



December 2019

# SECURITIES AND EXCHANGE COMMISSION

Systematically  
Assessing Staff  
Procedures and  
Enhancing Control  
Design Would  
Strengthen Internal  
Oversight

## Why GAO Did This Study

Section 961 of the Dodd-Frank Wall Street Reform and Consumer Protection Act directs SEC to assess and report annually on internal supervisory controls and procedures applicable to staff performing examinations, investigations, and securities filing reviews. The act also contains a provision for GAO to report on SEC's internal supervisory control structure and staff procedures. GAO's last report was in 2016 ([GAO-17-16](#)).

This report examines SEC's internal supervisory control framework and assessment of staff procedures, the design of selected controls, and the operation of selected controls.

GAO analyzed SEC's internal supervisory control framework and related policies and guidance and evaluated the design and execution of a non-generalizable sample of controls selected because they addressed high-risk processes.

## What GAO Recommends

GAO is making five recommendations to SEC related to developing policies to assess the effectiveness of staff procedures and ensuring that all relevant divisions and offices follow SEC guidance and federal internal control standards for implementing control activities through documented policies. SEC agreed with the recommendations.

View [GAO-20-115](#). For more information, contact Michael Clements at (202) 512-8678 or [ClementsM@gao.gov](mailto:ClementsM@gao.gov).

# SECURITIES AND EXCHANGE COMMISSION

## Systematically Assessing Staff Procedures and Enhancing Control Design Would Strengthen Internal Oversight

### What GAO Found

As of fiscal year 2018, the Securities and Exchange Commission's (SEC) internal supervisory control framework—which provides guidance for division and office staff responsible for assessing the effectiveness of internal supervisory controls—reflected federal internal control standards. GAO determined that SEC's framework included elements covering each of the five components of internal control—control environment, risk assessment, control activities, information and communication, and monitoring. However, SEC does not have written policies or guidance to ensure that relevant SEC divisions and offices systematically assess the effectiveness of procedures applicable to staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate securities filings. Establishing such policies would provide SEC greater assurance that these procedures are effective at achieving their objectives.

All the SEC controls GAO evaluated were designed consistent with standards, and a majority operated as intended. SEC guidance and federal internal control standards state that (1) controls should be designed to address objectives and respond to risks and (2) control activities should be implemented through policies, including documentation requirements, and include detail to enable management to monitor control execution.

- **Control design.** All 39 controls GAO evaluated included design elements to achieve SEC's control objectives and respond to risks it identified. However, 10 of these 39 controls did not include key attributes, such as requirements to document, and set time frames for, control execution (see fig.).
- **Control operation.** GAO could not assess the operation of three of 18 selected controls because documentation of control execution did not exist. Of the remaining controls, 12 operated as intended and three partially operated as intended. Examples of controls that operated as intended include SEC's approval of examinations and tracking of investigations.

By more consistently following SEC guidance and federal internal control standards for developing control activities, including documentation requirements, relevant SEC divisions and offices would enhance their ability to monitor and ensure the effectiveness of their internal supervisory controls.

**Evaluation of Control Activity Attributes for Selected SEC Controls, Fiscal Year 2018**

	Total	Corporation			OCR
		OCIE	Finance	Enforcement	
Number of controls that incorporated all attributes	29	6	6	7	10
Number of controls that lacked at least one attribute	10	2	2	3	3
<b>Total number of controls reviewed</b>	<b>39</b>	<b>8</b>	<b>8</b>	<b>10</b>	<b>13</b>

Legend: Corporation Finance = Division of Corporation Finance; Enforcement = Division of Enforcement; OCIE = Office of Compliance Inspections and Examinations; and OCR = Office of Credit Ratings.

Source: GAO analysis of Securities and Exchange Commission (SEC) documents. | GAO-20-115

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## Abbreviations

CAP	corrective action plan
Corporation Finance	Division of Corporation Finance
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
Enforcement	Division of Enforcement
FMFIA	Federal Managers' Financial Integrity Act of 1982
NEP	National Examination Program
NRSRO	nationally recognized statistical rating organization
OCIE	Office of Compliance Inspections and Examinations
OCR	Office of Credit Ratings
OMI	Office of Market Intelligence
RCM	risk and control matrix
SEC	Securities and Exchange Commission
TCR	tip, complaint, or referral
Working Group	Section 961 Working Group

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December 19, 2019

The Honorable Mike Crapo  
Chairman  
The Honorable Sherrod Brown  
Ranking Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Maxine Waters  
Chairwoman  
The Honorable Patrick McHenry  
Ranking Member  
Committee on Financial Services  
House of Representatives

The failure of the Securities and Exchange Commission (SEC) to detect high-profile cases of securities misconduct before and during the 2007–2009 financial crisis raised concerns about SEC’s internal controls over its oversight activities. Internal control comprises the plans, methods, and procedures used to meet an agency’s mission, goals, and objectives. SEC maintains internal controls to help staff effectively manage its operations and financial resources, achieve its objectives, and ensure procedures are performed consistently and in accordance with its standards.

Section 961 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) directs SEC to provide Congress with an annual report on the conduct of SEC’s examinations, investigations, and securities filing reviews.<sup>1</sup> The report must contain an assessment of the effectiveness of (1) SEC’s internal supervisory controls and (2) staff procedures (that is, the procedures applicable to SEC staff who perform reviews of corporate financial securities filings, enforcement investigations, and examinations of registered entities).<sup>2</sup> The activities

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<sup>1</sup>Pub. L. No. 111-203, § 961(a), 124 Stat. 1376, 1907 (2010) (codified at 15 U.S.C. § 78d-6(a)).

<sup>2</sup>15 U.S.C. § 78d-6(b)(1). In addition, the report must contain a certification regarding the adequacy of SEC’s internal supervisory controls, signed by the directors of relevant divisions and offices. See 15 U.S.C. §§ 78d-6(b)(2), 78d-6(c).

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subject to section 961 fall within the purview of the Division of Corporation Finance (Corporation Finance), Division of Enforcement (Enforcement), Office of Compliance Inspections and Examinations (OCIE), and, since 2012, Office of Credit Ratings (OCR)—to which we refer collectively as the divisions and offices.<sup>3</sup>

Section 961 also includes a provision that GAO review SEC's internal supervisory control structure and staff procedures and report to Congress at least every 3 years. In our last review, we found that as of the end of fiscal year 2015, SEC's internal supervisory control framework reflected key components of federal internal control standards.<sup>4</sup> The vast majority of controls we tested operated as intended. Of those that did not, none appeared likely to prevent the divisions and offices from achieving the controls' objectives. We also found that SEC's annual section 961 reports to Congress during fiscal years 2013–2015 were consistent with Dodd-Frank Act requirements and processes for developing the annual reports reflected components of internal control. We recommended the SEC Chair formalize an informal working group for activities related to section 961 or otherwise establish a formal body to facilitate the coordination of compliance with section 961. In 2017, SEC formalized its Section 961 Working Group (Working Group) in response to our 2016 recommendation.

In this report, we examine (1) the extent to which SEC's internal supervisory control framework during fiscal years 2016–2018 reflected federal internal control standards; (2) how SEC evaluated the effectiveness of staff procedures in fiscal year 2018; (3) the extent to which selected controls in fiscal year 2018 were designed consistent with relevant standards; and (4) the extent to which selected controls operated as intended in fiscal year 2018.

For our first objective, we reviewed SEC's internal supervisory control framework for fiscal years 2016–2018. We obtained and reviewed documentation on policies and procedures and interviewed SEC staff to assess SEC's framework against internal control standards for the federal

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<sup>3</sup>SEC determined that OCR is a successor of OCIE, subject to the section 961 reporting and certification requirement. See 15 U.S.C. § 78d-6(c)(1).

<sup>4</sup>The key components included identifying and assessing risks; designing, implementing, monitoring, and evaluating controls; and reporting the results. See GAO, *Securities and Exchange Commission: Management Has Enhanced Supervisory Controls and Could Further Improve Efficiency*, [GAO-17-16](#) (Washington, D.C.: Oct. 6, 2016).

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government and to determine the extent to which the framework was consistent with these standards.<sup>5</sup> We reviewed changes SEC made to its framework since our last review and compared the framework against federal internal control standards to determine the extent to which it continued to reflect those standards as of fiscal year 2018.<sup>6</sup> We also reviewed the internal supervisory controls in place in the divisions and offices in fiscal year 2018.

For our second objective, we reviewed policies, procedures, guidance documents, and other agency documentation to evaluate how SEC and the divisions and offices assess the effectiveness of staff procedures. We interviewed SEC staff to obtain an understanding of the steps the divisions and offices take to assess the effectiveness of staff procedures.

For our third objective, we used control documentation, such as the policies, procedures, and stated control objectives of the divisions and offices to determine if the design of selected internal supervisory controls in place in fiscal year 2018 was consistent with federal internal control standards and SEC guidance for designing internal controls. We developed an evaluation template based on federal internal control standards and assessed selected controls from each division and office against those criteria. We reviewed documents and interviewed staff to understand the internal supervisory controls used to oversee the processes for conducting securities filing reviews, investigations, and examinations.

We selected a non-generalizable sample of 53 controls in place during fiscal year 2018 for review—13 controls in Corporation Finance, 15 in Enforcement, 11 in OCIE, and 14 in OCR. To select controls for review, we grouped the controls into sets if the underlying staff processes had multiple associated controls, and we selected controls and control sets that addressed the processes with the highest risk or potential impact, as designated by SEC, until we reached our target of 10–15 controls per division or office. Some control sets contained both controls that SEC designated as internal supervisory controls and those that it did not so designate. Therefore, to fully assess complete control sets associated with underlying processes, our selection contained some controls that

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<sup>5</sup>See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

<sup>6</sup>See [GAO-17-16](#).

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were not related to section 961. In this report, we only discuss and include analysis for those controls SEC identified as related to section 961, which comprised 39 controls—eight in Corporation Finance, 10 in Enforcement, eight in OCIE, and 13 in OCR.

For our fourth objective, we used the divisions' and offices' policies, procedures, and documentation of control implementation to determine if selected internal supervisory controls in place during fiscal year 2018 operated as intended. As we did for the assessment of control design, we created an evaluation template using SEC's control activities and related policy and procedural documents to assess selected controls from each division and office. We judgmentally selected 18 internal supervisory controls from the population of 39 internal supervisory controls reviewed in the third objective, based on whether the controls were labeled as key to achieving objectives, high-risk, potentially having a major impact, or as having a likelihood of failure.<sup>7</sup> For these controls, we reviewed documentation of control implementation to determine if the procedures outlined in the controls' designs were followed. We created a generalizable, random sample of cases to review for eight of the controls, and reviewed all instances for the remaining controls because they occurred annually or were executed in only a few instances.

We conducted this performance audit from October 2018 to December 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

The Dodd-Frank Act was enacted to promote the financial stability of the United States by improving accountability and transparency in the financial system and protecting consumers from abusive financial services practices, among other purposes. To help detect and prevent securities misconduct, section 961 of the Dodd-Frank Act promotes complete and consistent performance of SEC staff examinations, investigations and reviews, and appropriate supervision of these activities

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<sup>7</sup>We originally selected 19 controls, but removed one selected control involving updates to policies and procedures from the scope of our review based on discussions with OCR staff. See appendix I for more information.

