being deobligated and available for use to support the SEC's programs, operations and mission.

Further, our audit found that: (1) the SEC's IAA forms and the determinations and findings (D&Fs), which are prepared to support the IAAs, lacked information required by the FAR; (2) the "Securities and Exchange Commission (SEC) Interagency Agreement/ Amendment" (SECIAA/A) form was outdated; and (3) the SEC's IAA award documents and forms did not include all of the information necessary to document the basis for the interagency acquisition and the obligation of funds. We reviewed the D&Fs from a judgmental sample of 13 out of 133 IAAs to evaluate compliance with the FAR. Our review disclosed that three of 13 D&F documents (two of which were for Economy Act IAAs) lacked the required statement that "[t]he supplies or services cannot be obtained as conveniently or economically by contracting directly with a private source."

We also judgmentally selected 21 IAAs from the population of 133 IAAs to test the completeness of the IAA documentation. Of the 21 selected IAAs, ten were prepared on the SEC's award forms, while the remaining 11 were prepared on other agencies' forms. We found that while the SECIAA/A forms included information required by the FAR, the forms lacked the specific fields needed to identify delivery requirements, acquisition authority, and the resolution of disagreements, as required by TFM Bulletin No. 2007-03. In addition, five SECIAA/A forms appeared to lack information entirely on either the acquisition authority or the resolution of disagreements. Also, the SECIAA/A form did not contain certain TFM bulletin requirements, including the business event type code, the business partner network number, and the method of performance reporting.

In addition, our audit found that the SEC's IAA documentation was not consistent with the format recommended by the OFPP, which issued guidance on "Interagency Acquisitions" in June 2008. That guidance requires specified documentation of IAAs for assisted acquisitions that were entered into on or after November 3, 2008. The information contained in OFPP's enumerated elements was also not readily found in the IAA documentation that we reviewed. In several instances, we were required to review several documents (*e.g.*, the IAA form, the terms and conditions, and the statement of work) to locate the required information.

We further found that OA lacked critical information to review IAA cost estimates. Specifically, we found in connection with an August 2008 IAA for administrative support services that the OA contracting officer was unable to explain why the SEC was paying a unit cost that was significantly higher than the estimated employee hourly rate and fringe rate. When we analyzed the costs associated with a judgmental sample of task orders, we found that these costs contained a differential of $281,000, which included overhead, general and administrative expenses, and profit on direct labor cost/fringe benefits and represented 27 percent of the total cost of the corresponding task orders. We then compared this percentage to the fees associated with other SEC IAAs, and found it to be high. When we judgmentally selected a sample of 15 out of 269 small business contractors listed on the GSA schedules used to provide administrative support to agencies, we found that nine out of 15 contractors in our review listed lower rates than the entity chosen by the SEC in at least one labor category.

We also determined that in connection with an IAA for payroll services, OA failed to provide the necessary input to ensure that the proposed contract prices were fair and reasonable. Moreover, in connection with a cancelled Economy Act IAA, OA did not take appropriate steps to seek return of $50,000 that had been advanced under this IAA, instead allowing the $50,000 to be subsequently applied as a reduction to the cost estimate of an unrelated IAA for payroll services.

Our audit further disclosed that the Office of Human Resources' (OHR's) statement of work (SOW) for its IAA with the Office of Personnel Management Training and Management Assistance (OPM/TMA) program for human resources management assistance did not specifically identify the required services or products, or include information that was specified in the OPM/TMA program's guidance. The OPM/TMA program provides assistance to agencies in the areas of training and human capital management, workforce planning and restructuring, process improvement, and performance and compensation systems. The OPM/TMA program provides agencies with access to its contracts with a number of private sector vendors with expertise in human capital management. The OPM/TMA issues task orders for the required services and maintains funding received from external agencies in a revolving fund, which is used to pay for work done under the IAA.

Between FYs 2006 and 2007, OHR transferred approximately $5.1 million into OPM/TMA program's revolving fund in connection with an IAA. Specifically, in June 2006, OHR requested that $2 million be immediately transferred from its operating fund to the OPM/TMA program account. In August 2006, OHR entered into an IAA for $2 million with OPM/TMA to obtain human resources management assistance for its staff. The IAA consisted of a SOW that OHR included with its funding request. The IAA's period of performance was from October 2006 to September 2007, and the IAA was an assisted acquisition, pursuant to which an OPM staff member served as the contracting officer for the IAA. Between September 2006 and September 2007, according to OHR, approximately an additional $3.1 million was transferred to the OPM/TMA account for the IAAs so the SEC could "lock in" a lower, more favorable fee rate.

The OPM/TMA program provides written guidance on the information that agencies should submit to transfer funds to OPM/TMA. The OPM/TMA program guidance, which is posted on OPM's website, describes a six-step process for agencies to follow when entering into an IAA with OPM/TMA. According to the guidance, the statement of objectives (SOO) (which is similar to an SOW) should clearly and concisely describe the agency's needs and expectations. Although the OPM/TMA guidance specifically described the information that should typically be included in the SOO, we found that OHR's SOW for the IAA with OPM/TMA did not include much of the necessary information and did not even specify the services or products requested.

Recommendations

The OIG issued its final report of the results of the audit on March 26, 2010. The report included 15 recommendations intended to enhance OA's controls regarding oversight of IAAs and improve its procedures, compliance with applicable requirements, and ability to identify cost saving opportunities. These recommendations were as follows:

(1) OA, in coordination with the Office of Financial Management (OFM), should identify its universe of open interagency acquisitions and the corresponding amounts obligated and expended on each interagency acquisition. Once this is accomplished, OA should reconcile its universe of active and open interagency acquisitions with the financial information maintained by OFM regarding open interagency acquisitions and the corresponding amounts obligated and expended.

(2) OA should maintain its interagency acquisition data in its centralized automated system to ensure appropriate access to and accuracy of data and to provide for report generation capabilities.

(3) OA should establish appropriate internal controls to provide reasonable assurance that, in the future, IAA data is accurate, timely, complete and reliable.

(4) OA should develop internal written policies and procedures to guide it in administering interagency acquisitions. These policies and procedures should be based on appropriate risk assessments, address both Economy Act and Non-Economy Act acquisitions, and incorporate FAR Subpart 17.5, the OFPP's guidance on interagency acquisitions, and other requirements regarding interagency acquisitions as appropriate.

(5) In developing written policies and procedures for assisted interagency acquisitions, OA should incorporate the requirements of the Economy Act, the OFPP guidance on interagency acquisitions, and other controlling authorities, and coordinate with OFM to assure its minimum requirements are also included. OA should ensure that its written policies and procedures for interagency acquisitions include guidance for:

- ensuring that statements of work for interagency acquisitions related to assisted services meet the applicable requirements;
- ensuring the reasonableness of interagency acquisition costs;
- including the appropriate documents in interagency acquisition files;
- recording and maintaining complete information on interagency acquisitions; and
- closing expired interagency acquisitions.

(6) OA should benchmark other federal agencies' written policies and procedures for interagency acquisitions when developing its IAA written policies and procedures.

(7) OA should develop written policies and procedures regarding interagency acquisitions that include timeframes and procedures for closing out Economy Act and non-Economy Act interagency acquisitions and deobligating funds for both assisted and direct acquisitions. The closeout procedures should also identify the Commission's process for coordinating with servicing agencies.

(8) OA should promptly identify fully all IAAs that have expired but have not been closed. OA should deobligate any funds that remain on the expired agreements.

(9) OA should take action to close the interagency acquisitions we identified for which the period of performance had expired and deobligate the $6.9 million in unused funds that remain

on the interagency acquisitions, in accordance with the appropriate close-out procedures.

(10) OA should update its interagency acquisition D&Fs and interagency acquisition forms to include the information required by the FAR, TFM Bulletin No. 2007-03 (in consultation with OFM), and the OFPP guidance on interagency acquisitions.

(11) OA should develop and implement appropriate procedures to review interagency acquisition cost estimates to ensure they are reasonable and properly supported.

(12) OA should assess the Mid-Atlantic Cooperative Administrative Support Unit (CASU) IAA to determine if the costs incurred are reasonable and the CASU IAA is in the best interest of the Commission.

(13) OA should consider sources of administrative support services that charge lower amounts if it determines that the CASU IAA does not provide the best value to the Commission.

(14) OA should provide additional training to its contracting staff and customers regarding interagency acquisitions. This training should include developing and ensuring the adequacy of statements of work and statements of objectives according to applicable guidance and requirements.

(15) OHR, in consultation with OA, should ensure that future Memoranda of Understanding provide appropriate specificity with regard to the types of products and services required, in accordance with applicable requirements.

OAS management concurred with 14 of the 15 recommendations included in the OIG's report. We expressed our concern that OAS did not concur with the recommendation to provide additional training to its contracting staff and customers regarding interagency acquisitions, including training designed to ensure the adequacy of statements of work and statements of objectives according to applicable guidance and requirements. We remain convinced that OA should further provide guidance to its customers to help ensure the adequacy of statements of work and statements of objectives.

Assessment of the SEC Information Technology Investment Process (No. 466)

Background

The SEC has established a Capital Planning and Investment Control (CPIC) process and structure for the approval and oversight of Information Technology (IT) investment projects. The primary mission of the CPIC process is to establish a strategic approach for how the Commission uses its IT funds. This process serves as a means of ensuring that the SEC's IT investments achieve specific outcomes. The CPIC process provides for the identification, selection, control, and evaluation of investments in IT resources. The process also addresses the decision criteria used to select IT investments, as well as the use of defined performance measures in assessing an investment's progress.

Specifically, the CPIC process is controlled by three governing boards:

1. The Information Technology Capital Planning Committee (ITCPC);

2. The Information Officers Council (IOC); and

3. The Project Review Board (PRB).

Each board has a charter that outlines its role in the IT investment process, and the boards are charged with ensuring that all projects are adequately reviewed and approved at various levels of the investment process.

The objectives of the audit were to examine whether SEC divisions and offices have established procedures to ensure that major IT investments are properly approved by the CPIC boards, specifically, the PRB, IOC and/or the ITCPC. The audit was also designed to:

- determine whether the CPIC process and procedures and the PRB, IOC and ITCPC structures adhere to governing Commission policy and applicable federal laws and regulations;
- examine whether procedures exist to ensure that major IT investments are properly approved within the CPIC process and are presented to the PRB, IOC and/or ITCPC as appropriate; and
- assess whether major IT investment projects are properly approved by the appropriate CPIC board(s).

Prior OIG Audit Report

On March 29, 2004, the OIG issued a report entitled, *IT Capital Investment Decision-Making Follow-up*, Report No. 365, on the IT investment process, and the report included 25 recommendations. The report found that the Commission's process for IT investment decision-making did not meet the minimum criteria of the Government Accountability Office's (GAO's) Information Technology Investment Management Maturity Model and was not in full compliance with applicable laws and regulations. The report further found that the SEC's IT investment decision-making process remained a "significant problem" for the Commission, and that the governance of this critical Commission function needed to be strengthened. The OIG recommended that the Commission assign specific responsibility and delegate appropriate authority for establishing a compliant and effective IT decision-making process. The report further recommended that the SEC ensure that the necessary changes were completed in a timely manner by the implementation of a performance accountability process. However, at the time we conducted our audit work for the current audit, several recommendations in the 2004 OIG report were not completely addressed, specifically, the recommendations regarding the publishing of an IOC charter and establishing the Chief Information Officer's (CIO) authority. As of the date of the issuance of our current audit report, over five years later, we found that the CIO still lacked the necessary authority to manage the CPIC process adequately.

Results

The audit found that although comprehensive procedures are documented for major IT investments, these procedures were not consistently followed throughout the Commission. We found that although the SEC has gone to great lengths, and expended significant resources, to develop an IT CPIC structure, approval process and procedures, the Commission has not adequately implemented all phases of the CPIC process and procedures that are contained in its regulations and implementing instructions.

Specifically, we found that two out of four investments we reviewed in a judgmentally-selected sample did not follow the process prescribed in the CPIC policies and procedures. As a result, significant decisions were made regarding IT investments without a meaning-

ful review by the appropriate boards. In the case of one of these investments, OAS made a decision to cancel a $3 million strategic acquisition project and began an entirely new, nearly identical project for an additional $3.5 million without formal approval. With regard to the second investment, we found that a decision was made to cancel a project after major problems were discovered with the contractor's performance without seeking appropriate approvals from the IT Boards.

The audit also found that IT investments were not being properly managed because the project managers were overloaded with assignments, resulting in the SEC's formalized policies and procedures not being followed. We also found that OIT's inability to provide adequate technical assistance for IT projects forced the program offices to contract out the project management function, leading to increased projects costs.

In addition, the audit determined that the CIO's control and effectiveness within the SEC was limited because he lacked the authority required by statute to manage IT resources adequately. We found that although federal statute and OMB guidance required that the CIO report directly to the Chairman, at the SEC, the Executive Director had administrative authority over the CIO and as a result, the CIO did not have authority to influence substantive IT decisions made by his direct supervisor (the Executive Director). Furthermore, interviews conducted during the audit revealed that there is a perception within multiple Commission divisions and offices that several offices are able to evade the CPIC process without any consequences because the heads of these offices report directly to the Executive Director. We found that although the CIO is supposed to be the custodian of the Commission's IT resources, his ability to perform this task effectively is limited by virtue of his reporting relationship with the Executive Director.

In addition, we found that the CPIC policies needed to be revised to create an enforceable mechanism that Commission divisions and offices must follow. Further, based on the results of an OIG survey concerning IT investments within SEC, we found the need for more direct involvement from the divisions and offices in connection with IT investments.

Recommendations

OIG issued the report for this audit on March 26, 2010. The report included nine recommendations designed to improve the IT investment process. The recommendations were as follows:

(1) Improve OIT's oversight of IT investments to ensure the requirements in the CPIC policies and procedures are followed.

(2) Require that status updates on all ongoing projects be provided every six months in order to manage resources for IT investments over a specified dollar amount.

(3) Immediately fill a critical vacant project management position with an experienced and qualified candidate.

(4) Perform an assessment of the project management functions to ensure an appropriate ratio of projects to project managers.

(5) Delegate to the CIO authority necessary for the management and oversight of the CPIC process, including full authority to develop and execute all IT policies.

(6) Revise the applicable Code of Federal Regulation provisions to give the CIO full authority to develop IT policies.

(7) Revise the SEC's internal regulation pertaining to the CIPC process to add responsibility for senior officials to ensure that IT investments adhere to the CIPC policies and procedures, and to create an enforcement mechanism for the CPIC process.

(8) Conduct periodic internal reviews to ensure that requirements applicable to IT investment management are properly enforced.

(9) Require that all SEC divisions and offices use OIT's project management system, and update and maintain the data in the system for the investments within their program areas.

Management concurred with all of the report's nine recommendations. The OIG plans to follow up appropriately to ensure that these recommendations are implemented, and that the Commission's ability to comply with the mandates of statutes, regulations and guidance pertaining to the management and oversight of IT capital investments is strengthened.

Management Alert – Data Security Vulnerabilities (No. 477)

Background

We conducted a review of data security vulnerabilities within the SEC after three recent investigations undertaken by the SEC OIG raised concerns about data security. In 2008 and 2009, we undertook two investigations involving the unauthorized release of non-public documents and reports available on the OCIE intranet sites and/or shared network drives. In a third investigation, we learned that files pertinent to our investigation had been deleted or removed from an OCIE shared network drive and have not been recovered. Despite our conducting extensive e-mail review and witness interviews, the sources of the release of non-public information and file removal have not been identified because OCIE's intranet sites and shared network drives do not employ auditing systems.

Results

In our review, we found that the SEC does not have in place an auditing system for OCIE intranet sites or its shared network drives. OCIE's intranet sites and shared network drives store extensive non-public information, including inspection and examination reports, deficiency letters, and other documents containing confidential registrant information. Approximately 2,000 employees have access to OCIE's intranet sites or shared network drives. However, use of the OCIE intranet sites and shared network drives is not audited, which allows users to view, print, copy, download, move, edit, or delete documents and files without detection.

Recommendations

The OIG issued a Management Alert memorandum to OCIE and OIT on March 10, 2010, to advise these Offices of our concerns about data security vulnerabilities. The memorandum requested that management take prompt access to address the OIG's concerns, including implementing a system for auditing the access and use of OCIE's intranet and share network drives.

Management's responses provided on March 10 and 11, 2010, indicated that OCIE agreed with the need to have in place an auditing system for its intranet sites and share network drives. The responses also indicated that OCIE technical staff was currently working with OIT staff to review various audit solutions and to determine the impact of the solutions on OCIE's current business practices, and that OIT was analyzing the technology aspects of the OIG's request.

2009 FISMA Executive Summary Report (No. 472)

Background

In August 2009, the 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 Office of Management and Budget (OMB) Memorandum M-09-29, entitled, "Reporting Instructions for the Federal Information Security Management Act and Agency Privacy Management." The OMB memorandum provided instructions and templates for meeting the FY 2009 reporting requirements under the Federal Information Security Management Act of 2002 (FISMA), Title III of Public Law No. 107-347.

FISMA provides the framework for securing the federal government's IT resources. All federal agencies must implement the requirements of FISMA and report annually to OMB and Congress on the effectiveness of their privacy programs and privacy impact assessment processes. OMB uses the reported information to evaluate agency-specific and government-wide privacy performance, develop OMB's annual security report to Congress, assist in improving and maintaining adequate agency privacy performance, and assist in the development of the E-Government scorecard under the President's management agenda.

C5i commenced work on this project in September 2009, after OMB promulgated the final FISMA questionnaires for FY 2009. C5i's tasks included completing the OIG portion of the FISMA reporting template (Section C) and developing an Executive Summary Report that communicates the Inspector General's response to the SEC's 2009 FISMA submission.

The objective of the OIG's FISMA assessment was to independently evaluate and report on how the Commission has implemented its mandated information security requirements. The assessment was also designed to provide background information, clarification, and recommendations for the OIG's response and input to Section C of the OMB reporting template.

Results

The OIG issued its final FISMA Executive Summary report on March 26, 2010. The report found as follows:

- The Commission operates a total of 48 systems, of which 46 have been evaluated as having a moderate system impact level. The remaining two systems were evaluated as having a low system impact level.

- The SEC routinely performs oversight and evaluations to ensure information systems used or operated by an agency contractor, or by other organizations on behalf of the agency, meet applicable requirements.

- The Commission has developed an inventory of major information systems. Although performing a full inventory of all systems exceeded the scope of our effort, but through our interviews, document reviews, and research, we ascertained that the inventory is approximately 90 to 100 percent correct.

- The Commission's plan of actions and milestones process provides an effective roadmap for continuous security improvement, assists with prioritizing corrective action and resource allocation, and is a valuable management and oversight tool.

- The Commission's overall certification and accreditation program is assessed as excellent and in compliance with applicable regulatory and statutory requirements.

- The SEC's Privacy Office has made significant progress in its development of privacy resources, outreach within Commission and regional offices, and benchmarking externally with other agencies. However, the privacy policies are still in draft form and, as a result, the program is not fully implemented throughout the Commission.

- The Commission has developed and disseminated formal, documented, configuration management policies, as well as implementing guidance that satisfactorily addresses security configuration management requirements. We found some areas of concern in the SEC's encryption policies and procedures that are further detailed in a separate report, although this information did not pertain to a specific question in the configuration management section of OMB's reporting template.

- Federal desktop core configuration has been successfully implemented on all SEC workstations and laptops, and appropriate language from FAR 2007-004, which modified Part 39 - Acquisition of Information Technology, is now included in all contracts related to common security settings.

- The Commission has robust incident prevention, detection, response, and reporting capabilities and follows documented policies and procedures for reporting incidents internally, to the U. S. Computer Emergency Readiness Team and to law enforcement.

- As of November 15, 2009, cyber security awareness training was successfully completed by 4,101 of 4,383 (94 percent) users.

- The Commission has monitoring systems and policies regarding the use of collaborative web technologies and peer-to-peer file sharing, which are included in IT security awareness training, ethics training, and other agency-wide training.