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through internal supervisory controls.<sup>8</sup> SEC has submitted eight annual reports to Congress under section 961, all of which stated that both its internal supervisory controls and its staff procedures were effective for the period under review. In addition, all such reports stated that no significant deficiencies in internal supervisory controls were identified.

Section 961 does not define “internal supervisory control.” SEC has defined internal supervisory controls as the processes established by management to monitor that the procedures applicable to staff (that is, established day-to-day procedures to be followed by the employees within the applicable programs) are consistently being performed according to policy and procedures, and also remain reasonable, adequate, and current.

SEC is the primary regulator of the U.S. securities markets and is responsible for protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. To fulfill this mission, SEC requires public companies to disclose meaningful financial and other information to the public, examines firms it regulates, and investigates potential violations of the federal securities laws. SEC is organized into five divisions and 24 offices. SEC’s approximately 4,400 staff are located in Washington, D.C., and in 11 regional offices. As discussed previously, four divisions and offices are subject to section 961 of the Dodd-Frank Act (see table 1).

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<sup>8</sup>See S. Rep. No. 111-176, at 137 (2010).

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**Table 1: Roles and Responsibilities of SEC Divisions and Offices Subject to Section 961 of the Dodd-Frank Act**

SEC division or office	Roles and responsibilities
Division of Corporation Finance	Reviews corporate disclosures, assists companies in interpreting SEC's rules, and recommends new rules for adoption.
Division of Enforcement	Conducts investigations of potential violations of federal securities laws, including the conduct of registered entities (such as broker-dealers and investment advisors) and unregistered entities (such as those offering unregistered and fraudulent securities); recommends, when appropriate, that SEC bring enforcement actions (in a federal court or in an administrative proceeding before an administrative law judge); litigates these actions; negotiates settlements on behalf of SEC; and works with criminal law enforcement agencies when warranted.
Office of Compliance Inspections and Examinations	Administers a nationwide examination and inspection program for registered entities (including self-regulatory organizations, broker-dealers, transfer agents, clearing agencies, and investment companies and advisors) to improve compliance, prevent fraud, monitor risk, and inform policy.
Office of Credit Ratings	Conducts examinations of nationally recognized statistical rating organizations, which are SEC-registered credit-rating agencies.

Legend: Dodd-Frank Act = Dodd-Frank Wall Street Reform and Consumer Protection Act; SEC = Securities and Exchange Commission

Source: SEC. | GAO-20-115

SEC formalized its Section 961 Working Group in 2017. The primary purposes of the Working Group are to enhance the efficiency and effectiveness of SEC's processes related to section 961 compliance and to enhance coordination and information sharing among the divisions and offices. The Working Group is a staff-level group comprising one or more representatives from each of the four divisions and offices subject to section 961 as well as the Office of the Chief Operating Officer. These staff are responsible for carrying out the Working Group's responsibilities, which include establishing a common understanding and consistent approach to compliance; creating a means to share information and ideas to improve the efficiency and effectiveness of section 961 compliance activities; discussing best practices to streamline procedures and documentation of internal control testing and reporting; and developing and updating guidance related to implementing section 961.

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## Federal Internal Control Standards

*Standards for Internal Control in the Federal Government* provides the overall framework for establishing and maintaining internal control in federal agencies.<sup>9</sup> Agency management is responsible for adapting the framework for an agency. Furthermore, an agency may use the framework to organize its development and implementation of internal

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<sup>9</sup>[GAO-14-704G](#).

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controls and implement its standards throughout the agency or at an office level.

Five interrelated components and associated principles establish requirements for developing and maintaining an effective internal control system:

- **Control environment:** The control environment is the foundation for an internal control system. It provides discipline and structure, which affect the overall quality of internal control. It influences how objectives are defined and control activities are structured. The oversight body and management establish and maintain an environment throughout the entity that sets a positive attitude toward internal control.
- **Risk assessment:** Management assesses the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses. Management assesses risks the entity faces from external and internal sources.
- **Control activities:** Control activities are the actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity's information system.
- **Information and communication:** Management uses quality information to support the internal control system. Effective information and communication are vital for an entity to achieve its objectives. Entity management needs access to relevant and reliable communication related to internal and external events.
- **Monitoring:** Internal controls are dynamic and have to be adapted continually to risks and changes an entity faces. Monitoring the internal control system is essential in helping internal control remain aligned with changing objectives, environment, laws, resources, and risks. Internal control monitoring assesses the quality of performance over time and promptly resolves the findings of audits and other reviews. Corrective actions are a necessary complement to control activities to achieve objectives.

To be effective, an agency's internal control system must incorporate the five components of internal control in an integrated manner throughout its operations and on an ongoing basis. Once in place, internal control provides reasonable, not absolute, assurance of meeting agency objectives. When evaluating the design of internal control, management

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determines if controls individually and in combination are capable of achieving an objective and addressing related risks.

To the extent a control does not fully achieve an objective or address related risks, it is deficient, and such deficiencies may be associated with a control's design or operation.

- A deficiency in design exists when a control necessary to meet a control objective is missing, or an existing control is not properly designed so that even if the control operated as designed, the control objective would not be met.
- A deficiency in operation exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively.

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## Federal Managers' Financial Integrity Act and SEC Assurance Statement

In addition to the requirements under section 961 of the Dodd-Frank Act, SEC must establish and maintain effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA).<sup>10</sup> FMFIA requires agencies to annually assess and report on the internal controls that protect the integrity of their programs and whether financial management systems conform to related requirements. In addition, FMFIA requires agencies to provide an assurance statement regarding the effectiveness of the agency's internal controls.<sup>11</sup> SEC's internal controls for financial management systems are not included in this report because they are reported in our annual financial audit of SEC. In addition, all of SEC's internal controls—including those which constitute internal supervisory controls—are in scope for FMFIA.

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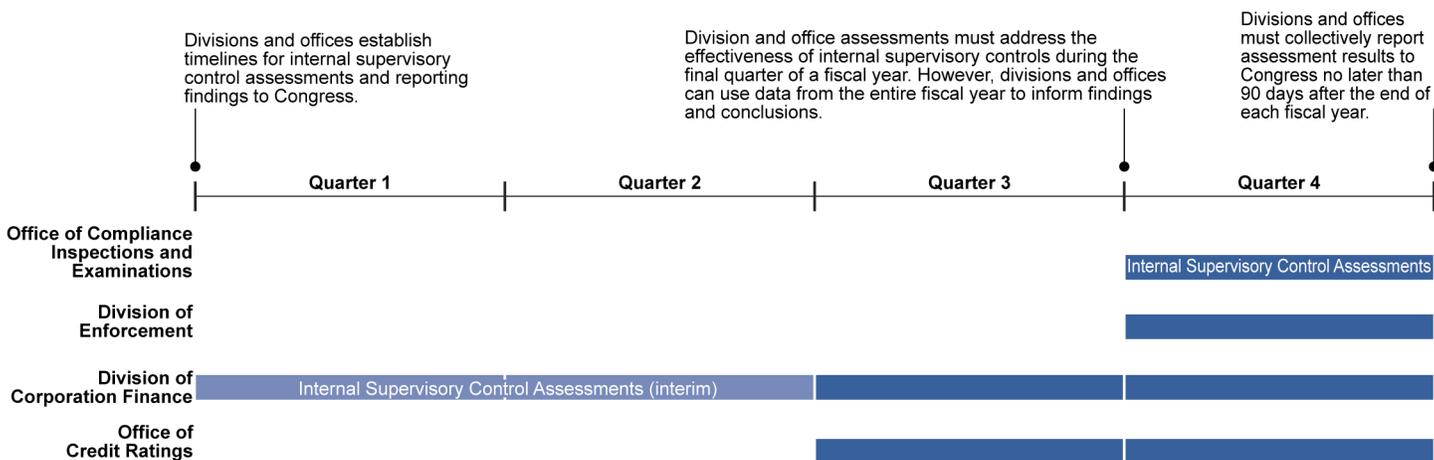
<sup>10</sup>See 31 U.S.C. § 3512.

<sup>11</sup>See 31 U.S.C. § 3512(d); and Office of Management and Budget, *Circular No A-123: Management's Responsibility for Internal Control*, M-16-17 (Washington, D.C.: July 15, 2016).

# SEC's Framework for Assessing the Effectiveness of Internal Supervisory Controls Reflected Internal Control Standards

In response to section 961 of the Dodd-Frank Act, the Working Group put in place a framework that provides guidance for division and office staff responsible for assessing the effectiveness of internal supervisory controls (control framework). The control framework draws on external sources such as federal internal control standards as well as internal documents such as SEC's Reference Guide for Compliance with Section 961 of the Dodd-Frank Act, the Risk Management and Internal Control Review Reference Guide from the Office of the Chief Operating Officer, and the charter for the Working Group.<sup>12</sup> These internal documents include definitions, criteria, and other guidance and together compose SEC's control framework. For example, the control framework includes time frames for when divisions and offices should assess their internal supervisory controls and report findings to Congress (see fig. 1).

**Figure 1: Internal Supervisory Control Assessment Timeline, by Securities and Exchange Commission Division or Office**



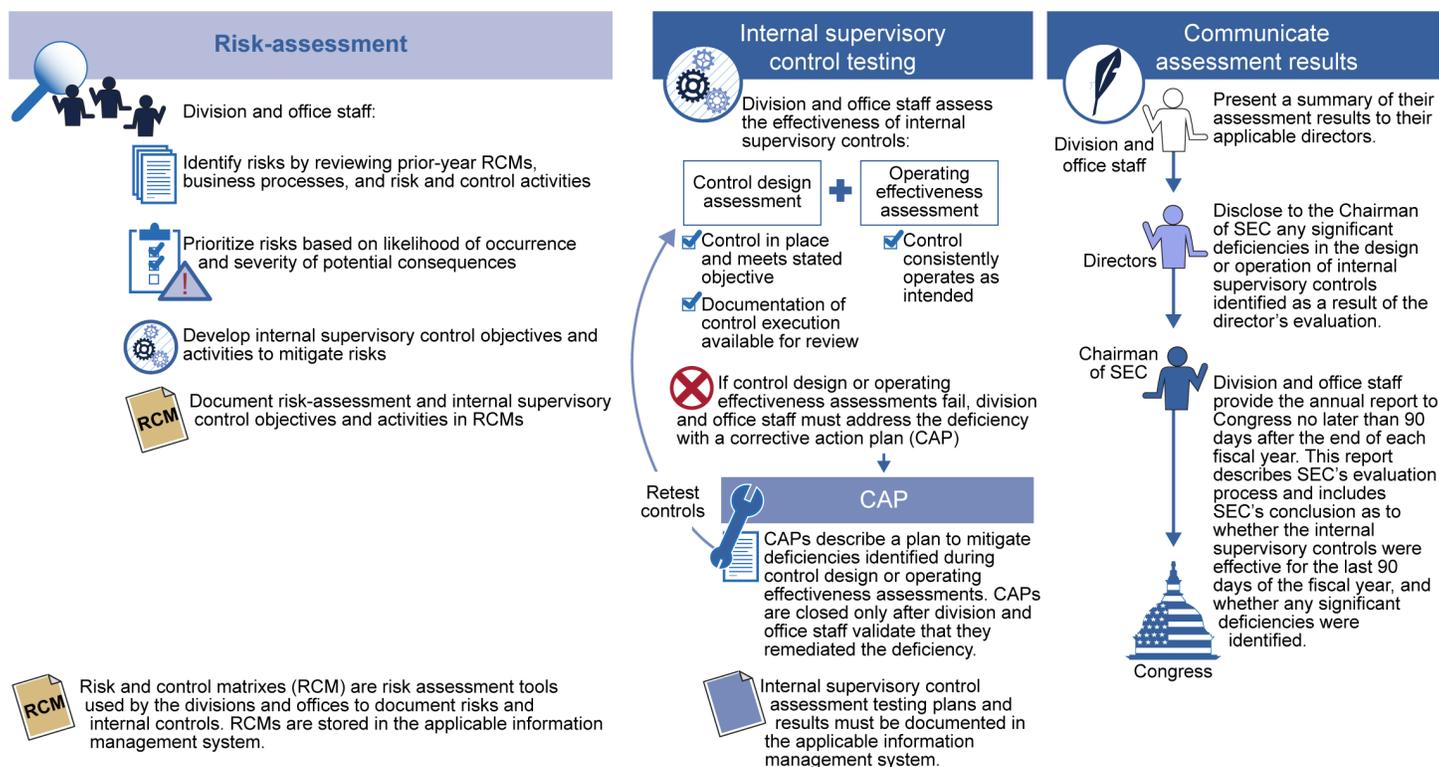
Source: GAO analysis of Securities and Exchange Commission (SEC) documents and interviews with staff. | GAO-20-115

Note: Officials stated that SEC staff test all controls, including internal supervisory controls, throughout the fiscal year for the annual assessments and reporting required by the Federal Managers' Financial Integrity Act of 1982.

<sup>12</sup>The Office of the Chief Operating Officer develops and executes SEC management policies and works closely with the Chairman's Office to promote operational effectiveness, management controls, and financial integrity, among other activities. The Risk Management and Internal Control Review Reference Guide provides guidance to staff for identifying, documenting, and monitoring nonfinancial risks and controls, including internal supervisory controls.

SEC's control framework consists of three phases—risk assessment, internal supervisory control testing, and communication of results—during which division and office staff conduct activities to systematically assess and report on the effectiveness of their internal supervisory controls (see fig. 2 for examples).

**Figure 2: Overview of Securities and Exchange Commission's Internal Supervisory Control Assessment**



Source: GAO analysis of Securities and Exchange Commission (SEC) documents and interviews with staff. | GAO-20-115

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## Changes to SEC's Control Framework Included Refining Guidance and Classification of Internal Supervisory Controls

Changes to SEC's control framework since our last review (which focused on fiscal years 2013–2015) include revisions to key guidance documentation and reclassification of some controls (as nonsupervisory controls). The Working Group revised elements of its control framework documentation since our last review. First, the Working Group streamlined the Reference Guide for Compliance with Section 961 by removing direct guidance—for example, steps staff should take to assess the design and operation of internal supervisory controls—and replaced it with references to the Risk Management and Internal Control Review Reference Guide. Second, the Working Group also updated other information such as the agency's definition for internal supervisory control.<sup>13</sup> Third, some divisions and offices changed which controls they considered to be internal supervisory controls subject to section 961 assessments.<sup>14</sup> As stated previously, SEC defines internal supervisory controls as the processes established by management to monitor that procedures applicable to staff (the established day-to-day procedures to be followed by the employees within the applicable program) are consistently being performed according to policy and procedures, and also remain reasonable, adequate, and current. Division and Office officials elaborated further, stating they only consider controls that are supervisory in nature and directly related to the consistent and complete execution of examinations of registered entities, enforcement investigation, or reviews of corporate financial securities filings to be internal supervisory controls relevant to section 961.

More specifically, OCIE reduced the number of controls it classified as internal supervisory controls from 40 in fiscal year 2015 to 14 in fiscal year 2018 by reclassifying some controls as nonsupervisory controls and

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<sup>13</sup>Before fiscal year 2017, SEC defined internal supervisory controls as the processes established by management for monitoring that "procedures applicable to staff" are performed consistently with competence and integrity, and also remain reasonable, adequate, and current. ("Procedures applicable to staff" refers to the established day-to-day procedures to be followed by employees charged with these functions.)

<sup>14</sup>We did not assess SEC's process for determining if a control is subject to section 961 of the Dodd-Frank Act. However, as stated previously, all internal controls related to operations, reporting, and compliance—including those which constitute internal supervisory controls under section 961—also are subject to the annual assurance statement provided under FMFIA.

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by consolidating others (see table 2).<sup>15</sup> For example, OCIE no longer classifies examination program strategy and selection controls (such as development and dissemination of examination program goals) as internal supervisory controls.<sup>16</sup> Therefore, the controls are no longer assessed under section 961. OCIE officials explained that the strategy and selection of controls are performed by management and related to the selection of registrants for examinations, and not to staff conducting examinations consistently with professional competence and integrity.

Similarly, the number of internal supervisory controls Corporation Finance maintained decreased from 25 in fiscal year 2015 to eight in fiscal year 2018. Corporation Finance officials told us that they determined that certain controls previously considered relevant to section 961 did not represent processes that fall within the core function of reviewing corporate financial securities filings and thus should not be considered internal supervisory controls under section 961.<sup>17</sup> Enforcement maintained 25 internal supervisory controls from fiscal year 2015 to fiscal year 2018, while OCR had 13–14 internal supervisory controls during the same period.

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<sup>15</sup>SEC officials stated that the consolidated control activities are all still active and are assessed each year as part of the agency's FMFIA reporting requirements, whether SEC identified them as internal supervisory controls or not.

<sup>16</sup>The program goals influence OCIE's examination selection and priorities. We noted that OCR—which also performs examinations—determined that controls related to examination program strategy and examination selection were internal supervisory controls.

<sup>17</sup>For example, Corporation Finance officials told us that in fiscal year 2017, they decided that activities related to the public release of staff comment letters and registrant correspondence did not constitute an internal supervisory control directly relevant to section 961. Corporation Finance officials stated that the publication of comment letters and responses supports Corporation Finance's commitment to transparency. However, they determined that the public release of this information was performed subsequent to the completion of, and therefore was not integral to, reviews of corporate financial securities filings.

**Table 2: Number of Internal Supervisory Controls Identified by SEC Divisions and Offices, Fiscal Years (FY) 2015–2018**

	FY 2015	FY 2016	FY 2017	FY 2018
Division of Corporation Finance	25	24	9	9
Division of Enforcement	25	25	25	25
Office of Compliance Inspections and Examinations	40	17	14 <sup>a</sup>	14
Office of Credit Ratings	13	14	14	14

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-20-115

<sup>a</sup>According to SEC officials, in fiscal year 2017 the Office of Compliance Inspections and Examinations consolidated four control activities into one control. SEC officials said that the four control activities remain active, despite being listed as one control.

## SEC’s Control Framework Reflected Internal Control Standards

As of the end of fiscal year 2018, SEC’s control framework continued to reflect key components of internal control. We compared the framework against federal internal control standards. Specifically, we assessed whether the control framework reflected the five components of internal control—control environment, risk assessment, control activities, information and communication, and monitoring.

We determined that SEC’s control framework included attributes covering each of the components. For example, the framework included oversight structures to monitor the design and operation of division and office internal supervisory controls, assigned responsibilities to division and office staff, incorporated steps for staff to follow to assess risks and test internal supervisory controls, and included mechanisms to correct deficiencies and report findings to internal and external stakeholders (such as Congress). See table 3 for additional examples that illustrate how the control framework reflected relevant standards.

**Table 3: Examples of Internal Control Components in SEC’s Internal Supervisory Control Framework**

Key components of internal control <sup>a</sup>	Examples in SEC’s internal supervisory control framework
Control environment	<ul style="list-style-type: none"> <li>• Assigns responsibility to relevant division and office staff and includes internal supervisory control testing criteria, time frames, reporting deadlines, and documentation requirements.</li> <li>• The Securities and Exchange Commission’s (SEC) Section 961 Working Group develops and maintains guidance, such as the internal supervisory control framework, and helps ensure coordination among the four divisions and offices subject to section 961 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.</li> </ul>
Risk assessment	<ul style="list-style-type: none"> <li>• Includes annual risk assessments and steps for assessing risk, such as reviewing changes to information systems and inclusion of subject-matter experts.</li> </ul>
Control activities	<ul style="list-style-type: none"> <li>• Includes timelines for when internal supervisory controls must be assessed to meet objectives and how staff should assess their internal supervisory controls, as well as internal supervisory control design and operation documentation requirements.</li> <li>• Includes guidance for division and office control activities. Instructs that evaluators be independent from the risk and control owner (the person responsible for executing a control or controls to mitigate risks) whenever practical and that control activities be dispersed at different levels within the divisions and offices.</li> </ul>
Information and communication	<ul style="list-style-type: none"> <li>• Directs staff to disclose all findings to their applicable directors (internal communication) and significant deficiencies to Congress in the annual Section 961 Report (external communication).</li> </ul>
Monitoring	<ul style="list-style-type: none"> <li>• Includes guidance for monitoring internal supervisory controls on an annual basis by assessing their design and operation.</li> <li>• Includes deficiency definitions, acceptable error rates, guidance for designing and implementing corrective actions, and mechanisms to report findings.</li> <li>• Includes documentation requirements that help ensure that internal supervisory controls can be assessed. These documentation requirements also state that documentation must be made available for internal and external use.</li> </ul>

Source: GAO analysis of SEC documentation. | GAO-20-115

<sup>a</sup>See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

## SEC Lacks Policies and Procedures to Systematically Assess the Effectiveness of Staff Procedures

Divisions and offices have not developed written policies and procedures to ensure that they systematically assess the effectiveness of procedures applicable to staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings. As mentioned previously, the report required under section 961 of the Dodd-Frank Act must include an assessment of the effectiveness of both internal supervisory controls and staff procedures.

Division and office officials told us that they used findings and conclusions from their internal supervisory control assessments to support their conclusions that staff procedures were effective.<sup>18</sup> As discussed earlier,

<sup>18</sup>SEC defines staff procedures as the day-to-day procedures to be followed by the employees within the applicable programs.

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SEC defines internal supervisory controls to include two types of processes used by managers: (1) those used to monitor whether staff follow existing procedures and (2) those used to monitor whether the procedures remain reasonable, adequate, and current.

We found that SEC's assessments of internal supervisory controls did not directly assess the effectiveness of staff procedures for three primary reasons. First, the controls included in SEC's assessment generally consist of processes that monitor whether staff follow existing procedures, not processes that monitor whether the procedures remain reasonable, adequate, and current. Second, SEC's assessments of internal supervisory control focus on evaluating the extent to which managers executed the controls for which they are responsible. Although the controls monitor whether staff follow underlying procedures, the control assessments do not directly address whether those underlying staff procedures are designed to effectively achieve their stated objectives (for example, identifying and mitigating securities misconduct by securities market participants). Lastly, documentation of division and office internal supervisory control assessments did not speak to how division and office staff reached conclusions that procedures applicable to staff were effective.