Evaluation of the SEC Privacy Program (No. 475)

Background

As part of the work described in the FISMA Executive Summary Report, C5i issued a separate report documenting the results of its evaluation of the Commission's privacy program. During this evaluation, C5i reviewed a broad range of issues covering policies, implementation and other related aspects of the SEC's privacy program.

Results

The OIG's evaluation found that in recent years, the SEC's Privacy Office within OIT had made progress in acquiring resources, performing outreach within SEC headquar-

ters and regional offices, and benchmarking best practices with external agencies. Further, the SEC's Privacy Office has devoted a significant amount of time to drafting an agency privacy policy and implementing guidance. Specifically, the Privacy Office issued draft guidance covering the privacy program and privacy incident management as follows:

- draft SECR 24-08 (01.0), Management and Protection of Privacy Act Records and Other Personally Identifiable Information; and
- draft OD 24-08.07 (01.0), Privacy Incident Management.

According to the evaluation, the draft guidance documented the roles and responsibilities of the Chief Privacy Officer and the Senior Agency Official for Privacy, identified procedures and provided direction based on governing guidance. The evaluation also found that the Privacy Office developed privacy policies regarding the management and protection of Privacy Act records and breach notification, (*i.e.*, incident management), which are pending approval.

However, the OIG's evaluation found that the SEC's privacy program has not been fully implemented throughout the agency. There remains significant and critical guidance that must be approved, some of which has been in draft form since 2008. Specifically, we found that draft privacy and privacy incident management program policies and procedures needed to be finalized, approved, and implemented. Therefore, we could not state with assurance that the SEC is managing and operating its privacy program with the appropriate internal controls.

Recommendation

The OIG issued a report summarizing the results of the evaluation on March 26, 2010. The report recommended that OIT should finalize its outstanding draft privacy related policies and procedures and implement them throughout the agency by the end of FY 2010, and management concurred with the recommendation.

Evaluation of the SEC Encryption Program (No. 476)

Background

Encryption is the process of transforming information (referred to as plaintext) using an algorithm (*i.e.* a cipher) to make the information unreadable to anyone except those possessing special knowledge (usually referred to as a key). The result of the process is encrypted information (referred to as ciphertext). The reverse process of encryption is called decryption, whereby encrypted information is transformed into readable form. Militaries and governments have long used the process of encryption to facilitate secret communication, and encryption is now commonly used to protect information in civilian systems and in the private sector. Encryption may be used to protect data that is "at rest" (*e.g.*, files on computers, portable media and storage devices), as well as data in transit (*e.g.*, e-mail). Encrypting data at rest helps protect the data in the event that physical security measures fail.

As is true with password strength (the more complex the password, the more difficult it is to guess), stronger encryption leads to safer data.

The use of forced encryption is the best approach for any organization to take, as it eliminates the element of human error. Therefore, all laptops, e-mails, and portable media should be encrypted to ensure that confidential or sensitive data is not compromised, and staff should always ensure that any data that is being copied to portable media is encrypted.

As part of its FISMA work on behalf of the OIG, C5i conducted a separate evaluation of the Commission's encryption program. The objective of the encryption evaluation was to examine the SEC's implementation of encryption technologies and processes.

Results

The OIG's evaluation found that the SEC has developed and implemented policies and procedures surrounding encryption technology and processes. The draft SEC encryption policy encompassed the recommendations and best practices contained in National Institute of Standards and Technology 800-53, "Recommended Security Controls for Federal Information Systems," OMB M-06-16, "Protection of Sensitive Agency Information," OMB M-07-16, "Safeguarding Against and Responding to the Breach of Personally Identifiable Information," and SEC Regulation 23-2a, "Safeguarding Non-Public Information."

All tools either currently being used or being considered for use by the SEC for the purposes of encryption must be compliant with Federal Information Processing Standards (FIPS) 140-2 and 200. Overall, we found that the SEC has a comprehensive encryption program that uses "best of breed" technologies and employs industry best practices to safeguard the Commission's information. However, there are some areas of concern related to mobile devices and portable media that we found OIT should address, including the following:

- certain mobile devices have not been properly encrypted throughout SEC headquarters and regional offices; and
- OIT has not implemented a policy requiring the encryption of portable media for all Commission headquarters divisions and offices and regional offices.

Our evaluation determined that OIT should take steps to ensure that the rollout of new handheld devices with forced encryption is completed on schedule. Until this rollout is completed, the SEC runs the risk that confidential or privacy-protected information will be exposed. Further, OIT's current policy for encryption is optional, and we found that two regional offices do not require its personnel to encrypt data that is copied to or contained on portable media. We determined that the current policy should be revised to require all removable media to be encrypted. The existing policy of allowing encryption to be optional exposes the SEC to potential breaches in the protection of personally identifying information and leakage or loss of sensitive data. As our evaluation concluded, the best way to protect the Commission's data is to ensure it is encrypted.

Recommendations

The OIG issued a report summarizing the results of the encryption evaluation on March 26, 2010. The report included three recommendations to OIT to improve the Commission's security posture in order to prevent the leakage or loss of sensitive data.

Management concurred with the recommendation to encrypt handheld devices to ensure the protection of confidential, proprietary or privacy information that may be contained on the devices. Management, however, did not concur with the other two recommendations, which involved revising OIT's current policy to require all portable media to be encrypted to eliminate the option for divisions and offices to determine if they will encrypt portable media. We noted our disagreement with the SEC's responses and requested that OIT reconsider its position and agree to eliminate the option for divisions and offices to determine whether or not they will encrypt portable media, and to encrypt all relevant devices in the future.

PENDING AUDITS AND EVALUATIONS

Review of the SEC's Section 13(f) Reporting Requirements

In 1975, Congress enacted Section 13(f) of the Securities Exchange Act of 1934 (the Exchange Act), 15 U.S.C. § 78m(f), to increase the public availability of information regarding the purchase, sale and holdings of securities by institutional investors. Congress's intent was for Section 13(f) information to be promptly disseminated to the public through the creation of a central depository of historical and current data about the investment activities of institutional investment managers in order to assist investors and government regulators. Section 13(f) requires institutional investment managers who exercise investment discretion with respect to accounts holding certain equity securities having an aggregate fair market value of $100 million or more on the last trading day in a calendar year to file quarterly reports of their holdings with the SEC on Form 13F. Under Commission Rule 13f-1, 17 C.F.R. § 240.13f-1, the reports on Form 13F must be filed within 45 days after the last day of such calendar year and within 45 days after the last day of each of the first three calendar quarters of the subsequent calendar year. Section 13(f) mandates that the Commission tabulate the information contained in the quarterly reports and disseminate the information to the public.

The securities that must be reported under Section 13(f) generally include equity securities that are traded on an exchange or quoted on NASDAQ, equity options and warrants, shares of closed-end investment companies, and some convertible debt securities. Form 13F requires disclosure of the name and address of the institutional investment manager filing the report and, for each security being reported, specific information, including the name of the issuer, the class, the Committee on Uniform Security Identification Procedures (CUSIP) number, the number of shares or principal amount, and the aggregate fair market value.

Pursuant to Commission Rule 24b-2 (17 C.F.R. § 240.24b-2), an institutional investment manager may request confidential treatment of information reported on Form 13F. Under Section 13(f)(3) of the Exchange Act, 15 U.S.C. § 78m(f)(3), the Commission may prevent or delay the public disclosure of the information reported on Form 13F in accordance with the Freedom of Information Act (FOIA), 5 U.S.C. § 552, and shall not disclose information identifying securities held by the account of a natural person or an estate or trust (other than a business trust or investment company).

The OIG is conducting an audit of the Commission's policies and procedures with respect to the requirements of Section 13(f) of the Exchange Act to examine whether the Commission's implementation and practices

are consistent with Congress's intent. We will also examine the sufficiency of the Commission's existing policies and procedures that implement Section 13(f) and whether the reporting by institutional investment managers covered by Section 13(f) is appropriately designed to comply with the requirements of that Section. The audit will also include an examination of whether the Commission's policies and procedures for reviewing and processing requests for confidential treatment of information reported under Section 13(f) are adequate or require improvement.

Assessment of the SEC Division of Corporation Finance's Confidential Treatment Processes and Procedures

The federal securities laws generally require any company that is publicly held or is registering its securities for public sale to disclose a broad range of financial and non-financial information in registration statements, annual reports and other filings made with the Commission.

Sometimes disclosure of the information required to be disclosed by the applicable laws or implementing regulations can adversely affect a company's business and financial condition because of the competitive harm that could result from the disclosure. Such a concern frequently arises in connection with the requirement that a registrant publicly file all contracts material to its business other than those it enters into in the ordinary course of business. To address the potential disclosure hardship, the Commission has implemented a system for allowing companies to request confidential treatment of information filed under the Securities Act of 1933 (the Securities Act) and the Exchange Act.

Specifically, Rule 406 under the Securities Act, 17 C.F.R. § 230.406, and Rule 24b-2 under the Exchange Act, 17 C.F.R. § 240.24b-2, set forth the exclusive means for obtaining confidential treatment of information that is contained in documents filed under the Securities Act and the Exchange Act, respectively, that would be exempt from disclosure under the FOIA.

The OIG is conducting an audit of the Division of Corporation Finance's policies and procedures pertaining to confidential treatment requests. Specifically, the audit will examine the Commission's procedures for granting confidential treatment requests to determine whether improvements are needed and best practices can be implemented for the confidential treatment process. We will also examine whether registrants to which the Division of Corporation Finance granted confidential treatment requests adhered to the applicable rules and requirements.

SEMIANNUAL REPORT TO CONGRESS

INVESTIGATIONS

OVERVIEW

The 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 Government-wide standards of conduct. The OIG receives complaints through the OIG Hotline, an office electronic mailbox or by mail, facsimile or telephone.

The most common way complaints were received during this reporting period continued to be through the OIG Hotline, which 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, seven 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 a mechanism for the receipt of complaints, the OIG's website also 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.

The Office of Investigations conducts thorough and independent investigations into allegations received in accordance with the Quality Standards for Investigations of the Council the of Inspectors General on Integrity and Efficiency. In instances where it is determined that something less than a full investigation is appropriate, the Office of Investigations conducts 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.

Upon the opening of an investigation, 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. In all investigations, the OIG investigator interviews the complainant whenever feasible and conducts significant interviews under oath and on the record. When there is any reason to believe a witness will not provide truthful testimony, the OIG investigator provides an appropriate perjury warning. In addition, the OIG investigator gives 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 the Department of Justice, including the Federal Bureau of Investigation, as appropriate. The OIG also obtains necessary investigative assistance from the SEC's Office of Information Technology, including the prompt retrieval of employee e-mail accounts as requested by the OIG investigators and forensic analysis of computer hard drives. The OIG investigative staff meets with the Inspector General frequently to review the progress of ongoing investigations. The OIG investigative unit also meets periodically 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 the Department of Justice and SEC management as appropriate. In the 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 on the disciplinary action taken in response to an OIG investigative report 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.

INVESTIGATIONS AND INQUIRIES CONDUCTED

Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme (Report No. OIG-526)

Opening of the Investigation

On October 13, 2009, the OIG opened an investigation after receiving a letter dated October 9, 2009, from United States Senators David Vitter (R-Louisiana) and Richard Shelby (R-Alabama) requesting that the OIG review, *inter alia*, the "history of all of the SEC's investigations and examinations (conducted either by the Division of Enforcement or by the Office of Compliance Inspections and Examinations) regarding [Robert Allen] Stanford." The OIG's investigation focused on any indications that the SEC had received prior to 2006 that Stanford was operating a Ponzi scheme or other similar fraud and what actions, if any, the SEC took in response.

Scope of the Investigation

Between October 13, 2009, and February 16, 2010, the OIG made numerous requests to the SEC's Office of Information Technology for the e-mails of current and former SEC employees for various periods of time pertinent to the investigation. The e-mails were received, loaded onto computers with specialized search tools and searched on a continuous basis throughout the course of the investigation. In total, the OIG received e-mails of 42 current and former SEC employees for time periods ranging from 1997 to

2009. The OIG estimates that it obtained and searched over 2.7 million e-mails during the course of its investigation.

On October 27, 2009, the OIG sent comprehensive document requests to both Enforcement and OCIE, specifying the documents and records required to be produced for the investigation. The OIG had numerous e-mail and telephonic communications with Enforcement and OCIE regarding the scope and timing of the document requests and responses, as well as meetings to clarify and expand the document requests, as necessary.

We carefully reviewed and analyzed the information received as a result of our document production requests. These documents included, but were not limited to, those relating to four SEC examinations and two SEC Enforcement inquiries of Stanford Group Company (SGC). In instances when documents were not available concerning a relevant matter, the OIG sought testimony and conducted interviews of current and former SEC personnel with possible knowledge of the matter.

The OIG also requested documents from the Financial Industry Regulatory Authority (FINRA), including documents concerning communications between FINRA or its predecessor, the National Association of Securities Dealers (NASD), and the SEC concerning Robert Allen Stanford and his companies (Stanford), and documents concerning the SEC's examinations and inquiries of Stanford. The OIG also received and reviewed documents provided by the Stanford Victims Coalition, including the results of surveys of Stanford investors conducted by the Stanford Victims Coalition. The OIG also reviewed numerous other publicly available documents.

Further, the OIG conducted 51 testimonies and interviews of 48 individuals with knowledge of facts or circumstances surrounding the SEC's examinations and/or investigations of Stanford and his companies.

Summary of the Results of the Investigation

The OIG investigation found that the SEC's Fort Worth office was aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme, having come to that conclusion a mere two years after SGC registered as an investment adviser with the SEC in 1995. We found that over the next eight years, the SEC's Fort Worth Examination group conducted four examinations of Stanford's operations, finding in each examination that the certificates of deposit (CDs) issued by the Antiguan-based Stanford International Bank (SIB) could not have been "legitimate," and that it was "highly unlikely" that the returns Stanford claimed to generate could have been achieved with the purported conservative investment approach.

Fort Worth examiners dutifully conducted examinations of Stanford in 1997, 1998, 2002 and 2004, concluding in each case that Stanford's CDs were likely a Ponzi scheme or a similar fraud. The only significant difference in the Examination group's findings over the years was that the potential fraud grew exponentially, from $250 million to $1.5 billion. While the Fort Worth Examination group made multiple efforts after each examination to convince the Fort Worth Enforcement program (Fort Worth Enforcement) to open and conduct an investigation of Stanford, the OIG investigation concluded that no meaningful effort was made by Fort Worth Enforcement to investigate the potential fraud until late 2005.

The first SEC examination of Stanford occurred in 1997, two years after SGC registered as an investment adviser with the SEC, when the SEC Fort Worth Examination staff identified SGC as a risk and target for examination. After reviewing SGC's annual audit in 1997, a former branch chief in the Fort Worth Broker-Dealer Examination group noted that, based simply on her review of SGC's financial statements, she "became very concerned" about the "extraordinary revenue" from the CDs and immediately suspected the CD sales were fraudulent.

In August 1997, after six days of field work in an examination of Stanford, the Fort Worth examiners concluded that the statements made by SIB in promoting the CDs appeared to be misrepresentations. The examiners noted that while the CD products were promoted as being safe and secure, with investments in "investment-grade bonds, securities and Eurodollar and foreign currency deposits" to "ensure safety of assets," the interest rate, combined with referral fees of between 11 percent and 13.75 percent annually, was simply too high to be achieved through the purported low-risk investments.

The branch chief concluded after the 1997 examination that the SIB CDs purported above-market returns were "absolutely ludicrous," and that the high referral fees SGC was paid for selling the CDs indicated the investments were not "legitimate CDs." The Assistant District Administrator for the Fort Worth Examination program concurred, noting that there were "red flags" about Stanford's operations that caused her to believe it was a Ponzi scheme, specifically the fact that the "interest that they were purportedly paying on these CDs was significantly higher than what you could get on a CD in the United States." She further concluded that it was "highly unlikely" that the returns Stanford claimed to generate could be achieved with the purported conservative investment approach.

The examiners also were concerned about the recurring annual "trailer" or "referral" fee that SGC received from SIB for referring CD investors to SIB, which they viewed to be "oddly high" and suspicious. This suspicion was heightened because the examiners found that SGC did not maintain books and records for the CD sales, and purported to have no actual information about SIB or the bases for the generous returns that the CDs generated, notwithstanding the fact that they were recommending the CDs to their clients and receiving these annual recurring fees for their referrals.

Further, the examiners made the surprising discoveries of a $19 million cash contribution that Robert Allen Stanford made personally to SGC in 1996, and of significant loans from SIB to Stanford personally. The branch chief testified that their discoveries were red flags that made her assume that Stanford "was possibly stealing from investors." In the SEC's internal examinations tracking system, the Broker-Dealer Examination group characterized its conclusion from the 1997 examination of SGC as "Possible misrepresentations. Possible Ponzi scheme."

The OIG investigation found that in 1997, the examination staff determined that as a result of their findings, an investigation of Stanford by the Fort Worth Enforcement group was warranted, and referred a copy of their examination report to Fort Worth Enforcement for review and disposition. In fact, when the former Fort Worth Examination Assistant District Administrator retired in 1997, her parting

words to the branch chief were, "[K]eep your eye on these people [referring to Stanford] because this looks like a Ponzi scheme to me and some day it's going to blow up."

Despite the examiners' referral of their serious concern that SGC was part of a Ponzi scheme, the Fort Worth Enforcement staff did not open a matter under inquiry (MUI) into the Stanford case until eight months later, in May 1998, and did so only after learning that another federal agency suspected Stanford of laundering money. The OIG investigation further found that the only evidence of any investigative action taken by Fort Worth Enforcement in connection with this MUI was a voluntary request for documents that the SEC sent to SGC in May 1998. We found that after Stanford refused to voluntarily produce numerous documents relating to SGC's referrals of investors to SIB, no further investigative steps were taken and, in August 1998, after being opened for only three months, the MUI was closed.

Fort Worth Enforcement staff reasoned that the inquiry was closed due to the lack of U.S. investors affected by the potential fraud and the difficulty of conducting the investigation because the staff would have to obtain records from Antigua. However, we found other, larger, SEC-wide reasons why the Stanford matter was not pursued, including the preference for "quick hit" cases as a result of internal SEC pressure, and the perception that Stanford was not a "quick hit" case.

The OIG investigation also found that in June 1998, while the Stanford MUI was open, the Fort Worth Investment Adviser Examination group began another examination of SGC. This investment adviser examination came to the same conclusions as the broker-dealer examination had reached, finding Stanford's "extremely high interest rates and extremely generous compensation" in the form of annual recurring referral fees, and the fact that SGC was so "extremely dependent upon that compensation to conduct its day-to-day operations," very suspicious.

The investment adviser examiners also noted during the 1998 examination the complete lack of information SGC had regarding the CDs and the SIB investment portfolio that purportedly supported the CDs' unusually high and consistent returns. The examiners concluded that SGC had "virtually nothing" that "would be a reasonable basis" for recommending the CDs to its customers. In fact, the examiners found that no one at SGC even maintained a record of all advisory clients who invested in the CDs. Accordingly, the examiners identified possible violations of SGC's fiduciary duty as an investment adviser to its clients, noting the affirmative obligation on the part of an investment adviser to employ reasonable care to avoid misleading clients, and that any departure from this fiduciary standard would constitute fraud under Section 206 of the Investment Advisers Act of 1940 (Investment Advisers Act).

The OIG investigation found, however, that the Fort Worth Enforcement staff completely disregarded the investment adviser examiners' concerns in deciding to close the Stanford MUI, and there was no evidence that the Fort Worth Enforcement staff even read the investment advisers' 1998 examination report. Notwithstanding this lack of Fort Worth Enforcement action, by the summer of 1998, it was clear that both the investment adviser and broker-dealer examiners knew that Stanford was a fraud.

In November 2002, the SEC's Investment Adviser Examination group conducted yet

another examination of SGC. In the 2002 examination, the investment adviser examiners found that Stanford's operations had grown significantly in the four years since the 1998 examination, from $250 million in investments in the purported fraudulent CDs in 1998, to $1.1 billion in 2002. In 2002, the examiners identified the same red flags that had been noted in the previous two examinations: "the consistent, above-market reported returns," which were "very unlikely" to be able to be achieved with "legitimate" investments; and the high commissions paid to SGC financial advisers for selling the SIB CDs without an understanding on the part of SGC as to what they were referring.