In addition to findings from internal supervisory control assessments, SEC officials also told us about policies and procedures, compliance testing, and other activities that provide information regarding the effectiveness of staff procedures. Corporation Finance officials further elaborated by stating that there is no single or discrete assessment to test the effectiveness of staff procedures. Rather, the officials explained that the division relies on activities performed throughout the year that contribute to the evaluation of the effectiveness of staff procedures. Examples of activities all or some divisions and offices referenced included the following:

- Enforcement, Corporation Finance, OCIE, and OCR officials told us that senior management from each division or office monitor the effectiveness of their programs throughout the year to help assess the effectiveness of staff procedures. Examples of monitoring activities include discussions with staff and subject-matter experts who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings. OCR and Corporation Finance provided examples of documentation for these activities.

- Enforcement, Corporation Finance, OCIE, and OCR provided documentation that showed they developed review teams, task forces, projects, or initiatives that review specific policies or risks, which can result in updates to procedures.
- Corporation Finance, OCIE, and OCR officials told us that they have implemented reviews and redesigns of their policies and procedures through periodic reviews of their respective program manuals.

See table 4 below for additional examples of activities that divisions and offices referenced as assessments of the effectiveness of staff procedures.

**Table 4: Examples SEC Divisions and Offices Provided of Activities That Assessed Effectiveness of Staff Procedures, Fiscal Year 2018**

Division or office	Activity and timing <sup>a</sup>
Division of Corporation Finance (Corporation Finance)	<ul style="list-style-type: none"> <li>• As necessary, Corporation Finance creates teams to assess existing or emerging risks to help identify issues that could have a material impact on corporate disclosures.</li> <li>• As necessary, Corporation Finance conducts research on financial disclosures and considers policy and procedure updates.</li> <li>• As necessary, Corporation Finance interacts with companies and other stakeholders (such as investor advocacy groups, industry groups, or professional groups) to obtain feedback on topics, including the effectiveness of the division's programs and activities.</li> <li>• Considers results from GAO's triennial review of SEC's implementation of section 961 of the Dodd-Frank Wall Street Reform and Consumer Protection Act that can provide feedback on the effectiveness of procedures.</li> </ul>
Division of Enforcement (Enforcement)	<ul style="list-style-type: none"> <li>• On an ongoing basis, Enforcement monitors changes in the market and applicable laws to identify any necessary updates to policies and procedures.</li> <li>• On an ongoing basis, Enforcement's management and staff monitor the division's governance structure (for how it executes investigations).</li> </ul>
Office of Compliance Inspections and Examinations (OCIE)	<ul style="list-style-type: none"> <li>• OCIE conducts multiyear reviews of its Examination Program Manual and makes updates as needed.</li> <li>• As necessary, OCIE vets proposed changes to policies and procedures through its governance process, which includes review by the Examination Process Advisory Committee.</li> <li>• As necessary, OCIE's Office of Chief Counsel Compliance Group conducts targeted reviews to assess the extent to which OCIE staff complied with existing policies and procedures.</li> <li>• OCIE Office of Chief Counsel Compliance Group periodically holds meetings with OCIE staff to obtain feedback on procedure effectiveness, among other subjects.</li> </ul>
Office of Credit Ratings (OCR)	<ul style="list-style-type: none"> <li>• On an ongoing basis, OCR management monitors the extent to which employees perform their duties, including implementing existing procedures. Performance evaluations are performed at least annually through OCR's performance work plan process.</li> <li>• On an ongoing basis, OCR's management monitors the performance of its examination program.</li> <li>• As necessary, OCR management solicits feedback from staff to help enhance policies and procedures.</li> <li>• OCR implemented an initiative to update the OCR Program Manual, which includes procedures for nationally recognized statistical rating organization (NRSRO) examinations.</li> </ul>

Division or office	Activity and timing <sup>a</sup>
	<ul style="list-style-type: none"> <li>As necessary, OCR conducts informal benchmarking with other SEC divisions and offices to validate underlying procedures applicable to staff who perform NRSRO examinations.</li> </ul>

Source: GAO analysis of Securities and Exchange Commission (SEC) activities. | GAO-20-115

<sup>a</sup>We did not independently verify the extent to which these activities address the effectiveness of staff procedures.

The activities mentioned above could provide valuable information for staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings, but they do not represent systematic assessments for the purposes of section 961. In particular, these activities varied between divisions and offices, mostly were implemented on an irregular basis, and were not established through written policies or procedures. In addition, none of the divisions and offices provided documentation linking the results of these, or any other, activities to the conclusions in SEC’s annual reports to Congress under section 961, each of which have stated that SEC’s staff procedures were effective for the period under review. Furthermore, only Corporation Finance officials told us that they discuss the effectiveness of staff procedures with their Director when they present their annual internal supervisory control assessment findings.

As stated previously, the control framework includes an oversight structure, timelines, evaluation criteria, and documentation requirements, and SEC considers its control assessments under the framework to represent assessments of the effectiveness of staff procedures. However, SEC has not developed detailed policies, procedures, or guidance for assessing the effectiveness of staff procedures for the purposes of section 961. For example, the activities that divisions and offices referenced as assessing the effectiveness of staff procedures were not established through written policies for section 961-reporting purposes. And, existing guidance documents such as the Reference Guide for Compliance with Section 961 do not include steps or documentation requirements for assessing staff procedures.

Federal internal control standards state the importance for agency management to establish policies and procedures to achieve objectives. Because divisions and offices lack written policies and procedures for assessing the effectiveness of staff procedures, each uses informal methods and varied processes instead of a systematic approach that document how each division and office reached its conclusions (that staff procedures were effective) in SEC’s annual section 961 report to

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Congress. Establishing written policies and procedures for systematically assessing the effectiveness of staff procedures would provide SEC with greater assurance that the procedures were effective in the context of section 961 and would help divisions and offices meet objectives.

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## Selected Controls Were Designed Consistent with Standards, but Some Lacked Directions for Implementing Control Activities

To evaluate the extent to which SEC's internal supervisory controls met federal internal control standards and SEC guidance, we evaluated a non-generalizable sample of internal supervisory controls. We assessed whether (1) controls were designed to address objectives and respond to risks and (2) control activities were implemented through policies. We discuss below our findings related to the 39 internal supervisory controls that SEC identified as related to section 961. See appendix II for an example of the template we used to evaluate the controls.

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## All of the Selected Controls Addressed Identified Objectives and Risks

All 39 internal supervisory controls that we evaluated incorporated design elements to achieve SEC's control objectives and respond to risks that SEC identified. We assessed the overall design of selected internal supervisory controls against four design elements identified in federal internal control standards:<sup>19</sup>

- Control activities should respond to identified objectives and risks,
- Appropriate types of control activities should be used,<sup>20</sup>
- Control activities should be designed at the appropriate levels of the organization (Director, Assistant Director, Branch Chief, etc.), and
- Control activity duties should be segregated where practical.

We found that, for the selected controls, each division and office designed control activities to respond to identified objectives and risks by identifying the risks addressed by each control and the control objective (how a control will address the associated risk) in their risk and control

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<sup>19</sup>See [GAO-14-704G](#).

<sup>20</sup>Control activity types include top-level reviews of staff performance or management of human capital, and should identify certain characteristics, such as whether a control is preventive or detective, or has an automated or manual implementation.

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matrixes.<sup>21</sup> In their risk and control matrixes, the divisions and offices also have established characteristics identified by relevant standards as important for designing appropriate controls, including the control frequency, control owner, and whether a control is automated or manual, preventive or detective, and key or secondary. To ensure that control activities are designed at the appropriate levels, each division and office identified control owners in their risk and control matrixes and in the control descriptions they identified the job title of staff responsible for executing the controls. Finally, the divisions and offices segregated control duties in cases in which the need for such segregation was apparent. For example, a second review by a higher-level official was included in some controls that required approval decisions. For the results of our control design assessments, see appendix III.

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### Some Control Activity Descriptions Lacked Sufficient Information for Implementation and Monitoring

Ten of the 39 controls we evaluated lacked key information needed to help ensure execution of the control activities (see table 5). Federal internal control standards state that documentation is required for the effective design, implementation, and operating effectiveness of an entity's internal control system, including documentation of internal control responsibilities through policies. We assessed SEC's documented control activities against three key attributes identified in federal internal control standards:

- Establishment of procedures to support control execution,
- Assignment of responsibility for control execution, and
- Establishment of time frames for control execution.<sup>22</sup>

Two or three of the selected controls from each division and office did not incorporate key execution attributes, as seen in table 5. For the results of our control design assessments, see appendix III.

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<sup>21</sup>Risk and control matrixes are risk-assessment tools used by the divisions and offices to document internal controls.

<sup>22</sup>See [GAO-14-704G](#).

**Table 5: Evaluation of Control Activity Attributes for Selected SEC Controls, Fiscal Year 2018**

	Total	OCIE	Corporation Finance	Enforcement	OCR
Number of controls that incorporated all attributes	29	6	6	7	10
Number of controls that lacked at least one attribute	10	2	2	3	3
<b>Total number of controls reviewed</b>	<b>39</b>	<b>8</b>	<b>8</b>	<b>10</b>	<b>13</b>

Legend: Corporation Finance = Division of Corporation Finance; Enforcement = Division of Enforcement; OCIE = Office of Compliance Inspections and Examinations; OCR = Office of Credit Ratings; and SEC = Securities and Exchange Commission.

Source: GAO analysis of SEC documents. | GAO-20-115

Descriptions for many control activities did not specify procedures to be performed or, in some cases include time frames, but all controls we assessed assigned responsibility for control execution (see table 6). More specifically, 10 of the 39 controls had no requirement to document execution of the control activities. For example, one Enforcement control and two Corporation Finance controls intended to monitor compliance with timeliness metrics did not include a requirement to document whether the control activities had been executed—that managers completed the review of the timeliness reports, noted if any cases were nearing the time frame threshold, or took appropriate actions in response.

In addition, three of the 39 controls we reviewed did not include the control activity attribute of follow-up actions to be taken. For example, the Corporation Finance timeliness controls discussed above also did not establish follow-up actions for cases in which a team or individual neared the timeliness threshold. Follow-up actions could include emailing or calling relevant staff when a timeliness threshold was within a certain number of days of being breached. The divisions and offices did not establish operational procedures for how the control activities would be performed in three of the 39 controls we reviewed. For example, an OCIE control intended to track enrollment and completion of new examiner training lacked underlying procedures for identifying or tracking training progress of new employees.<sup>23</sup>

<sup>23</sup>In its fiscal year 2018 internal supervisory control testing, OCIE identified these same control design issues.

**Table 6: Control Activity Design Deficiencies for Selected SEC Controls, Fiscal Year 2018**

	Total <sup>a</sup>	OCIE <sup>a</sup>	Corporation Finance <sup>a</sup>	Enforcement <sup>a</sup>	OCR <sup>a</sup>
Lack of fully established procedures <sup>b</sup>	9	2	2	2	3
No documentation requirement	10	2	2	3	3
No identified follow-up actions	3	0	2	1	0
Lack of operational procedures	3	1	1	1	0
Lack of assigned responsibility for control	0	0	0	0	0
Lack of time frames for executing control	3	1	1	0	1

Legend: Corporation Finance = Division of Corporation Finance; Enforcement = Division of Enforcement; OCIE = Office of Compliance Inspections and Examinations; OCR = Office of Credit Ratings; and SEC = Securities and Exchange Commission.

Source: GAO analysis of SEC documents. | GAO-20-115

<sup>a</sup>The number of deficiencies may exceed the number of controls because some controls may have multiple deficiencies.

<sup>b</sup>The total number of controls that lack established procedures may not equal the sum of the controls that lack specific procedural attributes, because some controls had deficiencies in more than one attribute.

The divisions and offices did not establish time frames for executing control activities in three of the 39 controls we reviewed. For example, while the Corporation Finance timeliness controls discussed above identified the reports to be reviewed, one of the two controls did not specify when the reports should be reviewed.

By not incorporating key control attributes into their control activities, SEC may not have reasonable assurance that internal supervisory controls are effectively implemented. Some of the controls with weaknesses in one or more of the control attributes lacked documentation of the controls' execution, which hindered our ability to test whether the controls operated as intended, as discussed in the next section. For example, two of the timeliness controls for Corporation Finance, described above, did not include a documentation requirement, and no documentation of control execution was created. In lieu of reviewing documentation of control execution, for SEC's assessment of the effectiveness of its internal supervisory controls, the divisions and offices asked supervisors twice a year (by email) whether they had executed this control weekly over the course of the year. Staff from some divisions and offices said the reason that control activity attributes were not included in some of the controls was because policies and procedures had been long established and orally communicated, but not written into the control activities.

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Based on *Standards for Internal Control in the Federal Government*, SEC developed a reference guide to provide guidance for identifying, documenting, and monitoring controls.<sup>24</sup> The reference guide states that internal control activities should be written to describe the actual activities performed to meet the control objective, and at a minimum, identify control procedures and how they are to be executed, establish a documentation requirement for control execution, and assign responsibility and establish time frames for control execution.

Following SEC guidance for developing control activities could help divisions and offices ensure evidence exists of control execution and better enable control monitoring by SEC, and oversight by external parties, such as GAO and the SEC Inspector General. In turn, better control monitoring would help ensure that SEC's internal supervisory controls are effectively implemented and that procedures necessary to achieve organizational objectives are followed. Furthermore, enhancing control activity descriptions would provide SEC greater assurance that staff have the information necessary to effectively implement the controls.

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<sup>24</sup>As previously discussed, the Risk Management and Internal Control Review Reference Guide (from the Office of the Chief Operating Officer) provides guidance to staff for identifying, documenting, and monitoring nonfinancial risks and controls, including internal supervisory controls.

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## Assessed Controls Operated or Partially Operated as Intended, but Some Controls Could Not Be Assessed Because of Documentation Weaknesses

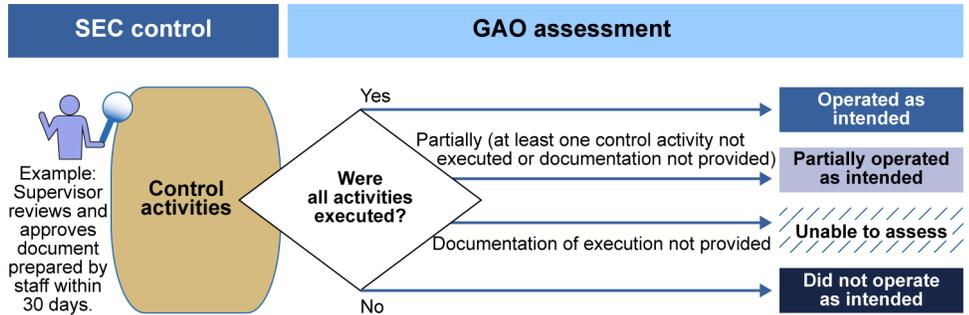
We selected 18 of 39 internal supervisory controls across the four divisions and offices to assess whether they operated as intended in fiscal year 2018.<sup>25</sup> (See figure 3 for an overview of how we determined they operated as intended, partially operated as intended, or did not operate as intended.) As an example of how we conducted these assessments, we reviewed one OCIE control that called for manager approval at three points of an examination and additional assistant director approval to close the examination, as described in OCIE’s control documentation. To assess whether this control operated as intended, we selected and reviewed a random, generalizable sample of examinations in OCIE’s internal system to determine whether all of the control’s activities—in this case, management approvals—had been executed.

We could not assess some of the controls we selected because SEC did not provide sufficient documentation to allow us to determine whether the control operated as intended. For example, two of four Corporation Finance controls did not include a documentation requirement for weekly monitoring of staff compliance with internal policy. As a result, documentation did not exist for us to assess whether supervisors executed these control activities throughout the year. For more information on how we determined whether controls were operating as intended, see appendix I.

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<sup>25</sup>We assessed the controls using the control activities defined in SEC’s control documentation and the related policy and design documents provided for our control design assessments, such as activities documented through divisions’ and offices’ risk and control matrixes and procedures manuals. For our testing, we identified whether controls (1) operated as intended, (2) partially operated as intended, (3) did not operate as intended, or (4) could not be assessed because sufficient control documentation did not exist or was not relevant.

**Figure 3: Illustrative Example of GAO Assessment of the Operation of a Securities and Exchange Commission (SEC) Internal Supervisory Control**



Source: GAO. | GAO-20-115

**All of the Controls That Could Be Assessed Operated or Partially Operated as Intended**

Of the 15 controls we could assess, 13 operated as intended and two partially operated as intended (see table 7).<sup>26</sup> We could not assess three controls because sufficient documentation was not provided. More specifically, a control documentation requirement was not established for the three controls—as identified through our assessment of the control’s design, described earlier.

<sup>26</sup>Because the nature of controls varied, we tested a generalizable sample of instances of execution for controls with large execution populations, and reviewed all instances for others that had an annual or low occurrence. See appendix I for more information.

**Table 7: Summary of GAO Testing of Selected SEC Internal Supervisory Controls, Fiscal Year 2018**

Number of controls tested by division and office

	<b>Total</b>	<b>Office of Compliance Inspections and Examinations</b>	<b>Division of Corporation Finance</b>	<b>Division of Enforcement</b>	<b>Office of Credit Ratings</b>
Operated as intended	<b>13</b>	2	2	4	5
Partially operated as intended	<b>2</b>	2	0	0	0
Did not operate as intended	<b>0</b>	0	0	0	0
GAO could not assess	<b>3</b>	1 <sup>a</sup>	2	0	0
<b>Total controls selected<sup>b</sup></b>	<b>18</b>	<b>5</b>	<b>4</b>	<b>4</b>	<b>5</b>

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-20-115

Notes: For controls that operated as intended, SEC provided documentation demonstrating that all control activities were executed. We considered controls to have partially operated as intended if the documentation supported execution of only some control activities or if at least one control activity did not operate as intended, but the overall control was executed. For controls that we could assess, we did not identify any that did not operate as intended (that is, had documentation indicating the divisions and offices did not execute all control activities). Controls that we could not assess lacked documentation allowing us to determine whether the controls operated as intended.

<sup>a</sup>This control relates to the tracking of new examiner training. The Office of Compliance Inspections and Examinations failed this control's design and operation during its section 961 assessment process for fiscal year 2018. The Office's officials told us that they subsequently developed procedures for obtaining information on new employees and ensuring completion of their training.

<sup>b</sup>We judgmentally selected 18 of 40 internal supervisory controls across the four divisions and offices to assess whether they operated as intended in fiscal year 2018.

We determined that two OCIE controls partially operated as intended. For example, while we found that 20 percent of sampled OCIE examinations were not approved within the designated deadline, all examinations were closed and included all required elements (see table 8).

**Table 8: SEC Internal Supervisory Controls That GAO Testing Determined Partially Operated as Intended, Fiscal Year 2018**

SEC division or office	SEC control descriptions	GAO testing results
Office of Compliance Inspections and Examinations (OCIE)	1. Prior to giving final approval of an examination, the assigned supervisor is responsible for ensuring that findings and risks are documented and supporting documents are included in the examination tracking system. Assistant Director review is documented by approval of the examination in the tracking system.	OCIE provided documentation demonstrating that all examinations were closed and approved by an Assistant Director. However, we found that 20 percent of examinations in our sample were not approved within the 30-day deadline as indicated in the related policy documents for this control. <sup>a</sup>
	2. Policy proposals/changes are approved through OCIE's governance process. The Office of Chief Counsel for Compliance guides policy proposals through the process and the Director approves all changes or new policies and procedures.	OCIE provided documentation on the tracking of policy changes and announcements of final policy updates to staff, but it did not provide documentation demonstrating that officials reviewed and approved all policy changes.

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-20-115

<sup>a</sup>We reviewed a generalizable sample of cases for this control. This estimate has a 95 percent confidence interval that extends from 11 to 32 percent.

### Some Selected Controls Could Not Be Assessed Because Documentation of Control Execution Did Not Exist

We were unable to assess three of 18 selected controls because the divisions and offices did not provide sufficient documentation on the execution of control activities (see table 9). We found these controls lacked a documentation requirement for control execution in their control activity descriptions and did not produce sufficient documentation, which prevented us from determining whether these controls operated as intended. For example, two of four Corporation Finance controls did not include a requirement to document execution of the control activity—weekly monitoring of staff compliance with internal policy. Because these controls did not produce documentation of weekly monitoring throughout the year as prescribed in the control activity frequency, we did not receive documentation to allow us to assess whether supervisors executed these control activities on a weekly basis or, in some cases, at all. Additionally, we could not assess one selected OCIE control involving tracking of new employee training.

**Table 9: SEC Internal Supervisory Controls That GAO Was Unable to Test**

SEC division or office	SEC control descriptions	GAO findings
Office of Compliance Inspections and Examinations (OCIE)	1. Training staff track enrollment and completion of new examiner training, and follow up with examiners as necessary by email.	OCIE did not provide documentation on the tracking of training for new examiners or that follow-up occurred when training was not completed. <sup>a</sup>
Division of Corporation Finance (Corporation Finance)	2. Assistant Directors monitor compliance with the internal policy of issuing comments within 30 days of the filing of registration statements.	Corporation Finance did not provide documentation demonstrating that staff actively monitored compliance with internal policy. Corporation Finance provided emails from staff performing control testing to supervisors asking them to confirm that they monitored these activities throughout the year. However, we did not receive documentation indicating that supervisors monitored or tracked staff compliance with internal policy.
	3. Assistant Directors and Office Chiefs monitor compliance with the internal policy of processing confidential treatment requests within the timing guidelines in the confidential treatment requests processing guide.	

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-20-115

<sup>a</sup>OCIE failed this control's design and operation during its section 961 assessment process for fiscal year 2018. OCIE officials told us they subsequently developed procedures for obtaining information on new employees and ensuring their training is completed.