The investment adviser examiners also found that the list of CD-holding investors provided by SGC was inaccurate, as the list did not match up with the total CDs outstanding, based upon the referral fees SGC received in 2001. The examiners noted that although they did follow up with SGC about this discrepancy, they never obtained "a satisfactory response, and a full list of investors."

The 2002 examination report concluded that SGC was violating Section 206 of the Investment Advisers Act by failing to conduct any due diligence related to the SIB CDs. The 2002 examination report stated:

> A review of SGC's "due diligence" files for the SIB [CDs] revealed that SGC had little more than the most recent SIB financial statements (year end 2001) and the private offering memoranda and subscription documents. There was no indication that anyone at SGC knew how its clients' money was being used by SIB or how SIB was generating sufficient income to support the above-market interest rates paid and the substantial annual three percent trailer commissions paid to SGC.

When the investment adviser examiners raised this issue with SGC, SGC markedly changed its representations to the SEC concerning its due diligence regarding SIB's CDs. Previously, SGC represented that it essentially played no role in the investment decisions by SIB. When challenged, however, SGC officials changed their story, and stated that they regularly visited the offshore bank, participated in quarterly calls with the Chief Financial Officer of the bank, and received quarterly information regarding the bank's portfolio allocations (by sector and percentage of bonds/equity), investment strategies, and top five equity and bond holdings. SGC also told the examiners that information regarding the portfolio allocations was included in SGC's due diligence files. Although the investment adviser examiners were surprised and suspicious about this discrepancy, and actually contemplated an unannounced visit to SGC to look at the purported documents, the OIG investigation found that the SEC did not follow up to obtain or review the newly-claimed due diligence information.

After the examiners began this third examination of Stanford, the SEC received multiple complaints from outside entities reinforcing and bolstering the suspicions about Stanford's operations. However, the SEC failed to follow up on these complaints or take any action to investigate them. On December 5, 2002, the SEC received a complaint letter from a citizen of Mexico who raised concerns similar to those the examination staff had raised. The October 28, 2002 complaint to the SEC Complaint Center raised several issues, including the considerably higher interest rate of the Stanford CDs when compared with the rates other banks were offering, the fact that Stanford's returns were steady while other similar investments were significantly down, and the

fact that SIB's auditor was in Antigua without significant regulatory oversight.

While the examiners characterized the complainant's concerns as "legitimate," the OIG investigation found that the SEC did not respond to the complaint and did not take any action to investigate its claims. We found that while an SEC examiner drafted a letter to the complainant asking for additional information, he was told that Enforcement had instead decided to refer the complaint letter to the Texas State Securities Board (TSSB) and, thus, the examiner never actually sent his draft letter to the complainant.

In addition, the OIG investigation found that although the examiners met with Fort Worth Enforcement officials in late 2002 to attempt to convince Fort Worth Enforcement to open an investigation or even an inquiry into the 2002 examination report's findings, Fort Worth Enforcement staff declined to open a matter and likely never even read the 2002 examination report. Moreover, even though Fort Worth Enforcement informed the examiners that the findings in the 2002 examination report were referred to the TSSB together with the complaint letter, after interviewing officials from the Fort Worth Enforcement staff and the TSSB, we found that no such referral was made.

Thus, by 2003, it had been approximately six years since the SEC Examination staff had concluded that the SIB CDs were likely a Ponzi scheme. During those six years, the SEC had conducted three examinations which concluded the Stanford fraud was ongoing and growing significantly, but no meaningful effort was made to obtain evidence related to the potential Ponzi scheme.

In 2003, the SEC Enforcement staff received two new complaints that Stanford was a Ponzi scheme, but the OIG investigation found that nothing was done to pursue either of them. On August 4, 2003, the TSSB forwarded to the SEC a letter that discussed several similarities between another Ponzi scheme and what was known at the time about Stanford's operations. Before sending the letter to the SEC, the TSSB Director of Enforcement called the SEC to discuss the matter and informed the SEC that because the Ponzi scheme the complainant was comparing to Stanford was such a large fraud, he needed to bring the concerns regarding Stanford to the SEC's attention. Although the complaint was forwarded to a branch chief in Enforcement, no action was taken to follow up on it.

On October 10, 2003, the NASD forwarded a letter dated September 1, 2003, from an anonymous Stanford insider, to the SEC's Office of Investor Education and Assistance (OIEA) which stated, in pertinent part:

> STANFORD FINANCIAL IS THE SUBJECT OF A LINGERING CORPORATE FRAUD SCANDAL PERPETUATED AS A "MASSIVE PONZI SCHEME" THAT WILL DESTROY THE LIFE SAVINGS OF MANY; DAMAGE THE REPUTATION OF ALL ASSOCIATED PARTIES, RIDICULE SECURITIES AND BANKING AUTHORITIES, AND SHAME THE UNITED STATES OF AMERICA.

The OIG investigation found that while this letter was minimally reviewed by various Fort Worth Enforcement staff, Fort Worth Enforcement decided not to open an investigation or even an inquiry, but to refer it to the Examination group for yet another examination. The Fort Worth Enforcement branch chief explained his rationale as follows:

> [R]ather than spend a lot of resources on something that could end up being something that we could not bring, the decision was made to – to not go forward at that time, or at least to – to not spend the significant resources and – and wait and see if something else would come up.

It is not clear what the Fort Worth Enforcement staff hoped to gain by "wait[ing] [to] see if something else would come up" after the SEC had conducted three examinations of SGC finding that the SIB CDs were likely a Ponzi scheme and received three complaints about Stanford. It is also not clear what purpose the Fort Worth Enforcement staff thought would be served by having the examiners conduct a fourth examination of SGC.

However, the examiners ultimately did just that. In October 2004, the Fort Worth Examination staff conducted its fourth examination of SGC. In fact, the broker-dealer Examination staff initiated this fourth examination of Stanford solely for the purpose of making another Enforcement referral. By October 2004, approximately seven years since the SEC's first examination of SGC, the SEC examiners found that SGC's revenues had increased four-fold, and sales of the SIB CDs accounted for over 70 percent of those revenues. As of October 2004, SGC customers held approximately $1.5 billion of CDs, with approximately $227 million of these CDs being held by U.S. investors. The 2004 examination report concluded that the SIB CDs were securities and part of a "very large Ponzi scheme."

The examiners analyzed the SIB CD returns using data about the past performance of the equity markets and found that they were improbable. The examination staff concluded that SGC's sales of the SIB CDs violated numerous federal securities laws and rules, including NASD's suitability rule; material misstatements and failure to disclose material facts, in violation of Rule 10b-5 of the Securities Exchange Act of 1934 (Exchange Act); failure to disclose to customers its compensation for securities transactions, in violation of Rule 10b-10 of the Exchange Act; and possible unregistered distribution of securities in violation of Section 5 of the Securities Act of 1933.

The 2004 examination report advocated that the SEC act against SGC for these violations, in part, because of the difficulties in proving that SIB was operating a Ponzi scheme. One examiner stated that after the 2004 examination, he believed it was incumbent on the SEC to do whatever it could to stop the growing fraud, noting that "although it may be difficult to prove that the offering itself is fraudulent, SGC has nonetheless committed numerous securities law violations which can be proved without determining the actual uses of the invested funds."

The Examination staff also conducted significant investigative work during the seven months from October 2004 through April 2005 to bolster its anticipated Fort Worth Enforcement referral. They reached out to the SEC's Office of Economic Analysis (OEA) for assistance in expanding the Examination staff's quantitative analysis of Stanford's historical returns. However, OEA did not assist the examiners with any analysis of Stanford's returns. The examiners also contacted an attorney in the SEC's Office of International Affairs (OIA) for information regarding Antigua's regulation of Stanford. In addition, the examiners interviewed a former registered representative of SGC, who told them that the sale of SIB's CDs was a "Ponzi scheme."

However, in March 2005, senior Fort Worth Enforcement officials learned of the Examination staff's work on Stanford and told them that it was not a matter that Fort Worth Enforcement would pursue. A Special Senior Counsel in the Broker-Dealer Examination group made a presentation about her ongoing work on Stanford at a March 2005 quarterly summit meeting attended by the SEC, NASD, and state regulators from Texas and Oklahoma. She recalled that, immediately after her presentation, she got "a lot of pushback" from both the head of the Fort Worth office and head of Fort Worth Enforcement who approached her and told her that they were not interested in investigating Stanford. Specifically, while she was "still standing in the room where the presentation had been made," the head of the Fort Worth office and head of Fort Worth Enforcement approached her and "summarily told [her] … it was not something they were interested in."

As the examiners were preparing a formal referral memorandum to the Fort Worth Enforcement staff in an attempt to finally convince them to open an investigation, it was announced that the head of Fort Worth Enforcement was leaving the SEC. Since he had made it clear that he was not going to investigate Stanford at the March 2005 meeting, the examiners waited until he left the SEC to forward the referral to Enforcement.

The 2005 referral memorandum to Fort Worth Enforcement characterized the SIB CD returns as "too good to be true," noting that "from 2000 through 2002, SIB reported earnings on investments of between approximately 12.4% and 13.3% … [while] [t]he indices we reviewed were down by an average of 11.05% in 2000, 15.22% in 2001 and 25.87% in 2002."

The Fort Worth Enforcement staff initially reacted enthusiastically to the referral and opened a MUI (which subsequently converted to an investigation) "with [the] hope of bringing [a] case quickly." They also contacted OIA to assist them in getting records from SIB in Antigua. Further, the Fort Worth Enforcement staff sent questionnaires to U.S. and foreign investors in an attempt to identify clear misrepresentations by Stanford to investors. However, the Enforcement staff almost immediately started raising concerns that the matter was too difficult to pursue for various reasons. Regarding some of those concerns, one member of the Examination staff e-mailed an Enforcement attorney, stating, "[W]e know the whole thing must be a fraud. As a result [of the difficulties], we've just sat around for ten years fussing about what is going on at [Stanford]."

By June 2005, the Fort Worth Enforcement staff had decided to refer the matter to the NASD, apparently as a precursor to closing the inquiry. They had considered several options to obtain further evidence, including a request under the Mutual Legal Assistance in Criminal Matters Treaties, which were designed for the exchange of information in criminal matters and administered by the U.S. Department of Justice. However, after the questionnaires revealed no valuable information, the only tangible action taken was the sending of a voluntary request for documents to Stanford.

On August 29, 2005, the Fort Worth Enforcement staff sent SIB a voluntary request for documents. However, requesting voluntary document production from Stanford was a completely futile exercise. Moreover, the Fort Worth Enforcement staff sent the request to SIB six days *after* SIB's attorney "made it clear that SIB would not be producing documents on a voluntary basis." The

only reason for the staff's document request to Stanford was apparent in a July 2005 e-mail from the branch chief, which stated as follows:

> I feel strongly that we need to make voluntary request for docs from bank. If we don't and close case, and later Stanford implodes, we will look like fools if we didn't even request the relevant documents.

The Enforcement staff sent the request even though it recognized that its efforts to obtain the requested documents voluntarily were moot.

After Stanford refused to voluntarily produce documents that would evidence it was engaging in fraud, the Fort Worth Enforcement staff was poised to close the Stanford investigation. However, the Examination staff fought to keep the Stanford investigation open. They appealed to the new head of Fort Worth Enforcement and considerable time was spent over the next few months in an internal debate in the Fort Worth office concerning whether to close the Stanford matter without further investigation. While the two sides debated whether to conduct additional investigation, all agreed that Stanford was probably operating a Ponzi scheme. One senior official noted that "[i]t was obvious for years that [Stanford] was a Ponzi scheme." Another official testified, "[E]verybody believed that this was probably a Ponzi scheme."

Finally, in November 2005, the new head of Fort Worth Enforcement overruled her staff's and predecessor's objections to continuing the Stanford investigation and decided to seek a formal order in furtherance of that investigation. However, the Fort Worth Enforcement staff rejected the possibility of filing an "emergency action" against SIB based on what they deemed circumstantial evidence that it was a Ponzi scheme. They also decided that attacking Stanford's alleged Ponzi scheme indirectly by filing an action against SGC for violations of the NASD's suitability rule, disclosure failures, or misrepresentations would not be worthwhile. Most significantly, the Fort Worth Enforcement staff did not even consider bringing an action against Stanford under Section 206 of the Investment Advisers Act, which establishes federal fiduciary standards to govern the conduct of investment advisers. Such an action against SGC could have been brought for its *admitted* failure to conduct any due diligence regarding Stanford's investment portfolio based upon the complete lack of information produced by SGC regarding the SIB portfolio that supposedly generated the CDs returns.

Had the SEC successfully prosecuted an injunctive action against SGC for violations of Section 206, it could have completely stopped the sales of the SIB CDs though the SGC investment adviser. Further, the filing of such an action against SGC could have potentially given investors and prospective investors notice that the SEC considered SGC's sales of the CDs to be fraudulent. A Stanford Victims Coalition survey indicated that approximately 95 percent of 211 responding Stanford investors stated that knowledge of an SEC inquiry would have affected their decision to invest. One Stanford victim said that had she "known that Stanford Group was ever under investigation by the SEC, [she] would not have bought at all." Indeed, a questionnaire that was sent out by Fort Worth Enforcement in June 2005 raised significant concerns among Stanford investors. A former vice president and financial adviser at Stanford from 2004 through 2007, who later contacted the SEC with concerns about Stanford, said his phone "lit up like a Christmas tree the morning [the SEC questionnaire] went out." However, after in-

vestors received the questionnaire about Stanford, many continued to invest because financial advisers told them that the fund had been given "a clean bill of health" by the SEC. Stanford officials were able to persuasively represent that Stanford had been given this "clean bill of health" because Stanford had been examined on multiple occasions and only been issued routine deficiency letters, which it purportedly addressed. However, had a Section 206 action been commenced in 2005, it could have put many of Stanford's victims on notice that there were regulatory concerns about their investments.

The OIG investigation found that the decision not to even consider a Section 206 action was based at least partially on the fact that the new head of Enforcement was unaware that the investment adviser Examination staff had done examinations of SGC in 1998 and 2002, and was unaware that SGC was a registered investment adviser when the staff briefed her on the matter in November 2005. In fact, she only learned that SGC had been a registered investment adviser in January 2010, during her OIG testimony in the course of this investigation. Because the Enforcement staff was not familiar with the findings of the 1998 and 2002 investment adviser examinations, they were not aware that this option had been documented by the examiners on more than one occasion.

The OIG investigation also found evidence of larger SEC-wide reasons that the Stanford matter was not pursued over the years. We found that the Fort Worth Enforcement program's decisions not to undertake a full and thorough investigation of Stanford were due, at least in part, to Enforcement's perception that the Stanford case was difficult, novel and not the type favored by the Commission. The former head of the Fort Worth office told the OIG that regional offices were "heavily judged" by the number of cases they brought and that it was very important for the Fort Worth office to bring a high number of cases. This same person specifically noted that he personally had been "very outspoken" while at the SEC, but felt he was "bullet proof" because of the high number of cases that Fort Worth brought and, as a result, the Commission "could not get rid of him." The former head of Fort Worth Enforcement also concurred that the "number of cases [brought] were extremely important." A Fort Worth Assistant Director who worked on the Stanford matter stated:

> Everybody was mindful of stats. … Stats were recorded internally by the SEC in Washington. … I think when I was assistant director, there was a lot of pressure to bring a lot of cases. I think that was one of the metrics that was very important to the home office and to the regions.

The former head of the Fort Worth Examination program testified that the former head of Fort Worth Enforcement "was pretty upfront" with the Fort Worth Enforcement staff about the pressure to produce numbers and communicated to the staff, "I want numbers. I want these things done quick." The former head of the Examination program also testified that this pressure for numbers incentivized the Fort Worth Enforcement staff to focus on "easier cases" – "quick hits." Accordingly, as a result of this pressure to produce numbers, anything that did not appear likely to produce a number in a very short period of time got less priority. A former Fort Worth Examination branch chief also testified that the Fort Worth Enforcement staff "were concerned about the number of cases that they were making and that perhaps if it wasn't a slam-dunk case, they might not want to take it because they wanted to make sure they had

enough numbers because that's what they felt the Commission wanted them to do." The OIG investigation found that because Stanford "was not going to be a quick hit," Stanford was not considered as high priority of a case as easier cases. The former Fort Worth Broker-Dealer Examination group branch chief testified that the Fort Worth Enforcement Assistant Director working on the Stanford matter "only wanted to bring cases that were slam dunk, easy cases." At one point, the former Fort Worth Broker-Dealer Examination group branch chief vented her frustration with the Enforcement staff's reluctance to pursue the matter in an e-mail as follows:

> I love this stuff. We all are confident that there is illegal activity but no easy way to prove. Before I retire the Commission will be trying to explain why it did nothing. Until it falls apart all we can do is flag it every few years.

In addition, according to the former head of the Fort Worth office, senior management in Enforcement at headquarters expressed concern to Fort Worth that they were bringing too many temporary restraining order, Ponzi scheme, and prime bank cases, which they referred to as "kick in the door and grab" cases, or "mainstream" cases. Fort Worth was told to bring more Wall Street types of cases, like accounting fraud. The former head of Fort Worth Enforcement told the OIG that when he was hired for his position, Enforcement management in Washington, D.C., told him to clean up Fort Worth's inventory and repeatedly told him that Fort Worth's emphasis should be on accounting fraud cases. He was cautioned that Fort Worth was spending way too much of its resources on "mainstream" cases, and that those resources would be better deployed on accounting fraud cases. He specifically recalled that in November 2000, after Fort Worth brought several Ponzi scheme cases, a senior Enforcement official at headquarters told him, "[Y]ou know you got to spend your resources and time on financial fraud. What are you bringing these cases for?"

The OIG investigation also found that the SEC bureaucracy may have discouraged the staff from pursuing novel legal cases. The former head of the Fort Worth office confirmed that the arduous process of getting the SEC staff's approval in Washington, D.C., to recommend an Enforcement action to the Commission was a factor in deciding which investigations to pursue. A former branch chief in the examination program stated that she believed that the desire of the Fort Worth Enforcement staff to avoid difficult cases was partly due to the challenges in dealing with the Commission's bureaucracy.

Finally, the OIG investigation revealed that the former head of Fort Worth Enforcement, who played a significant role in numerous decisions by the Fort Worth office to deny investigations of Stanford, sought to represent Stanford on three separate occasions after he left the SEC, and represented Stanford briefly in 2006 before he was informed by the SEC Ethics Office that it was improper to do so.

This former head of Fort Worth Enforcement was responsible for: (1) in 1998, deciding to close a MUI opened regarding Stanford after the 1997 broker-dealer examination; (2) in 2002, deciding to forward the complaint letter to the TSSB and deciding not respond to the complaint or investigate the issues it raised; (3) in 2002, deciding not to act on the Examination staff's referral of Stanford for investigation after its investment adviser examination; (4) in 2003, participating in a

decision not to investigate Stanford after receiving the complaint letter comparing Stanford's operations to a known Ponzi scheme fraud; (5) in 2003, participating in a decision not to investigate Stanford after receiving the complaint letter from an anonymous insider alleging that Stanford was engaged in a "massive Ponzi scheme;" and (6) in 2005, informing senior Examination staffer that Stanford was not a matter Fort Worth Enforcement planned to investigate.

Yet, in June 2005, a mere two months after leaving the SEC, this former head of the Fort Worth Enforcement program e-mailed the SEC Ethics Office that he had been "approached about representing [Stanford] … in connection with (what appears to be) a preliminary inquiry by the Fort Worth office" and requested clearance to represent Stanford. He further stated, "I am not aware of any conflicts and I do not remember any matters pending on Stanford while I was at the Commission."

After the SEC Ethics Office denied his June 2005 request, in September 2006, Stanford retained this former head of Fort Worth Enforcement to assist with inquiries Stanford was receiving from regulatory authorities, including the SEC. He met with Stanford Financial Group's General Counsel in Stanford's Miami office and billed Stanford for his time. Following the meeting, he billed 6.5 hours to Stanford on October 4, 2006, for, *inter alia*, "review[ing] documentation received from company about SEC and NASD inquiries." On October 12, 2006, he billed Stanford 0.7 hours for a "[t]elephone conference with [Stanford Financial Group's General Counsel] regarding status of SEC and NASD matters." In late November 2006, he called his former subordinate, the Fort Worth Assistant Director who was working on the Stanford matter, asked him during the conversation, "[C]an you work on this?" and in fact told him, "I'm not sure you're able to work on this." Near the time of this call, he belatedly sought permission from the SEC's Ethics Office to represent Stanford. The SEC Ethics Office replied that he could not represent Stanford for the same reasons given a year earlier and he discontinued his representation.

In February 2009, immediately after the SEC sued Stanford, this same former head of Fort Worth Enforcement contacted the SEC Ethics Office a third time about representing Stanford in connection with the SEC matter – this time to defend Stanford against the lawsuit filed by the SEC. An SEC Ethics official testified that he could not recall another occasion on which a former SEC employee contacted his office on three separate occasions trying to represent a client in the same matter. After the SEC Ethics Office informed him for a third time that he could not represent Stanford, the former head of Fort Worth Enforcement became upset with the decision, arguing that the matter pending in 2009 "was new and was different and unrelated to the matter that had occurred before he left." When asked why he was so insistent on representing Stanford, he replied, "Every lawyer in Texas and beyond is going to get rich over this case. Okay? And I hated being on the sidelines."

Recommendations in the Report of Investigation

The OIG investigation found that the former head of Fort Worth Enforcement's representation of Stanford appeared to violate state bar rules that prohibit a former government employee from working on matters in which that individual participated as a government employee. Accordingly, the OIG

referred the report of investigation to the Commission's Ethics Counsel for referral to the Office of Bar Counsel for the District of Columbia and the Chief Disciplinary Counsel for the State Bar of Texas, the states in which he is admitted to practice law.

The OIG also recommended that the Chairman carefully review this report's findings and share with Enforcement management the portions of this report of investigation that relate to the performance failures by those employees who still work at the SEC, so that appropriate action (which may include performance-based action, if applicable) is taken, on an employee-by-employee basis, to ensure that future decisions about when to open an investigation and when to recommend that the Commission take action are made in a more appropriate manner.

The OIG further recommended that the Chairman and Director of Enforcement give consideration to promulgating and/or clarifying procedures with regard to seven specific areas of concerns that we identified in the report. Specifically, these recommendations included that the Chairman and the Director of Enforcement give consideration to promulgating and/or clarifying procedures with regard to:

(1) the consideration of the potential harm to investors if no action is taken as a factor when deciding whether to bring an enforcement action, including consideration of whether this factor, in certain situations, outweighs other factors such as litigation risk;

(2) the significance of bringing cases that are difficult, but important to the protection of investors, in evaluating the performance of an Enforcement staff member or a regional office;

(3) the significance of the presence or absence of United States investors in determining whether to open an investigation or bring an enforcement action that otherwise meets jurisdictional requirements;

(4) coordination between the Enforcement and OCIE on investigations, particularly those investigations initiated by a referral to the Enforcement by OCIE;

(5) the factors determining when referral of a matter to state securities regulators, in lieu of an SEC investigation, is appropriate;

(6) training of Enforcement staff to strengthen their understanding of the laws governing broker-dealers and investment advisers; and

(7) emphasizing the need to coordinate with the Office of International Affairs and the Division of Risk, Strategy, and Financial Innovation, as appropriate, early in the course of investigations.

As the OIG's report of investigation was issued just prior to the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendations.

Allegations of Conflict of Interest, Improper Use of Non-Public Information and Failure to Take Sufficient Action Against Fraudulent Company (Report No. OIG-496)

On July 10, 2008, the OIG opened an investigation after the former SEC Chairman's Chief of Staff asked the OIG to review allegations outlined in a *Wall Street Journal* article about a then soon-to-be released book. The article outlined several complaints raised in

the book about the SEC. Specifically, a former Enforcement attorney, who aggressively questioned the book's author about his short-selling of a company's stock, began working for that company after he left the SEC. In addition, the article noted that the company obtained a purloined copy of the author's telephone records. Further, there were concerns that the former Enforcement attorney may have engaged in illegal activity and taken non-public SEC investigatory materials, including the author's telephone records.

The OIG conducted a comprehensive investigation of the allegations outlined in the book. Specifically, the OIG obtained and reviewed voluminous documents related to this matter, including staff e-mails, work papers from an OCIE examination of the company identified above, and Enforcement documents pertaining to two relevant investigations. The OIG took the sworn, on-the-record testimony of eight former and current SEC employees and officials, as well as the author of the book. The OIG also conducted on-the-record interviews of two other SEC officials, as well as telephone interviews of the former Enforcement attorney.

The OIG investigation revealed that the above-referenced company successfully lobbied the SEC to begin investigating the author without specific evidence of wrongdoing, after the author gave a negative speech about the company. We found that the investigation of the author was supervised by the former Enforcement attorney, who went to work for the company a year after he left the SEC. We also found that the former Enforcement attorney made numerous, successful efforts to learn about the company during the course of that investigation.

The OIG investigation further found that the author submitted several letters to the SEC detailing evidence of the company's overvalued investments and requesting an investigation of the company. We found that although OCIE had begun an examination of the company based upon these allegations, Enforcement staff was unaware of the examination. The OIG investigation also determined that very soon after Enforcement began looking at the allegations against the author, they concluded that there was no credible evidence to demonstrate that his activities violated any federal securities laws. However, although the investigation was, as a practical matter, completed by mid-2003, the investigation was not formally closed until December 2006, and the author was never notified that he was no longer a subject of investigation despite his request for such notification.

We further found that in 2003, while supervising the investigation against the author and others, the former Enforcement attorney was asked to leave Enforcement because of performance problems. In October 2004, the former Enforcement attorney began to work for the company that the author was alleging had engaged in wrongdoing. The OIG investigation disclosed that the former Enforcement attorney obtained clearance from the Commission's Ethics Office to do this work based on representations he made that he had not worked on any related matters while working at the SEC. However, the evidence showed that he had worked on the investigation of the author for which the company had lobbied and, in the course of this investigation, learned a substantial amount of sensitive, non-public information regarding the author and the company for which he ended up working. On the other hand, the OIG found no evidence that the former Enforcement attorney took any non-public or case-related

documents with him when he left the SEC. Nor did we obtain evidence that he received any non-public information from any SEC employee after he left the SEC.

The OIG investigation revealed that in March 2005, the author raised concerns that the company illegally gained access to his telephone records. In 2007, after a grand jury was convened, the company's counsel informed the SEC and the applicable United States Attorney's Office that the former Enforcement attorney had engaged in the offense of pretexting (*i.e.,* impersonating someone to obtain his or her telephone records) against the author on behalf of the company. The company then filed with the SEC a form acknowledging that one of its agents had illegally obtained the author's telephone records, although it claimed not to have authorized the pretexting. The OIG found that the SEC took no action against the company related to the pretexting.

Moreover, although Enforcement found no evidence of wrongdoing against the author based upon the company's unsupported allegations, the author's claims against the company were validated to a great extent by OCIE's examination. However, the record shows that OCIE's examination, which was prolonged by delays, was unusual in many ways. Specifically, it was conducted primarily by only one headquarters examiner with very close supervision by an Associate Director in OCIE. In addition, although the examination lasted for 18 months, there was no visit to the company's offices, even though they were located just blocks from the SEC. We also found that the Associate Director supervising the examination knew a company official, who formerly worked at the SEC, and indicated that he trusted her and had the view that anyone who had worked at the SEC was "not going to be doing anything illegal."

The examiner on the examination of the company testified that she received considerable "pushback" from the Associate Director with regard to her findings against the company. Specifically, the examiner expressed concerns about the method the company utilized to raise cash to pay dividends, noting that the company had not had sufficient cash from earnings to pay dividends for several years without the issuance of additional stock. The examiner was concerned that the manner in which the company was financing its dividends was akin to a "Ponzi scheme." Moreover, all of the work papers from that examination were later inexplicably deleted from the OCIE shared computer drive.

In April 2004, the record shows that OCIE referred three findings from its examination of the company to Enforcement, including the concern about how the company financed its dividends with which the Associate Director disagreed. The OIG determined that the issue of how the company financed its dividends was never investigated by Enforcement. In May 2004, Enforcement finally began its investigation of the claims raised by the author beginning in May and June 2002. We found that Enforcement determined by mid-2006 that more than a dozen of the company's investments had significant problems with the calculation of their value and the company had materially overstated its net book income in its filings with the SEC for several years.

However, after investigating the matter for three years, in June 2007, just after the company told the SEC its agent engaged in pretexting, the Commission entered into a settlement agreement with the company. In that agreement, the company agreed to continue to employ a Chief Valuation Officer to oversee its quarterly valuation process and third-party valuation consultants to assist in its

quarterly valuation process for two years. No penalties were assessed against the company or any of its officers or directors. The OIG investigation further disclosed that company's counsel had requested and obtained a "pre-Wells" meeting with Enforcement. We found that during this meeting, a former SEC Enforcement Director, and other attorneys representing the company, successfully lobbied Enforcement not to bring fraud charges against the company or a company officer who Enforcement found had overvalued some of the company's investments, but instead to have the company accept a "books and records" charge. We further found that under the settlement with the company, there were no efforts made by the Commission, or even any provisions included in the settlement order, to monitor compliance by the company with the settlement agreement.

The OIG issued its report of investigation to management on January 8, 2010. In its report, the OIG recommended that the Directors of OCIE and Enforcement carefully review the report of investigation and the history of the examination and investigations that were described in the report. In addition, the OIG recommended that the Commission give serious consideration to promulgating and/or clarifying procedures with regard to:

(1) how examinations and investigations are initiated where there are requests from outside persons or entities, including whether specific allegations of wrongdoing have been provided, in determining whether to commence an examination or investigation;

(2) informing individuals and entities under investigation that they are no longer subjects of an investigation in a timely manner, as required by the Enforcement Manual;

(3) ensuring that other than traditional Wells meetings are not utilized by aggressive counsel to influence decisions in Enforcement actions;

(4) incorporating provisions in Enforcement settlement agreements that ensure requirements are adequately monitored for compliance;

(5) limiting the ability of OCIE personnel to delete examination work papers from OCIE computer systems;

(6) ensuring that OCIE management is not unduly influenced by the presence of former SEC employees in examinations and that all issues identified as potential federal securities law violations be carefully considered for referral to Enforcement;

(7) documenting the reasons specific issues referred to Enforcement from OCIE are not investigated; and

(8) ensuring there is no appearance of impropriety where former SEC staff attorneys represent a company shortly after their work at the SEC provided them with specific and sensitive information related to that company.

In response to this report, the agency has indicated publicly that it intends to implement all of the recommendations outlined in the report. As of the end of the semiannual reporting period, the agency has submitted for OIG review the corrective actions it has completed, or plans to complete in the near future. The OIG is in the process of determining whether the corrective actions fully address the OIG's recommendations.

Failure to Timely Investigate Allegations of Financial Fraud (Report No. OIG-505)

On November 16, 2008, the OIG opened an investigation into whether the SEC had vigorously enforced the securities laws with regard to complaints received from a registered representative about a media company registered with the SEC at the time of the complaints.

The OIG obtained and reviewed voluminous documents related to this matter, including: (1) the e-mails of 11 current and former SEC employees; (2) relevant records maintained by the SEC Office of Investor Education and Advocacy (OIEA); (3) documents produced by Enforcement related to investigations of the company from 2002 to 2009; (4) relevant information from Enforcement's internal case tracking systems; (5) documents submitted to the OIG by the complainant; and (6) the official personnel folders of four current SEC employees. The OIG took sworn, on-the-record testimony of the complainant, twelve current SEC employees, and one former SEC employee. In addition, the OIG conducted interviews of four current SEC employees with knowledge of relevant facts in the investigation.

The OIG investigation revealed that from February 2005 through November 2007, the SEC received more than twenty complaints from the complainant raising serious allegations of financial fraud about the company. The complaints primarily focused on allegations that the company's financial reporting was delinquent and erroneous, the company's assets were being sold at below market prices, and the company's management had engaged in self-dealing. The complainant repeatedly requested that the SEC stop the proposed acquisition of the company by an investor group until the SEC had investigated his allegations.

In addition, the OIG investigation found that from February 2005 through September 2007, at least sixteen of the complainant's allegations were provided to current or former staff in Enforcement. However, the OIG investigation further found that the complainant's allegations were not reviewed, analyzed, or investigated over this two-and-a-half-year period due to multiple instances of mishandling and mismanagement.

SEC records and witness testimony showed that the complainant's first two complaints were referred to Enforcement's Office of Chief Accountant (Enforcement Accounting Group), but were not reviewed. The first complaint was received by a legal advisor in the Enforcement Accounting Group. The legal advisor sent it to an Enforcement branch chief, who was listed in Enforcement's database as having an open investigation of the company. Although the legal advisor specifically asked the branch chief to let him know if his branch was not going to be pursuing the complaint and the branch chief immediately e-mailed back, "I know my branch will not be pursuing this," the legal advisor did not take any further action on the complaint and did not forward it to anyone else in the SEC for review or investigation.

The complainant's second complaint was also received by the legal advisor, who forwarded it to the Enforcement Accounting Group's administrative assistant and requested that this second complaint be added "to the referral file." However, no "referral file" was created and, although the procedure was for the administrative assistant to log complaints into the Enforcement Accounting Group's Financial and Accounting Referrals Tracking System, the complainant's first two complaints were not entered into the system and were not reviewed or analyzed.

SEC records indicated that the complainant's third complaint was referred to a former Enforcement branch chief who had recently left Enforcement to join another SEC office. The former branch chief did not recall receiving the complaint, and there is no evidence that the complainant's third complaint was ever reviewed.

Similar to the complainant's first and second complaints, his fourth and fifth complaints were referred to the Enforcement Accounting Group. The OIG investigation found that while these complaints were entered into the Accounting Group's tracking system and assigned to an accountant for review, they sat unreviewed with the accountant for more than two years.

The OIG investigation further found that the Enforcement Accounting Group employed a "referral triage process," which was intended to be only a swift initial review to determine whether the complaint was worthy of further investigation. For instance, the complainant's fourth and fifth complaints were assigned to an accountant for triage in or about September 2005. We found that the accountant never reviewed or analyzed these complaints. The accountant remarked that his impression was that the complaints "looked real complicated, like it would require some work," but the work was not performed. One year later, in September 2006, the accountant reported to his supervisor that the complainant's complaints were one of three uncompleted referrals that he had outstanding at that time and that he would complete his review of them "as soon as possible." However, the OIG investigation found that over a year after informing his supervisor that he would complete his review "as soon as possible" and two years after receiving the complaints, he had still not completed his review. The accountant explained that he had reviewed other complaints during that time period and that the complainant's complaints were "always one at the bottom of the pile." We found that the accountant's supervisors received periodic updates showing that the accountant's review was not completed, but took no action to follow up with him.

We also found that the Enforcement Accounting Group's referral procedures for monitoring the progress of referrals of complaints like those submitted by the complainant were not followed in the 2005-2007 time period. For example, regular meetings to decide the disposition of referrals were not being held and no timelines were established for the triage review process.

Despite the lack of action on his prior complaints, we found that the complainant continued to submit complaints to the SEC in 2006. According to SEC records, the complainant's sixth, seventh, eighth, and ninth complaints were submitted to the SEC in 2006 and 2007 and referred to an Enforcement staff attorney who had left an investigative position to assume another position within Enforcement. The staff attorney testified that all of the complainant's complaints that the attorney received were forwarded to the Assistant Director of the attorney's former Enforcement group. The OIG investigation revealed that these complaints were not reviewed, analyzed, or investigated by anyone.

We found that a failure to properly close an earlier, unrelated investigation of the company or to update staff information in Enforcement databases contributed to the SEC's failure to review the complainant's sixth through ninth complaints. The OIG investigation revealed that after working in

Enforcement for years, the staff attorney and the Assistant Director working on the unrelated investigation did not know the procedures necessary to close an investigation. We also found that it could take up to two years for Enforcement's Office of Chief Counsel to complete the investigation closing process after the staff submitted the proper paperwork to close an investigation. Moreover, the status of investigations and the identity of the staff assigned to investigations were often not updated in Enforcement databases causing complaints to be sent to the wrong SEC personnel.

Thus, while the Assistant Director, branch chief, and staff attorney working on the unrelated 2002 investigation of the company had decided to close that investigation, they failed to take the necessary steps to formally close it. As a result, the complainant's sixth, seventh, eighth and ninth complaints were mistakenly sent to the Enforcement attorneys who worked on this unrelated, and not formally closed, investigation of the company. Because these Enforcement attorneys were not actively working on the unrelated investigation of the company, they did not review the complainant's complaints that were sent to them. In addition, the Assistant Director did not inform anyone that his group was not going to review or consider the complaints and, accordingly, the complainant's complaints were never sent or referred to another office for review or investigation.

Meanwhile, despite the fact that no one at the SEC was reviewing or investigating the complainant's complaints, the SEC's Office of Investor Education and Advocacy responded to the complainant's sixth complaint in March 2006, with a letter stating, "We are taking your complaint very seriously and have referred it to the appropriate people within the SEC." In actuality, at that time, the complainant's sixth complaint (along with his first five complaints) had not been referred to the appropriate people within the SEC and, not only was it not being considered very seriously, it was not being considered at all.

SEC records further reflected that the complainant sent his tenth through sixteenth complaints to the SEC in August and September 2007, but the complaints were not immediately referred for review. In late September 2007, the complainant sent his seventeenth complaint to an official in the former SEC Chairman's Office, complaining about the SEC's failure to investigate the company. This complaint was then circulated among senior Enforcement personnel, and it was determined that the complainant's complaints should be reviewed. The complainant's tenth through sixteenth complaints were then referred to the Enforcement Assistant Director who had received his earlier complaints (and not reviewed them) and whose group was tasked with evaluating the complainant's allegations. In October and November 2007, staff assigned to the investigation received at least five additional complaints from the complainant.

Thus, the OIG investigation found that by late September 2007, no Enforcement group had reviewed, analyzed, or investigated any of the at least sixteen complaints that the complainant had submitted to the SEC from February 2005 through September 2007.

The OIG investigation also found that after the complainant contacted the former Chairman's Office and multiple members of Congress, Enforcement finally conducted an appropriate review of the complainant's complaints. The OIG investigation found, however, that soon after Enforcement began its review of the complainant's complaints, the

Enforcement attorneys assigned to the investigation determined that, even if the complainant's allegations were true, it was too late to take meaningful action against the company. The Enforcement attorneys determined that the company was no longer a public company registered with the SEC and many of the potential claims would fall outside the statute of limitations.

The OIG investigation found that beginning in late 2007, Enforcement attorneys assigned to the investigation finally performed the extensive work analyzing the complainant's complaints that should have been done years earlier. Work performed by the staff included interviewing the complainant, analyzing his complaints, reviewing the company's filings, interviewing the complainant's accountant, speaking to other law enforcement organizations familiar with the complainant's allegations, and reviewing documents from private litigation involving the company.

The OIG investigation also found that there were additional investigative steps that the Enforcement staff did not undertake, including requesting the company's audit work papers and interviewing the company's executives. The Associate Director in Enforcement responsible for the investigation testified that the additional steps would have been undertaken if they had concluded that a full investigation of the company should have been pursued.

In April 2008, the Enforcement attorneys assigned to the investigation determined that the investigation of the company should be closed due to the age of the alleged conduct, the fact that the company was no longer a public company registered with the SEC, and a lack of evidence that the company or its executives had committed fraud. However, the investigation was not closed at that time, at least in part, because the supervisory accountant assigned to the investigation, who had been the supervisor responsible for the complainant's unreviewed fourth and fifth complaints, would not agree that the investigation should be closed. The Enforcement Accounting Group, which had been tasked with reviewing the complainant's complaints since 2005, requested even more time to consider the complainant's allegations and to review the company's filings. The supervisory accountant assigned to the investigation of the company agreed in November 2008 that the investigation should be closed.