## Conclusions

To help detect and prevent securities misconduct, section 961 of the Dodd-Frank Act requires SEC to assess the effectiveness of both its internal supervisory controls and the procedures applicable to staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings. While SEC has established a framework for systematically assessing the effectiveness of its internal supervisory controls, it has not established a framework for systematically assessing the effectiveness of staff procedures or documenting how SEC reached related conclusions about the procedures in its annual reports to Congress under section 961. Creating written policies and procedures to systematically assess the effectiveness of staff procedures and documenting the results of such assessments would provide SEC with greater assurance that the staff procedures are effective, a key objective of section 961.

Every control we reviewed incorporated design elements to achieve SEC's control objectives and respond to risks that it identified. However, nine of the 39 controls did not incorporate one or more key attributes that would help ensure execution of the control, including documentation requirements, detailed procedures, identification of follow-up actions, assignment of responsibility for control execution, and time frames for control execution. Following SEC guidance for developing detailed control

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activities could help divisions and offices ensure evidence of control execution and better enable control monitoring by SEC and external parties, such as GAO and the SEC Inspector General. In turn, better control monitoring would help ensure that SEC's internal supervisory controls are effective and that procedures necessary to achieve organizational objectives are followed. Furthermore, enhancing control activity descriptions would provide SEC greater assurance that staff have the information necessary to effectively implement the controls.

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## Recommendations for Executive Action

We are making the following five recommendations to SEC.

The SEC Chair should direct the Directors of the Division of Corporation Finance, Division of Enforcement, Office of Compliance Inspections and Examinations, and Office of Credit Ratings to develop written policies and processes to systematically assess the effectiveness of staff procedures (procedures applicable to staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings). Examples of elements SEC could include in the policies and processes are the steps necessary to conduct such assessments, including time frames in which the assessments should be performed and reviewed; assignment of responsibilities related to the assessments; requirements for documenting assessments; and steps for staff to take to mitigate and report deficiencies identified as a result of the assessments. (Recommendation 1)

The Director of the Division of Corporation Finance should ensure that all internal supervisory controls include documentation requirements, detailed procedures, identified follow-up actions, implementation time frames, and assignment of control execution responsibility, in accordance with SEC guidance and federal internal control standards for implementing control activities through documented policies. (Recommendation 2)

The Director of the Division of Enforcement should ensure that all internal supervisory controls include documentation requirements, detailed procedures, identified follow-up actions, implementation time frames, and assignment of control execution responsibility, in accordance with SEC guidance and federal internal control standards for implementing control activities through documented policies. (Recommendation 3)

The Director of the Office of Compliance Inspections and Examinations should ensure that all internal supervisory controls include documentation

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requirements, detailed procedures, identified follow-up actions, implementation time frames, and assignment of control execution responsibility, in accordance with SEC guidance and federal internal control standards for implementing control activities through documented policies. (Recommendation 4)

The Director of the Office of Credit Ratings should ensure that all internal supervisory controls include documentation requirements, detailed procedures, identified follow-up actions, implementation time frames, and assignment of control execution responsibility, in accordance with SEC guidance and federal internal control standards for implementing control activities through documented policies. (Recommendation 5)

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## Agency Comments

We provided a draft of this report to SEC for review and comment. In written comments (reproduced in appendix VI), SEC agreed with our findings and concurred with our recommendations. In addition, SEC provided technical comments, which we incorporated as appropriate.

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We are sending copies of this report to the appropriate congressional committees, the Chair of SEC, and other interested parties. In addition, this report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff members have any questions about this report, please contact me at (202) 512-8678 or [clementsm@gao.gov](mailto:clementsm@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix VII.



Michael Clements  
Director, Financial Markets  
and Community Investment

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# Appendix I: Objectives, Scope, and Methodology

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This report focuses on activities that fall within the purview of the Division of Corporation Finance (Corporation Finance), Division of Enforcement (Enforcement), Office of Compliance Inspections and Examinations (OCIE), and Office of Credit Ratings (OCR) at the Securities and Exchange Commission (SEC)—to which we refer collectively as the divisions and offices. We examined (1) the extent to which SEC’s internal supervisory control framework during fiscal years 2016–2018 reflected federal internal control standards; (2) how SEC evaluated the effectiveness of staff procedures in fiscal year 2018; (3) the extent to which selected controls in fiscal year 2018 were designed consistent with relevant standards; and (4) the extent to which selected controls operated as intended in fiscal year 2018.

For our first objective, we obtained and reviewed relevant documentation on SEC’s internal supervisory control framework for fiscal years 2016–2018 and interviewed division and office staff responsible for developing and updating the framework. We then assessed this framework against *Standards for Internal Control in the Federal Government* and determined the extent to which the framework reflected these standards.<sup>1</sup> Specifically, we assessed the framework against the five components of internal control—control environment, risk assessment, control activities, information and communication, and monitoring—and the 17 principles associated with these components. We compared information on changes SEC made to its internal supervisory control framework with information from our previous review and federal internal control standards to determine the extent to which the framework continued to reflect internal control standards.

For our second objective, we reviewed policies, procedures, and guidance documents (for fiscal year 2018) relating to SEC assessments of the effectiveness of procedures applicable to staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings. We also interviewed SEC staff to obtain an understanding of the steps and activities that divisions and offices take to assess the effectiveness of staff procedures. We intended to assess how SEC assessed staff procedures to determine the extent to which SEC’s assessments reflected federal internal control standards. However, as discussed in the report, we found SEC did not

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<sup>1</sup>*Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

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have a framework for assessing the effectiveness of staff procedures. We therefore examined policies, procedures, and guidance, but did not assess them against the components and principles associated with the federal standards for internal control.

For our third objective, we used the policies, procedures, and control objectives to determine if the design of selected division and office internal supervisory controls in place during fiscal year 2018 was consistent with federal internal control standards and SEC guidance for designing internal controls. We developed an evaluation template and used it to assess selected controls from each division and office by having multiple analysts conduct independent reviews and then reached a final consensus by conducting a joint review with the same analysts. We used *Standards for Internal Control in the Federal Government* and The Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control – Integrated Framework* to develop our template. We also reviewed documents and interviewed staff to obtain a thorough understanding of the internal supervisory controls used to oversee the processes for conducting examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings.

We selected for our review a non-generalizable sample of 53 controls in place during fiscal year 2018—13 controls in Corporation Finance, 15 controls in Enforcement, 11 in OCIE, and 14 in OCR. We grouped these controls into sets because some underlying staff processes had multiple associated controls. In cases in which we selected a control that was part of a set, we would review every control in the associated set. We selected controls and control sets that SEC designated as being associated with processes that have the highest risk or potential impact on achieving stated objectives until we reached our target of 10–15 controls per division or office. Some control sets also contained controls that were not related to section 961. Therefore, to fully assess complete control sets associated with underlying processes, our selection contained some controls that were not related to section 961. However, in this report we only discuss and include analysis for those controls that SEC identified as related to section 961, which comprises 39 controls—eight in Corporation Finance, 10 in Enforcement, eight in OCIE, and 13 in OCR.

For our fourth objective, we developed an evaluation template for each control and conducted independent primary and secondary reviews to reach a final consensus on the operation of each control. The template was created using SEC's control activities and related policy and

procedural documents we received as part of our design assessment. We used the template to determine the extent to which the execution of controls met the design criteria. Depending on the extent to which they met criteria established from control design documents, the selected controls were grouped under one of the following categories: (1) operated as intended, (2) partially operated as intended, (3) did not operate as intended, and (4) could not be assessed because control documentation did not exist due to design weaknesses, was not received, or was not relevant.

Because the nature of controls varied, we evaluated controls by applying the factors below in conjunction with professional judgment. We focused on whether deficiencies would affect the implementation and operation of controls.

- For controls that operated as intended, we determined that the divisions and offices provided documentation demonstrating that all control activities were executed for the instances of control implementation we reviewed.
- We considered controls to have partially operated as intended if the documentation provided supported that only some control activities were executed or if at least one control activity did not operate as intended, but the overall control was executed for most instances.
- We did not identify any controls that did not operate as intended. This determination would have applied to controls for which we received sufficient documentation to assess the control's operation and for which the divisions and offices did not execute all control activities in most instances.
- For controls that we could not assess, we did not receive sufficient documentation that would enable us to make a determination of whether the control was executed or operated as intended. For these controls, we also used the results of our design assessments to determine whether the controls included a documentation requirement that would enable us to assess whether they operated as intended.

We judgmentally selected a non-generalizable sample of 18 controls across all four divisions and offices from the population of 39 internal

supervisory controls we reviewed in the third objective.<sup>2</sup> We selected these controls based on factors such as whether they were classified as key to achieving objectives, high-risk, or having high potential impact on achieving stated objectives or likelihood of failure. We then created a generalizable, random sample of cases to review for eight controls, and we reviewed all instances for the remaining controls because they occurred annually or had few instances. In some cases, we conducted on-site testing in which we assessed samples of cases for controls by demonstrations of the divisions and offices' internal systems.

We conducted this performance audit from October 2018 to December 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>2</sup>We originally selected 19 controls, but removed one selected control involving updates to policies and procedures from the scope of our review based on discussions with OCR staff. This control did not apply during the scope of our review because OCR was undergoing a comprehensive overhaul of its manual, which would override the review represented in this control.

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# Appendix II: Template for GAO's Assessment of the Internal Supervisory Control Design of the Securities and Exchange Commission

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This appendix illustrates the template we used to assess the design of selected controls from each division and office that we reviewed at the Securities and Exchange Commission (SEC). For each control, we reviewed policies, procedures, and control objectives to determine if the design of the selected internal supervisory controls was consistent with federal internal control standards and SEC guidance for designing internal controls.

**Appendix II: Template for GAO's Assessment  
of the Internal Supervisory Control Design of  
the Securities and Exchange Commission**

**Figure 4: GAO Template for Assessing the Design of SEC Internal Supervisory Controls**

Control Number	
<b>Control Description</b>	
<b>Individual Control Evaluation (Principle 10)</b>	
<b>Risk Assessment Principles</b>	<b>Y/IN/Partial/NA</b>
<b>10. Selects and Develops Control Activities—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.</b>	
<b>10.1 Response to Objectives and Risks—Are the control activities designed to address and mitigate identified risks associated with the underlying processes?</b>	
<b>10.2 Design of Appropriate Types of Control Activities—Are appropriate types of control activities designed for the entity's internal control system? Did management evaluate the purpose of the control activity and the effect a deficiency would have on the entity in achieving its objectives? Controls can be preventative or detective and automated or manual. Did management design control activities at the appropriate levels in the organizational structure? Are control activities designed for appropriate coverage of objectives and risks in the operations?</b>	
<b>10.3 Design of Control Activities at Various Levels—Did management consider control activities at various levels in the entity?</b>	
<b>10.4 Segregation of Duties—Are control activity duties segregated where practical?</b>	
<b>Other particular points of focus, if any?</b>	
<b>Deficiencies Applicable to Principle 10</b>	
<b>Evaluate preliminary deficiency severity:</b>	
<b>Identification No.</b>	<b>Internal control deficiency description</b>
<b>Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)</b>	<b>Comments/ Compensating Controls</b>
<b>List internal control deficiencies related to another principle that may impact this internal control deficiency</b>	
<b>Evaluate deficiencies within the principle:</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.	<b>Explanation/Conclusion</b>
<b>Evaluate the principle using judgment.</b> <i>If it is determined that there is a major deficiency, then the component is not present and functioning and the overall system of internal control is not effective.</i>	<b>Yes/No/Partially</b>
<b>Is the principle present?</b>	<b>Explanation/Conclusion</b>