In January 2009, the Associate Director responsible for the investigation requested that an Enforcement Deputy Director provide a second review of the issues the complainant had raised and determine whether closing the investigation was appropriate. After the Deputy Director independently reviewed the complainant's allegations and supporting documentation and interviewed him, the Deputy Director supported the staff's decision to close the investigation due to the age of the conduct and the difficulty in obtaining evidence. In October 2009, the investigation of the company was officially closed.

In summary, the OIG identified significant flaws in the processes Enforcement used to handle complaints and to close cases. The OIG investigation concluded that from February 2005 through September 2007, multiple complaints by the complainant were mishandled and mismanaged and, consequently, these complaints were simply not reviewed, analyzed or investigated. The OIG also concluded that by late 2007 and early 2008, when the complainant's allegations were finally reviewed by Enforcement staff, a full investigation of the company was no longer meaning-

ful because many of the complainant's allegations were stale and the company was no longer a public company registered with the Commission.

The OIG issued its report of investigation to management on February 26, 2010. The OIG recommended that SEC management carefully review the portions of the report that related to performance deficiencies by those employees who still work at the SEC, so that appropriate action (which may include performance-based action, as appropriate) could be taken, on an employee-by-employee basis, to ensure that future complaints are better handled and that the mistakes outlined in the report are not repeated.

In its report of investigation, the OIG also made specific recommendations with respect to the Enforcement complaint-handling system and case-closing process to ensure that the flaws identified in our report are remedied. Specifically, the OIG recommended that as part of the ongoing changes being made to the SEC's complaint-handling system and Enforcement's case-closing system, the SEC and Enforcement ensure that: (1) the databases used to refer complaints are updated to accurately reflect the status of investigations and the identity of the staff handling such investigations; (2) complaints are reviewed, responded to, and referred for investigation in a timely and appropriate manner; (3) referrals are monitored to ensure that they are being actively investigated and that complainants are being provided with accurate information; (4) cases that are not actively being pursued are closed promptly; (5) Enforcement staff have access to accurate information about the status of investigations and the status of staff requests to close investigations; and (6) staff at all levels be appropriately trained in case-closing procedures.

As of the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendations.

Unauthorized Disclosure of Non-Public Information by Regional Office Attorneys (Report No. OIG-512)

The OIG conducted this investigation following disclosure in a criminal trial that two SEC Regional Office Enforcement attorneys had communications with a former Federal Bureau of Investigation Special Agent (FBI Agent) about ongoing SEC Enforcement investigations. The OIG had received a complaint on January 11, 2008, alleging that a known financial analyst and short-seller (Financial Analyst) had obtained non-public information about ongoing SEC investigations from employees of the SEC. In addition, the OIG received a subsequent complaint on July 27, 2009, alleging that certain SEC employees had released non-public information without authorization to the Financial Analyst and his associates.

Beginning on November 2, 2004, the FBI Agent and the Financial Analyst were tried in the U.S. District Court for the Eastern District of New York on a variety of criminal charges including fraud, theft, racketeering and conspiracy in connection with short selling of stocks orchestrated by the Financial Analyst. In the course of the criminal trial, the two Regional Office Enforcement attorneys were called to testify for the government concerning their interactions with the FBI Agent and the Financial Analyst. During their testimony, the two Regional Office Enforcement attorneys both stated they had frequent contacts with the FBI Agent concerning ongoing SEC Enforcement investigations.

During its investigation, the OIG took sworn testimony of the two Regional Office Enforcement attorneys. The OIG also reviewed transcripts of testimony from the criminal trial of the FBI Agent and the Financial Analyst. The OIG further reviewed: (1) online chat transcripts among the Financial Analyst and his associates; (2) transcripts of taped telephone conversations among the Financial Analyst, his associates, and various SEC employees; (3) e-mails between the Financial Analyst and various SEC employees; and (4) telephone logs and notes of conversations among the Financial Analyst, the FBI Agent, and various SEC employees. In addition, the OIG extensively reviewed internal database search histories of the two Regional Office Enforcement attorneys from January 2001 through December 2002.

The OIG investigation found that one of the Regional Office Enforcement attorneys (Enforcement Attorney One) released non-public Commission information to the FBI Agent. In his testimony before the OIG investigator, Enforcement Attorney One acknowledged that non-public information included "anything that's not out in the public domain … [and] anything that's part of an investigative record." Despite Enforcement Attorney One's general insistence that he only released non-public information to the FBI Agent related to one SEC investigation of a publicly-traded company, the OIG found that Enforcement Attorney One disclosed non-public information to the FBI Agent on multiple other occasions. In fact, Enforcement Attorney One testified that he informed the FBI Agent on numerous occasions about the existence of ongoing SEC investigations upon requests from the FBI Agent. In addition, Enforcement Attorney One admitted that he "at least provided the name and telephone number of the staff and the fact that it was an open investigation" in response to the FBI Agent's inquiries. Moreover, in at least one instance, Enforcement Attorney One acknowledged that his discussions with the FBI Agent "would have included information about the progress of [an] investigation." These investigations, however, had not yet been made public by the Commission. Therefore, by disclosing information to the FBI Agent about whether certain companies and individuals were under investigation, Enforcement Attorney One released non-public information to the FBI Agent. The FBI Agent would then provide this information to the Financial Analyst and his associates, and they would sell short the companies' stock in order to earn illegal profits.

The OIG investigation found that by releasing non-public information to the FBI Agent, Enforcement Attorney One violated SEC policy. Under 17 C.F.R. § 203.2, information obtained relating to investigations is deemed non-public unless the Commission makes the information a matter of public record. Pursuant to17 C.F.R. §§ 203.2 and 200.30-4(a)(7), an access request must be in place or an employee must obtain express authorization from an Assistant Director or above before releasing non-public information to individuals outside the agency, including other law enforcement agents. Enforcement Attorney One explicitly acknowledged the prohibition against disclosure of non-public information to unauthorized individuals, but nonetheless released non-public information to the FBI Agent because the FBI Agent was "a good source" and a "fellow law enforcement agent."

The OIG also found that numerous events and pieces of information should have raised Enforcement Attorney One's suspicions and indicated that the FBI Agent did not merely desire to aid Enforcement Attorney One in investigating securities fraud. For example,

the FBI Agent told Enforcement Attorney One that he had traded in the company's stock and that he had not disclosed this information to the FBI or the U.S. Attorney in order to "continue to investigate" the company. Enforcement Attorney One also learned that the FBI Agent worked closely with the Financial Analyst, a known short-seller who had been convicted of mail fraud, and that the Financial Analyst ran a website that the FBI Agent suggested Enforcement Attorney One use to find potential future SEC investigations. We found that Enforcement Attorney One's familiarity with the website should have made him suspicious of the FBI Agent's recommendation because the website contained negative information about various companies and made short-selling recommendations based upon this negative information.

In addition, Enforcement Attorney One admitted observing a correlation between the stocks recommended as short sales on the Financial Analyst's website and those stocks about which the FBI Agent requested information from Enforcement Attorney One. Despite these suspicious events, Enforcement Attorney One believed the FBI Agent "wasn't just fishing" for information about investigations and continued to inform the FBI Agent if there was another investigation open for a stock about which the FBI Agent inquired. By disregarding the suspicious nature of his communications with the FBI Agent, Enforcement Attorney One released non-public information to the FBI Agent, which the FBI Agent and the Financial Analyst were able to use to generate profits from short-selling.

The OIG investigation also found that a second Regional Office Enforcement Attorney (Enforcement Attorney Two) released non-public information to both the Financial Analyst and the FBI Agent without an access request. Although Enforcement Attorney Two recognized that "investigations are non-public," he admitted telling the Financial Analyst, on at least one occasion, "that the SEC was conducting an inquiry of certain people and a certain company." Similarly, Enforcement Attorney Two admitted that he disclosed non-public information to the FBI Agent by informing him that another Regional Office had an investigation to which the Financial Analyst was "somehow connected." In fact, although Enforcement Attorney Two stated that he did not recall numerous aspects of his conversations with the FBI Agent, he conceded that he knew the information discussed was non-public, insisting that he released it to the FBI Agent because the Financial Analyst was "not somebody that should be trusted."

The OIG investigation concluded that Enforcement Attorney Two's release of non-public information to the Financial Analyst and the FBI Agent in the absence of an access request violated SEC policy. In his OIG testimony, Enforcement Attorney Two acknowledged the SEC policy prohibiting disclosure of non-public information to unauthorized individuals, noting that he would not "go out of [his] way to share non-public information with … the public." He also explained that he would require an access request before releasing substantive information to law enforcement officials. However, despite these statements, Enforcement Attorney Two admitted that he disclosed non-public information to both the Financial Analyst and the FBI Agent without having an access request in place. In doing so, Enforcement Attorney Two violated the agency's policy prohibiting disclosure of non-public information to unauthorized persons.

The OIG issued its report of investigation to management on January 12, 2010. In its report, the OIG referred these matters to management for consideration of disciplinary action against the two Regional Office Enforcement attorneys. The OIG also recommended that the Regional Office conduct training of its Enforcement attorneys on the prohibitions of providing non-public information to officials outside of the Commission without an access request.

The OIG has been informed that, as of March 31, 2010, both Regional Office Enforcement attorneys were issued written counseling memoranda and were required to attend training.

Whistleblower Allegations of Fraudulently Obtained Award Fees by SEC Contractor (Report No. OIG-491)

On May 23, 2008, the OIG opened an investigation into allegations of misconduct by a contractor. The SEC awarded a multi-year, performance-based contract, valued at over $100 million, to the contractor beginning in 2001 through an interagency acquisition agreement (IAA) with another federal agency. We commenced our investigation after being contacted by the OIG from the other federal agency, which had already opened an investigation into allegations that the contractor falsified documents in order to obtain higher award fees under the contract. The SEC OIG initially worked jointly on this investigation with a Special Agent from the other federal agency OIG and an attorney from the United States Attorney's Office (USAO) for the District of Columbia for more than a year.

The OIG, along with the Special Agent and USAO attorney, conducted interviews of six former and current SEC and other federal agency officials. After conducting these interviews and reviewing many relevant documents provided by the SEC OIG investigators, the USAO declined prosecution of the matter in September 2009, due to the lack of specific evidence of fraud. After the USAO declined prosecution, the other federal agency OIG closed its investigation of the matter. During our investigation, we obtained and reviewed thousands of e-mails of former SEC and contractor employees, as well as e-mails for two current OIT officials. In addition, we obtained and reviewed relevant contract and award fee documents. The SEC OIG then completed its investigation, focusing on the SEC's oversight and management of this contract.

The OIG issued its report of investigation to management on March 29, 2010. Although the OIG found insufficient evidence substantiating the allegation that documents were intentionally falsified, the OIG found there were serious questions about whether the over $6 million of award fees given to the contractor over the contract period were legitimate and properly earned. The OIG determined that for more than five years of the contract, the contractor's self-evaluations of its performance were largely accepted by the SEC without any verification, resulting in the contractor obtaining nearly all of the maximum obtainable award fees. The evidence further showed that the original computer system utilized by the SEC failed to properly track data used to determine the contractor's performance and did not allow the SEC to verify the contractor's self-evaluations. Moreover, the OIG found that the contractor's managers and employees received bonuses tied to the amount of award fees the contractor received, thereby creating an extra incentive for the contractor and its employees to report above-average performance under the contract.

The OIG investigation determined that because of the failure on the part of the SEC to verify the contractor's self-evaluations, over the course of the first six years of the contract, the contractor received $6,139,910 (over 93 percent) of the potential $6,599,325 of total award fees available. We further found that there was reason to believe that these award fees were severely inflated and not fully earned by the contractor. For example, there was evidence that the contractor excluded unfavorable performance data that resulted in skewing the data in the contractor's favor to show a near perfect performance by the contractor, thus generating significant award fees. In addition, we discovered that the contractor changed certain fields toward improving overall metrics on a significant portion of reported incidents after they were opened, creating a strong suspicion that the contractor was intentionally manipulating data in an attempt to increase the award fees it received from the SEC.

The OIG investigation further found that after a new, full-time SEC project manager was appointed in late 2006, problems were quickly identified with the metrics the contractor was reporting. Those metrics were used to evaluate how well the contractor was meeting the contract requirements, and resulted in the contractor obtaining the maximum available award fees in numerous cases. Although we found that the SEC transitioned to a new computer system six years after the contract began, there were problems with the transition. Specifically, the OIG discovered that, until 2008, the SEC was unable to generate data to verify the contractor's self-reported data. It also appears there was no procedures manual until late 2007, after transitioning to the new system.

The OIG found that after a whistleblower came forward in mid-2008 and alleged that the contractor was altering the metrics to show better compliance with contract requirements, the SEC began to analyze the data under the new tracking system to determine if this was true. The SEC performed an "audit" in May 2008, which seemed to verify the whistleblower's claims. In August 2008, the SEC announced that the next multi-year contract for outsourced IT services was not awarded to this contractor.

In all, the OIG found that the SEC failed to adequately manage this contract. The OIG investigation revealed that this $150 million contract, which was an essential element of the SEC's operations, was not given sufficient or high-level attention. For example, no SEC Senior Officer played any role in overseeing the contract; instead, a branch chief was assigned duties as the project manager of the contract for the first several years. In addition, the Office of Acquisitions within the SEC's Office of Administrative Services, which generally oversees contracts and IAAs, had no role in the oversight of this contract, other than initially signing contract documents. Moreover, insufficient attention was paid to the performance of the contractor for several years and its self-evaluations were largely accepted at face value without verification. While the SEC did not have a computer tracking system that allowed verification of the contractor's self-reported performance, the evidence showed that the contractor's alleged performance was so contrary to industry standards it should have raised red flags much earlier in the contract. The lack of sufficient, high-level attention by the SEC likely resulted in the contractor being improperly awarded at least some of the more than $6 million additional fees from SEC funds.

The OIG recommended that management officials carefully review the report of investigation, as well as a recent OIG

audit on IAAs, Report No. 460, to identify improvements in the manner in which the SEC manages and supervises its contracts and agreements. In addition, the OIG recommended that the SEC:

(1) make efforts to recapture the portion of additional award fees the contractor obtained based on potentially inaccurate information;

(2) assign staff at the level of the equivalent of Assistant Director or higher, as well as the Office of Acquisitions which provides oversight for various SEC acquisitions, to all incentive contracts with a value of over $1 million; and

(3) ensure there is a process to validate any additional award fees awarded under contracts.

As the report was issued just prior to the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendations.

Inappropriate Conduct by a Current SEC Employee and Unauthorized Computer Access by a Former SEC Employee (Report No. OIG-508)

On December 12, 2008, the OIG opened an investigation into a complaint from two SEC employees, alleging inappropriate conduct by an SEC supervisor. The two employees specifically alleged that the supervisor instructed a former employee not to communicate with the SEC Ethics Office without first notifying him. The employees further alleged that the same supervisor provided inappropriate instructions to his employees before an inspection by suggesting that each inspector strive for a certain minimum number of findings, and that he engaged in unprofessional behavior at certain self-regulatory organizations (SROs). The OIG interviewed a third individual, a then-SEC employee who worked under the same supervisor, who corroborated the allegations of the first two employees. The former employee also alleged that he was instructed, via e-mail, not to communicate with the Ethics Office without first contacting his supervisor.

Less than three months after the OIG opened its investigation, the former employee's supervisor, along with an Assistant Director and another supervisor, visited the OIG to report that the former employee had conducted an unauthorized scan of 255 computers at an SRO the week before in possible violation of federal criminal law. Later that same day, the supervisors: (1) transferred the employee to another group; (2) removed his access to the group's security lab; and (3) retrieved his secure laptop and Blackberry. The employee subsequently resigned from the SEC.

During the course of this investigation, the OIG reviewed numerous e-mails, correspondence, statutes, regulations, and other supporting materials, and also conducted sworn, on-the-record testimony of several SEC employees. The OIG also consulted with other individuals, including an SRO employee and the SEC Ethics Counsel.

After conducting a thorough investigation into the complainants' allegations of supervisory misconduct and management's allegations of misconduct by the former employee, the OIG issued its report of investigation on March 29, 2010. In the report, the OIG found that the supervisor acted inappropriately by: (1) instructing his employee not to contact the Ethics Office, or any other division within the SEC or an outside agency, without contacting him first; and (2) telling his em-

ployee that he liked to stay "under the radar" of the Ethics Office. Specifically, the OIG found that the supervisor's instruction not only prevented the former employee from obtaining an answer to his legitimate ethics concern, but ran afoul of ethics rules and regulations. This direction could also have the effect of discouraging employees from seeking ethics advice, which, according to the SEC Ethics Counsel, is contrary to the very purpose for the Ethics Office. The supervisor's instruction was clear, in writing, and undisputed, as was his statement that he liked to stay under the Ethics Office's radar. Further, the supervisor acknowledged that, although he did not intend to discourage his employee from going to the Ethics Office, it was reasonable for that employee to feel discouraged from doing so. Finally, the supervisor informed the OIG that he: (1) gave this instruction; (2) understood that the instruction was inappropriate; (3) notified management about it and was instructed not to do it again; and (4) apologized to the former employee, which the former employee acknowledged.

The OIG found also that, prior to an inspection at a stock exchange, the supervisor instructed certain employees to strive for a certain minimum number of findings in each inspection area, stating that these were his expectations. The OIG found that these pre-inspection instructions suggesting that employees strive for a certain minimum number of findings inappropriate because they could have the effect of impairing an inspector's objectivity, which is required by generally accepted government auditing standards. The OIG also obtained, and found credible, the accounts of certain SEC employees, as well as an SRO employee, that the supervisor may have taken certain disagreements with SRO personnel too far and may have, at times, lost his composure.

Finally, the OIG found that the former employee admittedly conducted an unauthorized scan of an SRO's computer system and knew he was in breach of protocol. However, the OIG determined there was no further action that could be taken in the matter because: (1) the former employee declined to speak to the OIG upon advice of the union; (2) he then left the SEC before the OIG could complete its investigation; and (3) the OIG contacted federal criminal authorities, who declined to pursue the matter. The former employee also claimed that management's complaint against him to the OIG was in retaliation for his reporting the ethics incident to management. While mindful of the deteriorated work relationship between the former employee and his supervisor, the OIG did not find conclusive evidence of retaliation against the former employee.

In light of the foregoing, the OIG referred the matter to management for consideration of disciplinary action against the supervisor. As the report was issued just prior to the end of the semiannual reporting period, no action had yet been taken by management with respect to the OIG's recommendation.

Disclosures of Non-Public Procurement Information and Lack of Candor at Headquarters (Report No. OIG-515)

On April 13, 2009, we opened an investigation as a result of information received from several anonymous complaints made through the OIG's hotline. The complaints alleged that an Office of Financial Management (OFM) manager disclosed non-public procurement information relating to the contract bids for a support project to an SEC contractor. The complaints further alleged that certain OFM staff had been awarding contracts to their friends at various consulting firms.

During the course of this investigation, the OIG took sworn testimony of five SEC employees, including two senior managers (one who is no longer employed at the SEC) and an SEC contractor. In addition, the OIG interviewed an OFM manager.

After conducting a thorough investigation into the complainant's allegations, the OIG issued its report of investigation on November 24, 2009, finding that that the OFM manager had disclosed non-public information to an SEC contract employee regarding the support project. The OIG found that the OFM employee violated 41 U.S.C. § 423 by disclosing contractor bid or proposal information. We further found that the OFM manager was not completely truthful in his testimony to the OIG.

Moreover, the OIG found that the SEC contractor disclosed the non-public information he had learned from the OFM manager to his wife, who was the general counsel for one of the bidders in the procurement, and that this information provided the SEC contractor's wife's company an opportunity to recompete for the contract. Accordingly, the OIG investigation found that the SEC contractor violated provisions of a non-disclosure agreement he had signed, in which he expressly agreed to be bound by the Commission's Conduct Regulation, 17 C.F.R. § 200.753(b)(7), and not disclose any confidential or non-public information to which he had access during the performance of his duties under his contract to any unauthorized person. The OIG's investigation did not substantiate additional allegations that OFM staff members improperly awarded contracts to their friends.

In light of the foregoing findings, the OIG referred this matter to management for disciplinary action, up to and including removal for the OFM manager and removal from the contract for the SEC contractor. As of the end of the reporting period, no action had yet been taken by management with respect to the OIG's recommendations. In addition, because the OFM manager's disclosure of non-public procurement information appeared to violate a criminal statute, we referred his conduct to the United States Attorney's Office for the District of Columbia, and that referral was pending at the end of the reporting period.

Misuse of Government Resources and Official Time at Headquarters (Report No. OIG-517)

The OIG opened this investigation on June 8, 2009, after receiving information that an employee in the Office of Administrative Services (OAS) was using substantial SEC resources and official time in support of a non-profit business.

The OIG obtained, searched and reviewed the employee's e-mails for the relevant period. The OIG also took the on-the-record testimony or interviewed five SEC employees, including the subject of the investigation. In addition, the OIG reviewed the applicable Government-wide standards of conduct and SEC rules and guidance regarding employees' use of SEC e-mail and other government resources.

The OIG investigation found that for several years, the OAS employee used substantial Commission resources and official time in support of her non-profit business. The OIG's review of her SEC e-mail records during the relevant period revealed that approximately 1,500 of her e-mails related to that business. In fact, the employee admitted under oath that she had used her SEC computer "a lot" for her non-profit business. Addition-

ally, the OIG learned that she also received numerous faxes at the SEC regarding the non-profit business.

The investigation further found that, although she has been repeatedly admonished by her supervisors to stop doing so, the employee continued to operate her non-profit business during her duty hours and using government resources. Moreover, the OIG found that the employee's devotion of time to her non-profit business contributed to inadequate job performance on her part.

Accordingly, the OIG concluded that, for years, the OAS employee knowingly and repeatedly violated SEC and Executive Branch policies and regulations regarding appropriate use of government office equipment and information technology resources. The OIG issued its report of investigation to management on December 16, 2009, and recommended disciplinary action against the employee, up to and including dismissal. Management had proposed a suspension of the employee, but it was not finalized by the end of the semiannual reporting period.

Allegations of Conflict of Interest and Investigative Misconduct (Report No. OIG-470)

During the reporting period, the OIG completed a comprehensive investigation into allegations that a supervisory SEC Enforcement attorney participated in an investigation notwithstanding a personal conflict of interest that required his recusal from the investigation and that various misconduct occurred during the course of the investigation and subsequent litigation. The complainant alleged that, despite the conflict of interest, the Enforcement attorney continued to be involved in the investigation, "working around the edges" of the case, and continued to control it. According to the complainant, this attorney "affirmatively went out of his way to manipulate the situation" against the complaint, creating a "poisonous record" in the case.

The complainant's specific allegations included that: (1) at court-ordered settlement discussions before a mediator, the Enforcement attorney refused to recommend the proposed settlement to his superiors, leading the mediator to accuse the attorney of not negotiating in good faith and wasting everyone's time; (2) the Enforcement attorney refused to be in the room during the complainant's deposition, but controlled what was occurring in the deposition from behind the scenes by speaking with the staff attorney during long breaks in the deposition; (3) Enforcement attorneys improperly failed to provide a previous transcript of a witness's testimony until the night before the witness's deposition; (4) Enforcement attorneys mishandled a document at trial and falsely accused the complainant of fabricating the document; and (5) Enforcement unfairly charged the complainant, while not charging a more culpable party. The complainant subsequently raised an additional claim that OCIE had conducted an unauthorized examination of the complaint's investment advisory firm because it was not a registered entity.

During its investigation, the OIG took extensive sworn testimony of the complainant, interviewed the complainant over the telephone and in person, and had numerous additional communications with the complainant by telephone and e-mail. The OIG also took the sworn testimony of three current or former Enforcement attorneys, and interviewed nine other witnesses, including three former Enforcement supervisory attorneys and the

complainant's former counsel. The OIG also consulted with the SEC Office of Ethics Counsel and OCIE. In addition, the OIG obtained and reviewed e-mails of seven current or former Enforcement attorneys for the pertinent time periods, and reviewed relevant documents, including numerous court pleadings and documents provided by the complainant. Further, the OIG reviewed and analyzed the pertinent provisions of the Standards of Ethical Conduct for Employees of the Executive Branch, the Commission's Canons of Ethics and the Commission's Conduct Regulation.

On February 24, 2010, the OIG issued a 76-page report of investigation, finding that the supervisory Enforcement attorney who allegedly had the conflict of interest had made disclosures to an Enforcement ethics official and his supervisors concerning his previous history with the complainant. Further, the OIG found that the Enforcement attorney's supervisors considered and addressed on more than one occasion whether he should continue to participate in the matter. We also found insufficient evidence to substantiate the claim of actual animosity towards or bias against the complainant on the part of the Enforcement attorney. Nonetheless, because of the perception by the complainant and his counsel of animosity on the Enforcement attorney's part, which was based in large part on the attorney's conduct at the mediation that took place in the Enforcement case, the OIG concluded that it would have been better if the attorney had not participated in the matter. Therefore, the OIG's report recommended that Enforcement attorneys be instructed to exercise caution in these types of decisions in the future.

The OIG investigation further found insufficient evidence to support other allegations of staff misconduct made by the complainant. These included allegations that the Enforcement attorney with the alleged conflict of interest improperly and secretly controlled what was occurring during the complainant's deposition by speaking with the staff attorney during long breaks in the deposition; Enforcement attorneys improperly withheld a witness's investigative transcript until the night before the witness's deposition; Enforcement attorneys mishandled a document at trial and falsely accused the complainant of fabricating this document; and OCIE conducted an unauthorized examination of the complainant's firm.

Finally, the OIG's investigation did find evidence showing that Enforcement never made any actual decision as to whether it should recommend charges against another party, although we did not find this necessarily meant it was unfair for the SEC to charge the complainant. The evidence showed that the Enforcement staff continued to investigate the other party after the case was filed against the complainant, but became occupied with other cases and the matter was dropped. Accordingly, we recommended that Enforcement institute appropriate procedures to ensure that, where Enforcement has indicated to the Commission that it is continuing to consider recommending charges against an individual or entity, a decision on the matter be made, documented, and approved at an appropriate supervisory level. Management action on the OIG's recommendations was pending as of the end of the semiannual reporting period.

Allegations of Enforcement Failure to Investigate (Report No. OIG-521)

The OIG opened an investigation on August 6, 2009, after receiving an investor complaint from the office of Senator Charles E. Grassley (R-Iowa), alleging that a "bear

raid" against a manufacturer that took place in 2009, resulting in a 65 percent drop in the company's stock price within 75 seconds. According to the complainant, an Internet message board posting warned of the bear raid in advance of the precipitous fall in the stock price. The complainant further alleged that the SEC failed to investigate this bear raid, as well as additional instances of misconduct in connection with the review, and eventual non-approval, of a company product. The complainant also alleged that certain non-SEC government employees were responsible for serious improprieties in the product approval process and, due to conflicts of interest, should never have been allowed to participate in the process. The focus of the OIG's investigation was to determine whether the SEC had, in fact, failed to investigate the possible manipulation of the company's stock, in the form of a bear raid, as alleged.

During the course of this investigation, the OIG reviewed numerous pages of correspondence and supporting materials provided by the complainant, including approximately 200 e-mails and many attachments thereto. The OIG also reviewed internal SEC case tracking reports for evidence of SEC investigative activity. Finally, the OIG interviewed the complainant, as well as two Enforcement staff members in an effort to determine whether there was an investigation into the alleged bear raid on the company's stock.

After conducting a thorough investigation into the complainant's allegations against the SEC, the OIG issued its report to management on December 9, 2009. In the report, we determined that the SEC was, in fact, actively investigating the specific instance of market manipulation identified by the complainant, namely, the alleged bear raid against the company's stock. We also determined that the complainant's allegations that conflicts of interest tainted the product approval process were not within the OIG's jurisdiction to investigate. Finally, the OIG provided Enforcement staff with the complainant's numerous materials, and will continue to monitor the progress of Enforcement's investigation of possible market manipulation related to the Internet message board posting.

Allegations of Retaliatory Action by Enforcement Staff (Report No. OIG-487)

On April 6, 2008, the OIG opened an investigation into allegations received from a shareholder of a publicly-traded company. The trading of this company's securities was the subject of an SEC Enforcement investigation. The complainant alleged that: (1) the Enforcement staff's investigation of this company's former CEO for improprieties in the trading of its stock was conducted in retaliation for the complainant and the CEO having complained about naked short selling in the company's stock; and (2) the Enforcement staff improperly sought the disbarment of an attorney in retaliation for the attorney having assisted the CEO in transferring the company's stock.

During the course of this investigation, the OIG took the sworn, on-the-record testimony of the complainant and the Enforcement staff attorney who conducted the investigation into the trading of the company's securities. The OIG also interviewed a representative of a state legal bar. In addition, the OIG reviewed numerous items, including: (1) the memorandum seeking formal order authority for the Enforcement staff to investigate trading in the company's securities; (2) the memorandum recommending that the Commission accept a settlement offer from the CEO; (3) a docu-

ment subpoena from the Enforcement staff to the company's transfer agent; (4) Enforcement database records concerning the investigation; (5) the Commission's litigation release pertaining to its civil action against the CEO; (6) news articles and a public filing concerning the company's actions against short sellers; and (7) on-line databases of state legal bars.

The OIG investigation did not find evidence substantiating the allegation that the naked short selling complaints made by the complainant and the CEO led to, or influenced, the SEC Enforcement staff's investigation of trading in the company's securities. In fact, the OIG found evidence that the investigation was opened because of a referral by the National Association of Securities Dealers Regulation (NASDR) (which is now the Financial Industry Regulatory Authority). Moreover, the OIG found that the NASDR referral and the opening of the Enforcement staff's investigation in 1999 predated the complainant's and the CEO's earliest complaints about naked short selling of the company's stock.

Further, the OIG investigation found no evidence to substantiate the allegation that the Enforcement staff attempted to have an attorney disbarred in connection with its investigation. The records of the state legal bar evidenced the fact that the lawyer's license was suspended for reasons unrelated to the Enforcement staff's investigation long before the staff contacted the state bar in connection with the lawyer's testimony to the staff.

The OIG issued its report of investigation to management on November 20, 2009. In the report, we determined that there was no evidence that Enforcement staff committed the alleged wrongdoing.

Allegation of Preferential Treatment of a Former SEC Attorney (Report No. OIG-528)

The OIG opened an inquiry on November 18, 2008, after receiving an investor complaint alleging that over 50,000 investors of a publicly-traded company had been defrauded by the company, suffering losses of $250 million. The complainant also questioned why SEC officials had failed to name the company's former outside counsel, who was a former SEC Enforcement attorney, as a defendant in the SEC's civil complaint filed in U.S. District Court. The complainant specifically alleged that during the former Enforcement attorney's tenure as the company's attorney, he signed off on opinion letters that resulted in the fraudulent issuance of over 300 billion shares of the company's stock, but that he was not charged in the SEC's lawsuit. After conducting an initial inquiry into the allegations, the OIG opened an investigation of the matter on November 25, 2009.

During the course of this investigation, the OIG obtained, searched and reviewed nearly 2,000 e-mails and supporting materials. The OIG also conducted sworn, on-the-record testimony of the Enforcement attorneys who conducted the Enforcement investigation of the company to determine whether the former Enforcement attorney received preferential treatment.

After conducting a thorough investigation into the complainant's allegation of preferential treatment by Enforcement, the OIG issued its report of investigation to management on March 16, 2010. In the report, the OIG found no evidence to suggest that the former Enforcement attorney's employment with the SEC, which lasted a total of only 15 months, had any bearing on Enforcement's decision not to charge him in the federal lawsuit

against the company. To the contrary, the evidence demonstrated that Enforcement staff seriously considered the question of whether to charge the attorney, weighing the pros and cons of bringing an action against him in an attempt to resolve what could fairly be considered a "tough call." The OIG found that Enforcement investigated the matter in good faith and made its charging decisions on reasonable grounds. In light of these findings, the OIG closed the matter without making any referral to management.

Allegations of Improper Staff Conduct During Litigation and Collection (Report No. OIG-527)

On September 17, 2007, the office of Senator Bill Nelson (D-Florida) forwarded to the OIG a letter from a complainant alleging that SEC staff had engaged in misconduct during the course of civil proceedings and related criminal proceedings against the complainant. In March 2000, the SEC was granted summary judgment in a civil action brought against the complainant for operating a Ponzi scheme. Pursuant to that judgment, the complainant was ordered, *inter alia*, to disgorge approximately $24 million in ill-gotten gains. The complainant then pled guilty in a related criminal matter and was sentenced to five years in prison with three years supervised probation. The OIG responded to the complainant's letter and continued to receive additional letters from the complainant forwarded by members of Congress. The complainant's letters alleged that: (1) SEC and non-SEC employees engaged in misconduct in connection with the SEC's case against him and companies he once controlled; and (2) the aforementioned misconduct resulted in a fraud upon the federal courts that adjudicated his civil and criminal cases.

The OIG conducted an investigation of the complainant's allegations to the extent they fell within the OIG's jurisdiction. The OIG met with the complainant and his attorney, and interviewed officials in Enforcement's Office of Collections, Distributions and Financial Management (Office of Collections) regarding the complainant's claim that the SEC was attempting to collect more than he owed. The OIG also interviewed the Enforcement trial attorney who had litigated the SEC's action against the complainant, and conducted follow-up interviews with both the trial attorney and Office of Collections officials. In addition, the OIG contacted an account executive from the U.S. Department of the Treasury (Treasury). Further, the OIG reviewed numerous pages of correspondence and supporting materials provided by the complainant, as well as the civil and criminal court records for the complainant's various civil, criminal and appellate actions, including the numerous pleadings and orders filed therein.

After conducting a thorough investigation into the complainant's allegations against the SEC, the OIG issued its report of investigation on November 20, 2009. The OIG found no evidence substantiating the complainant's allegations of SEC staff misconduct and, similarly, found no evidence that the staff attempted to collect more from the complainant than he owed. However, the OIG did find that the complainant received a series of letters that, collectively, were confusing with respect to how much he actually owed. Consequently, the OIG recommended that the Office of Collections contact the complainant's counsel to: (1) clarify the amount of debt referred to Treasury for collection and the date of the referral; (2) clarify what portion of the debt consisted of penalties and interest; (3) explain how penalties and interest were

calculated on the debt; and (4) provide any available information regarding penalties and interest that continued to accrue while Treasury attempted to collect the debt. In response to the OIG's recommendation, the Office of Collections contacted the complainant's counsel by letter dated March 23, 2010, and provided the salient information.

Inquiries Conducted

During this semiannual reporting period, the OIG completed a total of 35 inquiries into complaints received by the OIG. Of these inquiries, seven were converted to, or included in, investigations, three resulted in the issuance of reports recommending disciplinary action, and two resulted in investigative memoranda on management issues. The investigative memoranda are described in the Advice and Assistance Provided to the Agency section of this report. Several of the most significant of the inquiries completed during the period are described below.

Misuse of Computer Resources (PIs 10-20, 10-21 and 10-22)

During the semiannual reporting period, the OIT provided the OIG with a report of employees who had received a substantial number of access request denials for websites classified as pornography by the SEC's Internet filter. In reviewing the information provided by OIT, the OIG learned that three of the employees who had received a large number of access request denials had also successfully accessed sexually explicit or sexually suggestive websites from their government-assigned computers. The OIG conducted inquiries into the Internet activities of these three employees, all of whom are attorneys, and issued memorandum reports to management in all three matters on March 8, 2010.

In one matter (PI 10-20), an SEC attorney received 99 access request denials for websites classified as pornography in a two-week period. This same attorney had received 528 access request denials for websites classified as pornography for a previous one-month period. The information provided by OIT showed that this attorney had attempted to access blocked websites during normal Commission work hours. Further, a review of the information provided by OIT revealed numerous instances in which the attorney had successfully accessed sexually explicit or sexually suggestive photographs, some during normal Commission work hours.

In a second matter (PI 10-21), an SEC attorney received 51 access request denials for websites classified as pornography in a two-week period. A review of the information provided by OIT revealed that the attorney had also successfully accessed sexual explicit or sexually suggestive photographs on several occasions. The OIT data indicated that some of these photographs were accessed during normal Commission work hours. Moreover, in some instances, the attorney saved inappropriate images to his government-issued computer hard drive.

In the third matter (PI 10-22), an SEC attorney received 66 access request denials for websites classified as pornography in a two-week period. A review of the information provided by OIT also revealed numerous instances in which the attorney successfully accessed sexually explicit or sexually suggestive photographs, some of which were accessed during normal Commission work hours.

In all three matters, the OIG concluded that the attorneys' inappropriate use of the

Internet violated Commission policy and rules, as well as the Government-wide Standards of Ethical Conduct. The OIG referred all three attorneys to management for consideration of disciplinary action. As of the end of the semiannual reporting period, management indicated to the OIG that it planned to take disciplinary action in all three matters.

Failure to Respond to Complaint Appropriately (PI 09-36)

The OIG reviewed an allegation that the SEC had not responded appropriately to complaints submitted on behalf of the Whistleblowing United Pilots Association. During its inquiry, the OIG carefully reviewed the correspondence received from the complainant and focused on the issues that fell within the OIG's jurisdiction. The OIG also spoke with staff within the Office of Investor Education and Advocacy (OIEA) with respect to a response OIEA had sent to the complainant in November 2007. Based upon its review, the OIG concluded that OIEA had not taken sufficient action to address the complainant's concerns.

In order to ensure that the complainant's concerns were appropriately reviewed, the Inspector General personally referred his complaints directly to an Enforcement Senior Counsel and requested that senior Enforcement attorneys carefully scrutinize the complainant's allegations and concerns for possible action. The Enforcement Senior Counsel assured the OIG that such careful scrutiny would take place. The Inspector General also met with the Director of OIEA regarding the OIG's concerns about the insufficient action taken by OIEA with regard to the complainant's correspondence. The OIEA Director advised the Inspector General that she was reviewing OIEA's templates for responding to complaints and would ensure that those templates were appropriately revised. The OIG will continue to monitor the process to ensure the appropriate changes are made.

Complaint of Improper Use of Appropriated Funds for Employee Awards (PI 09-07)

The OIG conducted an inquiry into a complaint that a former Regional Office official had improperly purchased inscribed glass trophies to give to favorite employees using office supply funds. The OIG's inquiry reviewed: (1) whether using appropriated funds to purchase the trophies was permissible under the Government Employee Incentive Awards Act (GEIAA) and Comptroller General opinions; (2) whether the awards were authorized under the SEC's Employee Recognition plan; (3) who could authorize an expenditure of this nature; (4) whether the appropriate Budget Object Class (BOC) was used for the purchase; and (5) whether the use of a government purchase card (GPC) for the purchase of the trophies was appropriate.

During its inquiry, the OIG took the sworn testimony of the Regional Office official who purchased the trophies and interviewed several staff members in the Offices of Administrative Services, Human Resources and Financial Management. The OIG also contacted a Government Accountability Office (GAO) senior attorney, an Office of Personnel Management (OPM) manager, as well as attorneys in the SEC's Office of General Counsel, to obtain information on the pertinent legal and policy requirements. The OIG also researched and reviewed applicable GAO guidance, Comptroller General decisions,

OPM regulations and guidance, and SEC policies.

The OIG's inquiry concluded that the Regional Office official's use of appropriated funds to purchase the trophies for employee awards was not permissible under Comptroller General decisions and OPM guidance because the awards were not part of an agency-sponsored awards program under the GEIAA. The OIG inquiry also found that the SEC's policies and procedures authorizing the agency's award program had not been updated for over 15 years. In addition, the OIG concluded that the use of the supplies BOC for the awards was not proper, although the use of the GPC to purchase the trophies was not itself problematic. In order to address the deficiencies identified in this inquiry, the OIG issued an investigative memorandum making specific recommendations for improvements regarding any awards and use of BOCs, which is discussed in detail in the Advice and Assistance Provided to the Agency section of this semiannual report.