Source: GAO analysis of Securities and Exchange Commission information. | GAO-20-115

Part 1 of 2

**Appendix II: Template for GAO's Assessment  
of the Internal Supervisory Control Design of  
the Securities and Exchange Commission**

Individual Control Evaluation (Principle 12)				
Risk Assessment Principles		Y/N/Partial/NA		Deficiencies/Notes
<b>12. Deploys through Policies and Procedures—The organization deploys control activities through policies that establish what is expected and</b>				
<b>12.1 Establishes Policies and Procedures to Support Deployment of Management's Directives</b> —Is this control built into business processes and employees' day-to-day activities through policies establishing what is expected, and relevant procedures specifying actions?				
<b>12.2 Establishes Responsibility and Accountability for Executing Policies and Procedures</b> —Are responsibility and accountability for this control established with management (or other designated personnel) of the operating unit or function in which the relevant risks reside?				
<b>12.3 Performs in a Timely Manner</b> —Are timeframes established for performance of the control?				
<b>Other particular points of focus, if any?</b>				
Deficiencies Applicable to Principle 12				
Identification No.	Internal control deficiency description	Evaluate preliminary deficiency severity:		List internal control deficiencies related to another principle that may impact this internal control deficiency
		Preliminary Severity—Is internal control deficiency a major deficiency? (Y/N)	Comments/ Compensating Controls	
<b>Evaluate deficiencies within the principle:</b> Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.		<b>Explanation/Conclusion</b>		
<b>Evaluate the principle using judgment.</b>		<b>Yes/No/Partially</b>	<b>Explanation/Conclusion</b>	
<b>Is the principle present?</b>				

Source: GAO analysis of Securities and Exchange Commission information. | GAO-20-115

Part 2 of 2

# Appendix III: GAO Testing Results for the Design of Selected Securities and Exchange Commission Controls, Fiscal Year 2018

To assess the extent to which design of the Securities and Exchange Commission’s (SEC) internal supervisory controls was consistent with federal internal control standards and SEC guidance for designing internal controls, we reviewed 39 internal supervisory controls across the four divisions and offices in place during fiscal year 2018. We used the policies, procedures, and control objectives to determine if the controls’ designs were consistent with the standards and guidance.

**Table 10: GAO Testing Results for the Design of Selected Securities and Exchange Commission (SEC) Internal Supervisory Controls for the Division of Enforcement (Enforcement), Fiscal Year 2018**

SEC control description	Control design addresses objectives and risks?	Control implemented through policies?	GAO findings
<p>The decision to close tips, complaints, or referrals (TCR) in Office of Market Intelligence (OMI) using a no further action disposition in the TCR System is a two-step process by which first, an OMI staffer makes a no further action recommendation, which is accepted or rejected by a second OMI staffer (the “reviewer”). The first OMI staffer makes a no further action recommendation in a workflow comment and assigns the relevant work item to the reviewer. The reviewer—who is an attorney, accountant or subject-matter expert—reviews both the TCR and the no further action recommendation. If the reviewer agrees with the recommendation, he/she will agree in a workflow comment and choose the appropriate disposition category to close the work item. If the reviewer does not agree with the recommendation, he/she will describe the reason for disagreement in a workflow comment and assign the TCR to a third OMI staffer for further triage or assign to another group for additional triage. This control is complemented by (1) control OPRISK-C-ENF-8030, under which the Chief of OMI (or designee) reviews the closure of TCRs within OMI by user id and identifies any TCRs closed by a user id not authorized to close TCRs, and (2) control OPRISK-C-8031, which is an audit of the closure recommendations made within OMI.</p>	Yes	Yes	No deficiencies identified.

**Appendix III: GAO Testing Results for the  
Design of Selected Securities and Exchange  
Commission Controls, Fiscal Year 2018**

<b>SEC control description</b>	<b>Control design addresses objectives and risks?</b>	<b>Control implemented through policies?</b>	<b>GAO findings</b>
Each month the OMI Chief (or designee) reviews a “Monthly Disposition” report provided by the Center for Risk and Quantitative Analytics to identify any instances in which a TCR has been closed by a staffer who may not have been authorized to close a TCR. For any such instance, OMI’s Chief will notify the relevant OMI manager and either obtain an assurance that the TCR was closed under appropriate authorization, or request that the Assistant Director take whatever remedial action is necessary, including alerting the closing party to the unauthorized closure, memorializing the circumstances of the closure, or generating a new TCR. (Note: List of staff authorized to close TCRs is maintained by the OMI Chief or designee.) <sup>a</sup>	Yes	No	No requirement is established to document the execution of the control, such as a requirement to document that a review of the “Monthly Disposition” report has been conducted or a requirement to document any follow-up actions taken as a result of the review.
Each quarter, OMI management, with the assistance of the Division of Economic and Risk Analysis conducts a stratified random sample of TCRs closed by OMI staff to confirm whether (1) there was a two-person review, (2) the closure recommendation was supported by a sufficient description, (3) the appropriate disposition category was chosen in the TCR system, and (4) the closure decision was appropriate. OMI management and senior counsel review the sample selection and document the results in an Excel file. Any errors identified through testing are addressed and documented in the TCR system, as appropriate, and with input from the Division of Economic and Risk Analysis, the error rate and sample precision are calculated. The results are communicated to the Chief of OMI, who determines if the sample precision is acceptable.	Yes	Yes	No deficiencies identified.
OMI managers receive weekly reports of TCRs that have remained in OMI, or in an individual OMI staff member’s queue, for 30 days or more. OMI’s Chief or designated staff instructs OMI’s managers to focus on TCRs aged 40 days or more, to avoid reaching the control’s 60-day threshold.	Yes	No	No requirement is established to document the execution of the control, such as a requirement to document that a review of the weekly report has been conducted.

**Appendix III: GAO Testing Results for the  
Design of Selected Securities and Exchange  
Commission Controls, Fiscal Year 2018**

<b>SEC control description</b>	<b>Control design addresses objectives and risks?</b>	<b>Control implemented through policies?</b>	<b>GAO findings</b>
<p>Each week an aging report of TCRs assigned from OMI to each Enforcement Division investigatory group in the Home Office, the Regional Offices, and the Specialized Units is sent to the Chief of OMI. The report is also sent to certain staff in each investigatory group.</p> <p>OMI staff—on behalf of OMI’s Chief and management—send an email each week to any staff and the associated Senior Officer for each TCR that has aged more than 30 business days from the date of assignment and contains no note to justify the reason for the delay in resolving the TCR.</p> <p>OMI staff—on behalf of OMI’s Chief and management—also notify the relevant Senior Officer and the Office of the Director of Enforcement of any TCR that has appeared as an aged TCR for more than 4 consecutive weeks.</p>	Yes	Yes	No deficiencies identified.
<p>Enforcement actions are approved by the Commission through a closed Commission meeting, by seriatim consideration, or by Duty Officer consideration.</p>	Yes	Yes	No deficiencies identified.
<p>The Division maintains a list of ongoing high-priority investigations, which consists of a “top 5 list” from each Senior Officer. This list is reviewed and updated each quarter by the applicable Senior Officer.</p>	Yes	No	No description exists of the mechanism through which the Top 5 list is reviewed and updated and no description exists of how the execution of the control should be documented.
<p>Investigative plans are required for each ongoing investigation (with some exceptions for certain standardized investigations). On a quarterly basis, investigative plans are reviewed by the Assistant Directors with the investigative team.</p>	Yes	Yes	No deficiencies identified.
<p>The Quarterly Case Review Checklist identifies all cases assigned to the Senior Officer’s group or office. The checklist is reviewed and certified by the Senior Officer as evidence of review.</p>	Yes	Yes	No deficiencies identified.
<p>Enforcement maintains a central repository on its intranet site for storing procedures and other related Enforcement documents, and has implemented a process to review and edit guidance on a periodic basis so that it is current and accurate.</p>	Yes	Yes	No deficiencies identified.

Source: GAO analysis of SEC information. | GAO-20-115

<sup>a</sup>According to SEC staff, this control was automated at the beginning of fiscal year 2019 and the control objective is now achieved through access controls on the TCR system. Since the scope of our review included controls from fiscal year 2018, we did not review the 2019 update to this control.

**Appendix III: GAO Testing Results for the  
Design of Selected Securities and Exchange  
Commission Controls, Fiscal Year 2018**

**Table 11: GAO Testing Results for the Design of Selected Securities and Exchange Commission (SEC) Internal Supervisory Controls for the Office of Credit Ratings (OCR), Fiscal Year 2018**

<b>SEC control description</b>	<b>Control design addresses objectives and risks?</b>	<b>Control implemented through policies?</b>	<b>GAO findings</b>
The Assistant Director prepares an examination plan and monitors it for compliance by all the nationally recognized statistical ratings organizations (NRSRO) examination teams.	Yes	Yes	No deficiencies identified.
The Risk Assessment Group considers significant issues in the industry, findings from prior examinations, and industry news to create a list of mandatory and optional risks for the examination teams to consider. The examination teams then conduct individualized risk assessments and document the scope of each examination in a scope memorandum. Scope memorandums are then reviewed by the relevant Branch Chief or Lead Examiner and approved by the Assistant Director.	Yes	Yes	No deficiencies identified.
Examination worksheets are prepared by examiners and approved by a Branch Chief or Assistant Director.	Yes	Yes	No deficiencies identified.
Examination summary letters are reviewed and approved (signed) by the Assistant Director. The letters are also subject to iterative reviews by a Branch Chief or Lead Examiner (or both), and the Assistant Director.	Yes	Yes	No deficiencies identified.
Approvals to close are reviewed and approved by the Assistant Director.	Yes	Yes	No deficiencies identified.
NRSRO examination findings and recommendations are memorialized and tracked via the examination summary letters. For annual examinations, all scope memorandums should contain every finding and recommendation from the prior year.	Yes	Yes	No deficiencies identified.
The annual "Staff's Examination of NRSROs" report is (1) included in the examination plan, which is monitored by the Assistant Director, and (2) primarily drafted by Regulatory Counsel.  Note: OCR does not control whether and when the Commission releases the annual NRSRO examination report. The Commission approves the release of the report. These decisions impact whether and when the report is made available to the public.	Yes	Yes	No deficiencies identified.
After drafting the annual report it is circulated to OCR staff for review and comment. Several other internal divisions and offices also review and comment on the report. The OCR Director reviews and comments on the report and has final approval prior to submission to the Commission.	Yes	Yes	No deficiencies identified.
All incoming tips, complaints, or referrals (TCR) are reviewed by OCR within the prescribed 45-day period for disposition and such disposition to be approved by the Assistant Director. OCR coordinates TCRs with the Division of Enforcement, as necessary.	Yes	No	Control does not establish a requirement to document review and approval.
A direct supervisor provides staff with feedback through a formal performance review process. The performance review is signed in accordance with SEC policies and procedures.	Yes	Yes	No deficiencies identified.