Improper Exclusion from Settlement Payment (PI 09-68)

The OIG performed an inquiry into a complaint filed by a bargaining unit employee that he had been improperly excluded from a lump-sum settlement payment due to an administrative error. During its inquiry, the OIG interviewed and obtained pertinent documentation from Office of Human Resources (OHR) staff members, as well as a National Treasury Employees Union (NTEU) officer. The OIG's inquiry disclosed that the complainant's name was erroneously omitted from the list of employees who were eligible to participate in a settlement reached between the SEC and the NTEU, which provided for both a lump-sum settlement and a salary increase. The OIG was informed that the error was not discovered in time for the complainant to participate in the lump-sum distribution, but that he did receive the salary increase.

The OIG inquiry further disclosed that the error that led to the complainant's exclusion from the lump-sum settlement may not have been an isolated occurrence, and that at least one other employee was improperly excluded from the lump-sum settlement. The OIG concluded that while OHR and the NTEU jointly identified the employees who were eligible to receive the distribution, more proactive efforts could have been made to ensure that all eligible employees were aware of the deadline for objecting to non-inclusion on the list of employees who were eligible to participate in the settlement. Accordingly, the OIG referred certain specific issues identified during its inquiry to its Office of Audits for consideration in connection with future internal audits of OHR.

Disclosure of Personally Identifiable Information on SEC's Website (PI 09-49)

In this inquiry, the OIG reviewed a complaint that a court order posted on the SEC's website included social security and bank account numbers for two individuals whom the SEC had sued for securities law violations. The OIG confirmed that the court order containing the personally identifiable information (PII) was, in fact, posted on the SEC's website under litigation documents from the case against the complainants and was misidentified as a "complaint." The OIG also learned during its inquiry that the full, unredacted court order was accessible through publicly available databases, as a result of the court's order that the redaction requirements of Federal Rule of Civil Procedure 5.2 should not apply to the order.

The OIG brought the information learned during its inquiry to the attention of the Commission's Secretary, who directed that the misidentified order immediately be removed from the Commission's website. The OIG confirmed that the court order was removed from the website. In addition, the Secretary indicated that the order would only be re-posted after the PII was redacted. In addition, the OIG recommended to the Secretary that court documents that are not complaints be labeled correctly in the future.

Improper Handling of Sensitive Personnel Information (PI 09-40)

The OIG reviewed a complaint that an SEC Regional Office failed to adequately safeguard employee PII in accordance with SEC requirements. During its inquiry, the OIG interviewed the complainant, Regional Office administrative personnel, an OHR staff member and the agency's Chief Privacy Officer. The OIG also reviewed e-mails provided by the complainant reflecting his communications with the Chief Privacy Officer regarding the alleged improper treatment of PII.

The OIG's inquiry disclosed that despite reminders from the Chief Privacy Officer to all SEC administrative contacts regarding the proper treatment of PII, there may have been inadequate safeguarding of personnel forms containing PII in the Regional Office in question, as well as in other SEC Divisions and Offices. However, we learned that OHR was developing a new electronic personnel file system (which was announced on March 30, 2010) that is expected to improve the safeguards for sensitive personnel documents. In the meantime, based upon the findings of our inquiry, an administrative supervisory official in the Regional Office about which the complaint was lodged sent an e-mail to that Office's administrative personnel, reminding them of the importance of ensuring that all documents containing personal information are secured, are not in public view, and are not left in office mail slots.

PENDING INVESTIGATIONS

Allegation of Enforcement Conflict of Interest

The OIG is continuing its investigation at the request of Congressman Elijah E. Cummings (D-Maryland) into the circumstances surrounding an Enforcement action brought against a prominent banking institution. The OIG is carefully scrutinizing the circumstances within the SEC that led to the decision for the SEC to recommend a settlement in its action against the banking institution that the presiding Judge rejected on September 14, 2009. During the course of the semiannual reporting period, the SEC presented a revised settlement with the banking institution that the Judge accepted on February 22, 2010. The OIG is expanding its investigation to analyze the circumstances surrounding the revised settlement, as well as those pertaining to the previous settlement that was rejected.

During the reporting period, the OIG reviewed over 500,000 e-mails of 15 current and former employees in five different offices and divisions within the SEC to obtain e-mails related to the Enforcement investigation. The OIG has also conducted several informal interviews of individuals both within and outside the SEC who have knowledge of the facts underlying the Enforcement investigation. In addition, we also conducted sworn, on-the-record testimony of an important whistleblower in this matter and began to schedule numerous additional sworn testimonies of

current SEC employees who worked on the investigation.

The OIG hopes to complete this investigation and issue a report of its findings in the next semiannual reporting period.

Allegation of Procurement Violations

The OIG continued its investigation into allegations made by a whistleblower that a senior management official awarded contracts to a company in violation of the governing laws, rules, and/or policies governing contracting procedures. In particular, it was alleged that the senior management official has a close relationship with the company to which he awarded the contracts. In addition, the product purchased by the SEC in connection with these contracts has allegedly not been used for the purpose described at the time the contracts were awarded, resulting in wasted agency resources. As of the end of the reporting period, the OIG had taken the sworn testimony of the whistleblower and obtained and reviewed numerous documents relating to this matter. The OIG plans to request further relevant documents and to take the testimony of several SEC employees and managers with knowledge of this matter. The OIG expects to complete this investigation and issue a report of investigation during the next semiannual reporting period.

Complaint of Investigative Misconduct by Various Enforcement Attorneys

The OIG is continuing its investigation of a complaint received from counsel for a defendant in an SEC Enforcement action that was dismissed by the District Court, alleging numerous instances of misconduct by Enforcement attorneys during the course of the investigation that led to the filing of the action. Early during the reporting period, the OIG took the sworn, on-the-record testimony of the defendant and two other witnesses in the matter. In connection with the dismissal of the Enforcement action, on August 28, 2009, the defendant filed a motion requesting attorneys' fees and litigation expenses. In support of this motion, the defendant made similar allegations as those contained in the initial complaint to the OIG, *i.e.,* that the SEC had insufficient evidence to support its claims against the defendant, made factual misstatements in its complaint in the Enforcement action, and engaged in investigative misconduct. On December 4, 2009, the District Court issued an order permitting discovery in connection with the defendant's motion and directing the parties to provide supplemental briefing following the discovery period. Because the Court had direct jurisdiction over these similar claims, and was in a position to grant the relief sought by the defendant, the OIG deferred further investigation of this matter pending a determination by the Court on these claims. Once the Court has ruled on these claims, the OIG will determine what further investigative steps should be taken as appropriate.

Allegation of Negligence in the Conduct of an Enforcement Investigation

The OIG is continuing its investigation into a complaint received from a former Enforcement attorney that Enforcement committed acts of negligence in the conduct of an insider trading investigation. The complaint was based upon recently-discovered information that purportedly demonstrated that Enforcement had access to specific evidence showing that insider trading had occurred prior to the time Enforcement closed its investigation. The OIG has taken the

sworn testimony of the complainant and has reviewed documentation provided by the complainant and reviewed additional documentation in its possession.

Additionally, during the reporting period, the OIG took the sworn testimony of the Enforcement branch chief and staff attorney assigned to the insider trading investigation. The OIG plans to continue its investigation of the allegations and conduct additional testimony or interviews. The OIG hopes to finalize the investigation and issue its report of investigation during the next semiannual reporting period.

Complaint of Misuse of Leave Without Pay by OCIE Managers

The OIG opened an investigation into an anonymous complaint that certain managers with full-time positions in OCIE are abusing the SEC's time and attendance system by working part-time schedules and taking leave without pay (LWOP) for the one to two days per week that they do not work. The OIG is investigating whether it is permissible for OCIE supervisors who have full-time positions to perform their duties on a *de facto* part-time schedule. The OIG is also inquiring into whether these supervisors are receiving full-time benefits to which they would not be entitled if they were officially part-time employees.

During the reporting period, the OIG reviewed pertinent documents, including e-mails, personnel records, and time and attendance records. The OIG also took the sworn testimony of witnesses who work in OCIE and interviewed several staff members in the SEC's Office of Human Resources. The OIG intends to finalize the investigation and issue its report of investigation during the next semiannual reporting period.

Allegation of Failure to Maintain Active Bar Membership

During the reporting period, the OIG continued its investigation into a complaint that the state bar license of an SEC headquarters attorney had been suspended, but that this individual continued to work as an SEC attorney. The OIG has conducted testimony and interviews of people with knowledge relevant to the investigation and reviewed pertinent information from state court officials regarding the attorney's bar status. Further, we searched and reviewed over 2,000 e-mails for the relevant time period. The review of this information uncovered additional potential misconduct pertaining to conflicts of interest, misuse of government resources, and abuse of leave.

The OIG plans to take additional testimony of relevant parties and complete this investigation during the next semiannual reporting period.

Allegation of Failure to Conduct an Adequate Investigation by Regional Office

The OIG conducted an investigation into a complaint alleging that Regional Office Enforcement officials failed to vigorously and diligently investigate the officers of a publicly traded corporation for securities fraud. The complaint further alleged that the Enforcement investigation was unduly delayed, relevant evidence was not examined and management improperly removed staff during the investigation.

During the reporting period, we took the testimony of the supervising attorney and four staff attorneys and accountants who conducted the investigation. The OIG also reviewed Enforcement memoranda, staff work

papers and meeting notes relating to the investigation. Further, the OIG searched and reviewed approximately one thousand e-mails of Enforcement and Office of Chief Accountant personnel, pertaining to the Enforcement investigation.

The OIG has completed its investigative work and plans to issue a report of its findings during the next semiannual reporting period.

Complaint of Unprofessional Conduct on Examination and Harassment

During the reporting period, the OIG opened an investigation into a complaint that a supervisor on an investment adviser examination acted unprofessionally by entering the firm's premises on two separate occasions without showing identification or properly identifying himself. The complaint further alleged that subsequent to these incidents, the supervisor harassed the examiner who he believed had reported the incidents to management officials. The OIG has taken the sworn testimony of the subject and three other witnesses. The OIG has also interviewed six individuals, including the complainant. In addition, the OIG obtained and reviewed pertinent procedures and numerous other documents and e-mails. The OIG plans to issue its report of investigation in this matter prior to the end of the next semi-annual reporting period.

Complaint Concerning Obstruction of Justice

The OIG continued its investigation into information received that an SEC employee may have offered to obstruct an SEC investigation. The OIG took the sworn testimony of an individual who stated that he learned of an SEC employee who had removed SEC files in the past and could do so again. The OIG also obtained and reviewed relevant documents, including e-mails, obtained from the SEC and relevant outside entities. The OIG worked with other federal law enforcement agencies in the course of this investigation. Subsequent to the opening of this investigation, the original source of the information recanted his story. The OIG has completed its investigative work and plans to issue its report of investigation during the next semiannual reporting period.

Complaint of Failure to Conduct Adequate Enforcement Investigation

The OIG opened an investigation into a complaint that Enforcement failed to properly and vigorously enforce the federal securities laws in the course of an investigation of accounting rule and insider trading violations by a publicly-traded corporation. The complaint also alleged specific acts of misconduct by an SEC Enforcement attorney during the course of the investigation.

During the course of this investigation, the OIG obtained and reviewed copies of each of the detailed complaints that the complainant had previously sent to the SEC, as well as copies of several memoranda Enforcement had submitted to the Commission concerning the investigation. The OIG plans to take on-the-record testimony of the complainant and other relevant parties and complete its investigative work prior to the end of the next reporting period.

Complaint of Unauthorized Disclosure of Non-Public Information

During the reporting period, the OIG opened an investigation into an allegation that non-public information provided to OCIE during the examination of a registrant was

leaked to a major newspaper. During the reporting period, the OIG analyzed the systems in place at the SEC that were supposed to guard against the improper release of this type of information. As discussed more fully in the Audits and Evaluations Conducted section of this report, the OIG issued a management alert to the SEC discussing its findings that the SEC does not have an auditing system for OCIE intranet sites or its shared network drives, thus allowing users to view, print, copy, download, move, edit, or delete documents and files without detection. In the management alert memorandum, the OIG recommended that prompt action should be taken to address these vulnerabilities.

With regard to the specific allegation being investigated, the OIG requested, obtained and reviewed over 500,000 e-mails for the relevant period from over 20 employees who may have viewed the non-public information shortly before that information was published in a newspaper article. The OIG also assembled a timeline of findings based on the e-mails reviewed. The OIG will continue to search for and review pertinent e-mails and plans to conduct testimony of witnesses with information relevant to the investigation during the next reporting period.

Office of Inspector General

SEMIANNUAL REPORT TO CONGRESS

REVIEW OF LEGISLATION AND REGULATIONS

During the 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.

In particular, the OIG reviewed statutes, rules, regulations and requirements, and their impact on Commission programs and operations, within the context of audits and reviews conducted during the period. For example, in the assessment performed of the SEC's program for awarding bounties to whistleblowers (Report No. 474), the OIG reviewed the existing statutory authority for the SEC's bounty program, Section 21A(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-1(e), and the regulations promulgated hereunder, 17 C.F.R. §§ 201.61-201.68. The OIG's assessment identified limitations and shortcoming in the existing authorities for the program, and the OIG reviewed proposed legislation included in H.R. 3817, the Investor Protection Act of 2009, which would significantly expand the SEC's authority to award bounties.

In its assessment of the SEC's Information Technology Investment Process (Report No. 466), the OIG reviewed and analyzed the statutory provisions specifying the responsibilities of, and reporting requirements for, agency Chief Information Officers (CIOs). *See, e.g.*, 44 U.S.C. § 3506. The OIG assessment found that the current CIO reporting structure within the SEC violated the statutory requirements, and that the SEC regulation describing the responsibilities and functions of the SEC's Executive Director, 17 C.F.R. § 200.133, required revision in order to meet the statutory requirements. Further, during its review of allegations of an improper use of appropriated funds to purchase trophies for employee awards (PI 09-07), the OIG reviewed the provisions of the Government Employee Incentive Awards Act, 5 U.S.C. § 4501, *et seq.*, and the implementing Office of Personnel Management regulations, including 5 C.F.R. § 451.104.

During the period, the OIG also reviewed, tracked and provided comments and views on pending legislation that would impact the SEC. For example, the OIG reviewed and

provided comment on a proposed whistleblower provision contained in the regulatory reform bill of the Chairman of the Senate Committee on Banking, Housing and Urban Affairs. In addition, the OIG also carefully reviewed the pending financial reform legislation for impact on the SEC as a whole and the OIG in particular. Specifically, the OIG performed a detailed review of various provisions of H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009, including sections that would establish a Council of the Inspectors General on Financial Oversight, elevate certain financial regulatory Inspectors General to Presidential appointees, provide for various reforms regarding credit rating agencies, and amend the Securities Exchange Act of 1934 to provide for whistleblower awards. Further, as discussed in the Congressional and Other Related Briefings and Requests section of this report, the Inspector General provided detailed legislative recommendations to Senator Christopher J. Dodd (D-Connecticut), Chairman of the U.S. Senate Committee on Banking, Housing and Urban Affairs, on October 29, 2009. These proposed reforms included suggested amendments to the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1, *et seq.*, and the Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq*.

Finally, in coordination with the Legislation Committee of the Council of Inspectors General on Integrity and Efficiency and the Inspectors General from several other Federal financial regulatory agencies, the OIG closely reviewed, tracked and provided views on various legislation of interest to the Inspector General community and, in particular, the financial regulatory agency Inspectors General. This legislation included H.R. 885, the Improved Financial and Commodity Markets Oversight and Accountability Act; H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009; S. 372, the Whistleblower Protection Enhancement Act of 2009; H.R. 3848, the Inspector General Authority Improvement Act of 2009; and a proposed amendment to H.R. 3996, the Financial Stability Improvement Act of 2009. On February 22, 2010, the SEC Inspector General, jointly with the Inspectors General of the Commodity Futures Trading Commission, the National Credit Union Administration, the Pension Benefit Guaranty Corporation and the Board of Governors of the Federal Reserve System, provided letters to Senator Christopher J. Dodd (D-Connecticut), Chairman, and Senator Richard Shelby (R-Alabama), Ranking Member, of the Senate Committee on Banking, Housing and Urban Affairs, setting forth their views on Subtitle C of H.R. 4173, which, like H.R. 885, would require Presidential appointments and Senate confirmations for these Inspectors General.

SEMIANNUAL REPORT TO CONGRESS

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.

Table 1
List of Reports: Audits and Evaluations

Audit / Evaluation Number	Title	Date Issued
470	Review of the Commission's Processes for Selecting Investment Advisers and Investment Companies for Examination	Nov 19, 2009
477	Management Alert - Data Security Vulnerabilities	Mar 1, 2010
460	Management and Oversight of Interagency Acquisition Agreements at the SEC	Mar 26, 2010
466	Assessment of the SEC Information Technology Investment Process	Mar 26, 2010
472	2009 FISMA Executive Summary Report	Mar 26, 2010
475	Evaluation of the SEC Privacy Program	Mar 26, 2010
476	Evaluation of the SEC Encryption Program	Mar 26, 2010
474	Assessment of the SEC's Bounty Program	Mar 29, 2010

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	3	$416,550.00
For which some decisions had been made on some issues at the commencement of the reporting period	1	$129,336.00
B. REPORTS ISSUED DURING THIS PERIOD	1	$6,945,831.00
TOTAL OF CATEGORIES A AND B	5	$7,491,717.00
C. For which final management decisions were made during this period	2	$515,574.00
D. For which no management decisions were made during this period	3	$6,976,143.00
E. For which management decisions were made on some issues during this period	0	$0.00
TOTAL OF CATEGORIES C, D AND E	5	$7,491,717.00

Table 3
Reports With Recommendations on Which Corrective Action Has Not Been Completed

RECOMMENDATIONS OPEN 180 DAYS OR MORE

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
412 - Oversight of the Public Company Accounting Oversight Board (PCAOB)	09/28/2006	Develop procedures for several PCAOB oversight issues.
428 - Electronic Documents Program	07/25/2007	Issue program guidance.
		Develop written procedures for loading data work from the regional offices.
		*Consider a larger forensics lab.
430 - Contract Ratifications	09/25/2007	*Reevaluate procurement in the regional offices.
		Develop procurement procedures and provide training for the regional offices.
433 - Corporation Finance Referrals	09/30/2008	*Develop a centralized tracking system for Divisions of Enforcement and Corporation Finance staff regarding non-delinquent filer referrals.
438 - Self-Regulatory Organization Rule Filing Process	03/31/2008	Enhance the Self-Regulatory Organization Rule Tracking System by identifying comment letters, improving speed, retaining proposed rule changes in inbox, and ensuring upload of all comment letters.
439 - Student Loan Program	03/27/2008	In consultation with the Union, develop a detailed distribution plan.
442 - Enterprise Architecture (EA) Assessment	03/31/2008	Develop EA metrics to assess or track the SEC's performance in implementing, and tracking performance of, the SEC's Federal EA program.
		Through the Information Technology Capital Planning and Investment Control Board, require periodic reports on EA progress overall, including specifically how EA can help to make strategic purchasing decisions.
446A - SEC's Oversight of Bear Stearns and Related Entities: Consolidated-Supervised Entity (CSE) Program	09/25/2008	Require compliance with existing rule requiring external auditors to review the CSE firms' risk management control systems, or seek Commission approval for deviation from this requirement.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		*Develop internal guidelines for timely Corporation Finance (CF) filing reviews, and track and monitor compliance with these guidelines.
		Establish a policy outlining when firms are expected to respond substantively to issues raised in CF comment letters, and track and monitor compliance with this policy.
446B - SEC's Oversight of Bear Stearns and Related Entities: Broker-Dealer Risk Assessment (BDRA) Program	09/25/2008	Establish a timeframe to update and finalize rules 17h-1T and 17h-2T within six months.
		Ensure the BDRA system includes financial information, staff notes and other written documentation and is used to generate management reports.
		Resolve technological problems with the BDRA system.
448 - 2008 Sensitive Payments	03/27/2009	*Keep an account of prohibited gifts that are returned of which the Ethics Office has knowledge.
450 - Practices Related to Naked Short Selling Complaints and Referrals	03/08/2009	Develop written in-depth triage analysis steps for naked short selling complaints.
		Revise written guidance to Enforcement Complaint Center (ECC) staff to ensure proper scrutiny and referral of naked short selling complaints.
		Add naked short selling to categories of complaints on public webpage and develop tailored online complaint form.
		Improve analytical capabilities of the ECC's e-mail complaint system.
		Improve CTR database to include additional information about and better track complaints.
		Ensure the Office of Internet Enforcement updates and resumes using previous complaint referral tracking system or develops a new system.
452 - Enforcement's Disgorgement Waivers	02/03/2009	Ensure staff comply with procedures and consider payment plans and partial waivers.
		Ensure the review of financial information for accuracy prior to recommending a disgorgement waiver.
		Clarify policies and procedures regarding when supporting documentation should be obtained and retained.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Ensure sworn financial statements from defendants/respondents who request disgorgement waivers are retained, signed and notarized.
		Ensure checklist for disgorgement waiver cases is retained and signed by supervisor.
		Ensure documentation is retained in case files and compliance with procedures for obtaining tax returns.
		Ensure public database searches are performed for all defendants/respondents.
		Ensure staff attorneys receive periodic formal training in disgorgement waiver process.
454 - The Division of Enforcement's Draft Policies and Procedures Governing the Selection of Receivers, Fund Administrators, Independent Distribution Consultants, Tax Administrators and Independent Consultants	09/16/2008	Revise policy on the selection of receivers and independent consultants to address actual and apparent conflicts of interest and provide guidance to staff.
		Determine whether any time limit should be placed on a request for conflict of interest or background information, or whether that information should be requested for more than five years.
		Include in the attachment to the policy the applicant's certification that the information provided is complete and truthful and that the applicant understands the consequences for providing false information.
455 - Attorney Annual Certification of Bar Membership	09/09/2008	Require all SEC attorneys to certify annually that they are active bar members and to acknowledge that their failure to maintain active bar membership may result in referral to the appropriate authorities and/or disciplinary action.
456 - Public Transportation Benefit Program	03/27/2009	Implement additional management controls over regional office program operations.
458 - SEC Oversight of Nationally Recognized Statistical Rating Organizations (NRSROs)	08/27/2009	Ensure that all significant issues identified in the application review process are resolved before recommending that a credit rating agency be registered as an NRSRO.
		Evaluate whether action should be taken regarding the credit rating agency that was granted NRSRO registration despite numerous significant problems identified with its application.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Ensure that all pending issues identified during the application process involving the credit rating agencies that the SEC approved as NRSROs are resolved within six months of the date of this OIG report.
		Develop measures for determining whether subscriber fees charged by the credit rating agencies are reasonable.
		Request guidance from the Office of General Counsel regarding the types of deficiencies that should prompt the Division of Trading and Markets to seek consent from the applicant to waive the 90-day statutory time period for granting registration as an NRSRO or recommend instituting procedures to determine whether registration should be denied.
		Take appropriate actions to inform NRSROs about the Commission's expectations regarding their compliance officers.
		Ensure that Commission orders are sought in response to requests from NRSROs for extensions of time when required by statute or Commission rules.
		Ensure that credit rating agencies applying for designation as NRSROs and firms that have registered as NRSROs comply with the Commission's rules and requirements regarding filing and certification of financial information.
		Review the OIG findings on conducting examinations before issuing orders approving applications and, as appropriate, seek legislative authority to conduct examinations as part of the NRSRO application process.
		Include NRSROs in the Office of Compliance Inspections and Examinations' (OCIE's) pilot monitoring program.
		Obtain an additional review of the draft OCIE NRSRO examination module by an expert in credit rating and NRSRO matters.
		Review the OIG findings concerning PCAOB oversight of NRSRO auditors and, as appropriate, seek legislative authority to provide the PCAOB with oversight over audits of NRSROs.
		Perform examination work to determine whether the quality of credit ratings is being adversely affected by NRSROs providing consulting and advisory services for issuers, underwriters or obligors that have paid the NRSROs for credit ratings.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Assess the impact of NRSROs providing consulting and advisory services on the quality of credit ratings and how to best minimize the harmful effects without unduly limiting competition among the NRSROs.
		Review the OIG findings on monitoring of credit ratings and direct the recommendation of appropriate rules to implement a comprehensive credit rating monitoring requirement for NRSROs.
		Perform examination work into whether credit rating analysts face undue influence and the effects of such undue influence on the credit ratings issued by the NRSROs.
		Assess the effects of undue influence on the quality of credit ratings and the potential benefits of a credit analyst rotation requirement.
		Review the OIG findings on credit ratings disclosures and, as appropriate, direct the recommendation of additional rule amendments to enhance the disclosures surrounding the credit ratings process.
		Conduct examinations to evaluate whether the revolving door problem is negatively impacting the quality of credit ratings.
		Assess the problems presented by the revolving door and, if appropriate, recommend rules to establish requirements to address the revolving door issue and meet with the Office of International Affairs periodically.
		Review the OIG findings on the Rule 17g-5 information disclosure program and Regulation FD and, as appropriate, direct the assessment of the potential effects on competition in the credit rating industry of the re-proposed amendments and recommend rule changes, if appropriate.
		Review the OIG findings on forum shopping for credit ratings and direct the recommendation of rules designed to reduce the potential harmful effects on the quality of credit ratings caused by forum shopping.
		Review the OIG findings on public comment on a firm's application and the status of competition and direct the incorporation of seeking and consideration of public comments into the SEC's NRSRO oversight process.
		Incorporate the additional concepts identified by the OIG' s review into the Commission's annual report to Congress on NRSROs.
459 - Regulation D Exemption Process	03/31/2009	Reintroduce the early intervention program and use it to assist in the enforcement of Regulation D.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Take efforts to finalize proposed rule.
		*Issue formal, public guidance on how to request a waiver of disqualification under Rule 505.
		Evaluate the Electronic Data Gathering And Retrieval (EDGAR) authentication process and make necessary changes to further streamline or simplify the process.
		Analyze how other agencies have implemented authentication processes and implement any appropriate procedures.
		*Determine further coordination with North American Securities Administrators Association staff and contact state regulatory staff when discussing and drafting proposed Regulation D rule changes.
461 - Review of the Commission's Restacking Project	03/31/2009	Conduct another survey of staff after the restacking process has been completed.
		Conduct appropriate analysis and complete and submit an Exhibit 300 to the Office of Management and Budget (OMB).
		Develop and adopt policies and procedures for investments in space consistent with OMB guidance.
464 - Notification to the OIG of Decisions on Disciplinary Actions and Settlement Agreements Involving Subjects of OIG Investigations	01/23/2009	Provide the OIG with three business days notice prior to decisions on disciplinary action.
		Provide the OIG with five business days notice prior to executing settlement agreements.
465 - Review of the SEC's Compliance with the Freedom of Information Act (FOIA)	09/25/2009	Ensure that accurate searches are made for responsive information and, in the event of a denial to disclose information, documented evidence is provided to certify there was a document-by-document review to segregate responsive records.
		Provide guidelines or written policies and procedures for all FOIA-related staff that specifically address the concerns raised in the OIG review.
		Ensure that sufficient legal expertise is available to the FOIA/Privacy Act Operations staff to process FOIA requests in compliance with FOIA, and to correctly apply exemptions.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Collaborate with office and division managers to review position descriptions of current FOIA/ Privacy Act staff and FOIA liaisons to include appropriate FOIA task descriptions and performance standards, and review pay grades to ensure they reflect actual FOIA responsibilities and duties.
		Ensure that training opportunities are provided to Commission staff that are appropriate for their level of FOIA responsibilities.
		Collaborate to produce a strategy that addresses information management obstacles hindering timely and comprehensive FOIA responses, and present the strategy to the Commission for action.
		Direct the conduct of training needed to fully implement the productive and suitable use of the FOIAXpress tracking and document management system.
467 - Program Improvements Needed Within the SEC's Division of Enforcement	09/29/2009	Establish formal guidance for evaluating various types of complaints (*e.g.*, Ponzi schemes) and train appropriate staff on the use of the guidance.
		Ensure the SEC's tip and complaint handling system provides for data capture of relevant information relating to the vetting process to document why a complaint was or was not acted upon and who made that determination.
		Require tips and complaints to be reviewed by at least two individuals experienced in the subject matter prior to deciding not to take further action.
		Establish guidance to require that all complaints that appear on the surface to be credible and compelling be probed further by in-depth interviews with the sources to assess the complaints' validity and to determine what issues need to be investigated.
		*Provide training to staff to ensure they are aware of the guidelines contained in Section 3.2.5 of the Enforcement Manual and Title 17 of the Code of Federal Regulations, Section 202.10, for obtaining information from media sources.
		Review and test the effectiveness of Enforcement's policies and procedures annually with regard to its new tip and complaint handling system, and modify these policies and procedures when needed to ensure adherence an adequacy.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		*Establish procedures to ensure that investigations are assigned to teams where at least one individual on the team has specific and sufficient knowledge of the subject matter, and the team has access to at least one additional individual who also has such expertise or knowledge.
		Train staff on what resources and information are available from the national specialized units and when and how assistance from these units should be requested.
		*Require that planning memoranda be prepared during an investigation, the plan includes a section identifying what type of expertise or assistance is needed from others, and the plan be reviewed and approved by senior Enforcement personnel.
		*Establish policies and procedures or training mechanisms to ensure staff have an understanding of what types of information should be validated during investigations with independent parties.
		Include in complaint handling guidance proper procedures for ensuring complaints received are properly vetted, even if an investigation is pending closure.
		*Implement a process to periodically remind staff of their responsibilities regarding impartiality in the performance of official duties and instruct staff where to find additional information on impartiality.
		Establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over communication of program priorities and recommend improvements to the Enforcement Director.
		Establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over case handling procedures within Enforcement and recommend improvements to the Enforcement Director.
		Establish or utilize an existing working group to analyze the OIG survey information regarding staff concerns over working relationships within Enforcement and recommend improvements to the Enforcement Director.
468 - Review and Analysis of the Office of Compliance Inspections and Examinations (OCIE) Examinations of Bernard L. Madoff Investment Securities LLC	09/29/2009	Provide all examiners access to relevant industry publications (*i.e., MAR/Hedge*-type publications) and third-party database subscriptions sufficient to develop examination leads and stay current with industry trends.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Establish a protocol for searching and screening news articles and information from relevant industry sources that may indicate securities law violations at broker-dealers and investment advisers.
		Establish a protocol that explains how to identify red flags and potential violations of securities law based on an evaluation of information found in news reports and relevant industry sources.
		Review and test annually the effectiveness of OCIE policies and procedures with regard to its tip and complaint collection system, and modify these policies and procedures when needed.
		Ensure that tips and complaints reviewed by OCIE that appear on the surface to be credible and compelling are probed further by in-depth interviews with the sources to assess their validity and to determine if there are other issues that need to be investigated.
		Ensure that all OCIE-related tips and/or complaints that are not vetted within 30 days of receipt are brought to the attention of the OCIE Director with an explanation for the delay.
		Preserve all potentially relevant information received from a tip or complaint source as a complete unit and augment with relevant information that may be provided in subsequent submissions.
		Augment OCIE's policies and procedures related to the use of scope memoranda to better reflect particular consideration given to information collected as the result of tips and complaints that lead to cause examinations.
		After examination scoping provisions have been approved, along with all other elements of the planning memorandum, subject the planning memorandum to concurring review by an unaffiliated OCIE associate or assistant director.
		After the planning memorandum is first drafted, circulate it to all examination team members, and have all team members meet, in person or electronically, to discuss the examination approach and methodology.
		Require the examination team leader to ensure that all steps of the examination methodology, as stated in the planning memorandum, are completed, and either the team leader or the appropriate team member signs off on each step as it is completed.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Document substantive interviews conducted by OCIE of registrants and third parties during OCIE's pre-examination activities and during the course of an active examination with notes circulated to all team members.
		Log all examinations into an examination tracking system, and require the team leader to verify that the appropriate entry is made into the tracking system with a notation in the planning memorandum.
		Review and test annually the effectiveness of OCIE's policies and procedures with regard to conducting, documenting and concluding its examinations and modify the policies and procedures when needed.
		Ensure the focus of an examination drives the selection of the examination team and that team members are selected based upon their expertise related to such focus.
		Ensure that personnel with the appropriate skills and expertise are assigned to cause examinations.
		Assign a Branch Chief, or a similarly designated lead manager, on every substantive project, including all cause examinations with unique or discreet needs.
		Develop a formal plan with specific goals associated with achieving and maintaining professional designations and/or licenses by industry certification programs that are relevant to the examination activities conducted by OCIE.
		Develop and implement interactive exercises to be administered by OCIE training staff or an independent third party and reviewed prior to hiring new OCIE employees in order to evaluate the relevant skills necessary to perform examinations.
		Subject to the approval of the examination team leader, contact clients of a broker-dealer or investment adviser when necessary to confirm statements made by broker-dealer or investment adviser personnel.
		Consult with the team leader, in the course of an examination, if an examiner becomes aware of a potential securities law violation at another firm and make a referral to the appropriate personnel or agency.
		Give OCIE staff direct access to certain databases maintained by self-regulatory organizations or other similar agencies to allow examiners to access necessary data for verification or analysis of registrant data.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Ensure that when an examination team is pulled off the examination for a project of higher priority, upon completion of that project, the examination team returns to their examination and brings the examination to a conclusion.
		Assign one person responsibility for tracking the progress of all cause examinations and ensure the tracking includes the number of cause examinations, the number ongoing and the number closed for each month.
		Indicate clearly in policies and procedures that, at the conclusion of each examination, the examination team must prepare a closing report that begins with the scope discussion from the planning memorandum, as modified by new issues arising during the course of the examination.
		Ensure the examination staff do not leave open any substantive issue without providing a sufficient basis for such a determination or a plan to pursue that issue at an appropriate later time.
		Report information deemed credible when an auditor's independence is questioned in a tip or complaint to the appropriate state board of accountancy and the PCAOB, if applicable, and consider a referral to the SEC's Enforcement Division or other government agency.
471 - Audit of the Office of Acquisitions' Procurement and Contract Management Functions	09/25/2009	Develop record-keeping standard operating procedures to track procurement and contracting (acquisition) activities.
		Develop a periodic internal review process to ensure the new record-keeping standards are followed.
		Determine the universe of active and open contracts and the corresponding value of the contracts and reconcile this information with the Office of Financial Management's active contract list.
		Develop an internal process to ensure procurement data is accurately and fully reported in the Federal Procurement Data System for both SEC headquarters and regional offices.
		Develop an acquisition training plan to ensure compliance with Office of Federal Procurement Policy training requirements.
		Provide regional offices with oversight, including the proper use of Contracting Officer Technical Representatives, Inspection and Acceptance Officials, Point-of-Contact personnel and other personnel who handle procurement and contracting activities.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Revise and finalize data migration plan and include key controls or steps to ensure accuracy of migrated data.
		Re-educate the acquisition workforce on the Federal Acquisition Regulation requirements that are related to time-and-materials and labor-hour contracts.
		Update SEC Regulation 10-14, Procurement Contract Administration, regarding contract closeout and ensure that it properly aligns with the Federal Acquisition Regulation.
		Develop an internal review process and checklist to further ensure compliance with the Federal Acquisition Regulation contract closeout procedures.
ROI-431 - Re-Investigation of Claims of Preferential Treatment and Improper Termination	09/30/2008	Clarify Commission's policies on the disclosure of non-public information in the context of Enforcement investigations and conduct training of Enforcement employees.
		Reassess and clarify to staff Enforcement's practice that allows outside counsel the opportunity to communicate with those above the line attorney level on behalf of their clients.
ROI-477 - Allegations of Perjury and Obstruction of Justice	03/17/2009	Review Commission's policies and procedures concerning employee performance files to ensure they are properly protected and produced upon request.
ROI-481 - Employees' Securities Transactions	03/03/2009	*Give one office primary responsibility for ensuring compliance with Rule 5.
		*Use an integrated computerized system for every facet of Rule 5 compliance.
		Give serious consideration to obtaining duplicate copies of brokerage record confirmations for each securities transaction for every SEC employee.
		*Amend SEC Form 681 to require employees to certify in writing that they do not have non-public information related to each securities transaction they conduct and report.
		*Review and check SEC Form 681s against the system clearances to ensure employees obtained clearance and the trades were timely made thereafter.
		Have employee's direct supervisor review a list of all pending cases in the group over the last year to compare against a list of all securities reported on Office of Government Ethics (OGE) Form 450 for each employee.

Audit/Inspection/ Evaluation or Investigation # and Title	Issue Date	Summary of Recommendation
		Have the office primarily responsible for Rule 5 compliance conduct regular thorough spot checks for Rule 5 compliance for randomly selected employees each quarter.
		Conduct separate comprehensive and more frequent training on Rule 5, its purpose and its requirements, for all SEC employees, supervisors and contractors.
		*Compare OGE Form 450s against each employee's SEC Form 681s to ensure accuracy.
		*Consider expanding staff who are required to file OGE Form 450s beyond the higher-paying grades currently required to file.
		*Establish a clear written policy on the confidentiality of Enforcement investigations and whether and when staff can discuss their confidential investigations or matters.
ROI-502 - Allegations of Improper Disclosures and Assurances Given	09/30/2009	Clarify policies on disclosure of non-public information, including what constitutes non-public information related to Enforcement investigations and parameters for discretionary release.
		Clarify Commission's policies regarding under what circumstances the staff is obligated to seek formal approval before making decisions that may bind the Commission.

* 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.

This table also includes an additional 46 recommendations for which management determined it had completed corrective action by the end of the reporting period. Subsequent to the end of the reporting period, the OIG determined that seven of these recommendations should not be closed, and the remaining 39 recommendations are under OIG review.

Table 4
Summary of Investigative Activity

CASES	NUMBER
Cases Open as of 9/30/09	17
Cases Opened during 10/01/09 - 3/31/10	9
Cases Closed during 10/01/09 - 3/31/10	13
Total Open Cases as of 3/31/10	13
Referrals to Department of Justice for Prosecution	1
Prosecutions	0
Convictions	0
Referrals to Agency for Disciplinary Action	6
PRELIMINARY INQUIRIES	**NUMBER**
Inquiries Open as of 9/30/09	78
Inquiries Opened during 10/01/09 - 3/31/10	28
Inquiries Closed during 10/01/09 - 3/31/10	35
Total Open Inquiries as of 3/31/10	71
Referrals to Agency for Disciplinary Action	3
DISCIPLINARY ACTIONS	**NUMBER**
Removals (Including Resignations)	1
Suspensions	3
Reprimands	2
Warnings/Other Actions	3

Table 5
Summary of Complaint Activity

DESCRIPTION	NUMBER
Complaints Pending Disposition at Beginning of Period	38
Hotline Complaints Received	141
Other Complaints Received	63
Total Complaints Received	204
Complaints on which a Decision was Made	235
Complaints Awaiting Disposition at End of Period	7
Disposition of Complaints During the Period	
Complaints Resulting in Investigations	3
Complaints Resulting in Inquiries	28
Complaints Referred to OIG Office of Audits	6
Complaints Referred to Other Agency Components	123
Complaints Referred to Other Agencies	10
Complaints Included in Ongoing Investigations or Inquiries	3
Response Sent/Additional Information Requested	50
No Action Needed	14

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.

	INSPECTOR GENERAL ACT REPORTING REQUIREMENT	PAGES
Section 4(a)(2)	Review of Legislation and Regulations	85-86
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	13-15, 19-40, 44-80
Section 5(a)(2)	Recommendations for Corrective Action	13-15, 19-40, 44-80
Section 5(a)(3)	Prior Recommendations Not Yet Implemented	93-105
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	44-80 107
Section 5(a)(5)	Summary of Instances Where Information Was Unreasonably Refused or Not Provided	87
Section 5(a)(6)	List of OIG Audit and Evaluation Reports Issued During the Period	89
Section 5(a)(7)	Summary of Significant Reports Issued During the Period	19-40, 44-80
Section 5(a)(8)	Statistical Table on Management Decisions with Respect to Questioned Costs	91
Section 5(a)(9)	Statistical Table on Management Decisions on Recommendations That Funds Be Put To Better Use	91
Section 5(a)(10)	Summary of Each Audit, Inspection or Evaluation Report Over Six Months Old for Which No Management Decision Has Been Made	87
Section 5(a)(11)	Significant Revised Management Decisions	87
Section 5(a)(12)	Significant Management Decisions with Which the Inspector General Disagreed	87

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