**Appendix III: GAO Testing Results for the  
Design of Selected Securities and Exchange  
Commission Controls, Fiscal Year 2018**

<b>SEC control description</b>	<b>Control design addresses objectives and risks?</b>	<b>Control implemented through policies?</b>	<b>GAO findings</b>
OCR has a Program Manual that contains up-to-date policies and procedures that have been approved by the Managing Executive (or Director of OCR, as needed). The manual (including all revisions) can be found on the applicable SharePoint. Additionally, emails are sent to staff to inform them of revisions in real time.	Yes	No	Control does not establish a requirement to document review and approval.
The Assistant Director monitors the examination completion deadline of 180 days. The examination due date and current status is tracked automatically within the applicable information management system.	Yes	No	Control does not establish a requirement to document review and approval. Control also does not establish time frames for how often the reviews should take place.
Extensions to the 180-day examination completion period are approved by the Director after providing notice to the Chairman.	Yes	Yes	No deficiencies identified.

Source: GAO analysis of SEC information. | GAO-20-115

**Appendix III: GAO Testing Results for the  
Design of Selected Securities and Exchange  
Commission Controls, Fiscal Year 2018**

**Table 12: GAO Testing Results for the Design of Selected Securities and Exchange Commission (SEC) Internal Supervisory Controls for the Office of Compliance Inspections and Examinations (OCIE), Fiscal Year 2018**

<b>SEC control description</b>	<b>Control design addresses objectives and risks?</b>	<b>Control implemented through policies?</b>	<b>GAO findings</b>
Policy proposals/changes are approved via OCIE's governance process. OCIE Office of Chief Council for Compliance guides policy proposals through the process, and the Director approves all changes or new policies and procedures	Yes	Yes	No deficiencies identified.
National Examination Program (NEP) managers review and approve examination work at four key points in the examination cycle. (Examination managers or higher may approve pre-field work and post-field work, Assistant Directors or higher must approve disposition letters and examination closing.)	Yes	Yes	No deficiencies identified.
Regional Office-specific procedures are used for identifying examination needs and staff members available for assignment. Generally, Assistant Directors coordinate examination staffing. Staffing decisions are made by management and documented at the pre-fieldwork approval stage in OCIE's tracking system. The tracking system allows for examination managers or higher to approve the pre-fieldwork of an examination but also generate a notification of approval that is sent to the assigned Assistant Director. After the examination is created, only the lead examiner, examination manager, or Assistant Director can make staffing changes to the examination team in the system.	Yes	Yes	No deficiencies identified.
Management conducts quarterly reviews within 30 days following the close of the calendar quarter of examinations that have been open for 30 or more days. The Assistant Director(s) update the Quarterly Management Review spreadsheets and upload them to the internal examination system.	Yes	Yes	No deficiencies identified.
Prior to giving final approval of an examination, the assigned supervisor is responsible for ensuring that findings are documented and reconciled to risk and review area documentation and supporting documents are included in the examination tracking system. Assistant Director approval of the examination in the tracking system documents the review.	Yes	Yes	No deficiencies identified.
Prior to closing the examination, the Assistant Director ensures that appropriate examination tracking information has been entered into the tracking system and that documents, including hard copies, are labeled and stored properly. Assistant Director approval is documented by the closing of the examination in the system.	Yes	Yes	No deficiencies identified.
The NEP training officer meets monthly with NEP training staff and contractors to discuss potential training needs and requests. OCIE's training officer reviews the evaluations of the training.	Yes	No	Control does not establish a requirement to document control execution.

**Appendix III: GAO Testing Results for the Design of Selected Securities and Exchange Commission Controls, Fiscal Year 2018**

<b>SEC control description</b>	<b>Control design addresses objectives and risks?</b>	<b>Control implemented through policies?</b>	<b>GAO findings</b>
Training staff track enrollment and completion of new examiner training, and follow up with examiners as necessary by email.	Yes	No	Control does not establish procedures for identifying or tracking training progress of new employees. Control does not establish a requirement to document control execution. Control does not set any time frames for control execution. In its fiscal year 2018 internal supervisory control testing, OCIE identified these same control design issues. According to OCIE staff, these design issues were subsequently addressed in fiscal year 2019.

Source: GAO analysis of SEC information. | GAO-20-115

**Table 13: GAO Testing Results for the Design of Selected Securities and Exchange Commission (SEC) Internal Supervisory Controls for the Division of Corporation Finance (Corporation Finance), Fiscal Year 2018**

<b>SEC control description</b>	<b>Control design addresses objectives and risks?</b>	<b>Control implemented through policies?</b>	<b>GAO findings</b>
Assistant Directors regularly monitor progress toward completion of reviews mandated by the Sarbanes-Oxley Act of 2002.	Yes	Yes	No deficiencies identified.
An audit of the Sarbanes-Oxley list occurs prior to providing it to the Division.	Yes	Yes	No deficiencies identified.
Managers approve removals from the Sarbanes-Oxley list for reasons other than performance of a review.	Yes	Yes	No deficiencies identified.
Initial screening recommendations are reviewed by a second staff member, unless the initial screener is an Assistant Director, Senior Assistant Chief Accountant, or Branch Chief.	Yes	Yes	No deficiencies identified.
Filings are reviewed by a second staff member, unless the initial examiner is an Assistant Director, Senior Assistant Chief Accountant, or Branch Chief.	Yes	Yes	No deficiencies identified.
Assistant Directors monitor compliance with internal policy to issue comments within 30 days of the filing of registration statements.	Yes	No	No written description exists of what mechanism (a report) is to be reviewed, when or how often a report is to be generated, or what follow-up actions are to be taken. Also, control does not establish a requirement to document control execution.

**Appendix III: GAO Testing Results for the  
Design of Selected Securities and Exchange  
Commission Controls, Fiscal Year 2018**

<b>SEC control description</b>	<b>Control design addresses objectives and risks?</b>	<b>Control implemented through policies?</b>	<b>GAO findings</b>
Assistant Directors and Office Chiefs monitor compliance with internal policy to process confidential treatment requests within the timing guidelines in the processing guide for such requests.	Yes	No	No written description exists of what follow-up actions are to be taken. Also, control does not establish a requirement to document control execution.
Filings are reviewed by a second staff member, unless the initial examiner is an Assistant Director, Senior Assistant Chief Accountant, or Branch Chief.	Yes	Yes	No deficiencies identified.

Source: GAO analysis of SEC information. | GAO-20-115

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# Appendix IV: Template for GAO's Assessment of the Operation of Internal Supervisory Controls by the Securities and Exchange Commission

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This appendix illustrates the template we used to assess the operation of selected Securities and Exchange Commission internal supervisory controls. For each control, we compared control activity descriptions, including policy and procedure documents to determine whether selected controls operated as intended.

**Appendix IV: Template for GAO's Assessment  
of the Operation of Internal Supervisory  
Controls by the Securities and Exchange  
Commission**

**Figure 5: GAO Template for Assessing the Operation of SEC Internal Supervisory Controls**

GAO Scorecard for Testing of SEC Control Operation - Case File Review			
Control Overview			
Division/Office	Control ID (SEC)	Link to Objective 3 Design Scorecard	Notes on Control
SEC Risk		SEC Risk Level (low, medium, high)	SEC 961-related? (Y/N)
Known Deficiency? (Y/N)	SEC Control Objective		
SEC Control Description (from Obj. 3 Scorecard & Design Documents)			
Testing Results			
Test Conducted by (Name/Date)	Number of cases reviewed (sample)	Description of case file documentation and type of testing being performed	Source for Case File Sample
Secondary Test Conducted by (Name/Date)			
Was this control operating as intended? (Y/N)	Result / Explanation	Number of Cases where control operating as intended	Number of exceptions found
Yes / No / Partially			
		Additional Notes	

Source: GAO analysis of Securities and Exchange Commission information. | GAO-20-115

# Appendix V: GAO Testing Results for Selected Securities and Exchange Commission Controls, Fiscal Year 2018

As part of our review, we tested 18 internal supervisory controls across four divisions and offices at the Securities and Exchange Commission (SEC) to determine whether they operated as intended. Controls were assessed using SEC’s control activity descriptions, including related policy and procedure documents. For controls that operated as intended, SEC provided documentation demonstrating that all control activities were executed. We considered controls to have partially operated as intended if the documentation supported that only some control activities were executed or if at least one control activity did not operate as intended, but the overall control was executed. We did not identify any controls that did not operate as intended, but this would have applied to controls for which we received sufficient documentation and the divisions and offices did not execute all control activities. Controls that we could not assess lacked sufficient documentation that would have enabled us to determine whether they operated as intended.

**Table 14: GAO Testing Results for Selected Securities and Exchange Commission (SEC) Division of Enforcement (Enforcement) Internal Supervisory Controls, Fiscal Year 2018**

SEC control description	GAO testing result	GAO findings
Enforcement maintains a list of ongoing high-priority investigations, which comprises a “top 5 list” from each Senior Officer. This list is reviewed and updated each quarter by the applicable Senior Officer.	Operated as intended	All control activities were executed.
Investigative plans are required for each ongoing investigation (with some exceptions for certain standardized investigations). On a quarterly basis, investigative plans are reviewed by the Assistant Directors with the investigative team.	Operated as intended	All control activities were executed.
The Quarterly Case Review Checklist identifies all cases assigned to the Senior Officer’s group or office to ensure investigations are tracked and monitored. The checklist is reviewed and certified by the Senior Officer as evidence of review.	Operated as intended	All control activities were executed.
Enforcement maintains a central repository on its intranet site for storing procedures and other related Enforcement documents, and has implemented a process to review and edit guidance on a periodic basis so that it is current and accurate.	Operated as intended	All control activities were executed.

Source: GAO analysis of SEC information. | GAO-20-115

**Appendix V: GAO Testing Results for Selected Securities and Exchange Commission Controls, Fiscal Year 2018**

**Table 15: GAO Testing Results for Selected Securities and Exchange Commission (SEC) Office of Credit Ratings (OCR) Internal Supervisory Controls, Fiscal Year 2018**

<b>SEC control description</b>	<b>GAO testing result</b>	<b>GAO findings</b>
The Risk Assessment Group considers significant issues in the industry, findings from prior examinations, and industry news to create a list of mandatory and optional risks for the examination teams to consider. The examination teams then conduct individualized risk assessments and document the scope of each examination in a scope memorandum. Scope memorandums are then reviewed by the relevant Branch Chief or Lead Examiner and are approved by the Assistant Director.	Operated as intended	All control activities were executed.
Examination worksheets are prepared by examiners and approved by a Branch Chief or Assistant Director.	Operated as intended	All control activities were executed.
Examination summary letters are reviewed and approved (signed) by the Assistant Director. The letters are also subject to iterative reviews by a Branch Chief or Lead Examiner (or both), and the Assistant Director.	Operated as intended	All control activities were executed.
The annual report is circulated after drafting to OCR staff for review and comment. Several other internal divisions and offices also review and comment on the report. The OCR Director reviews and comments on the report and has final approval prior to submission to the Commission.	Operated as intended	All control activities were executed.
All incoming tips, complaints, or referrals (TCR) are reviewed by OCR within the prescribed 45-day period for disposition and such disposition is to be approved by the Assistant Director. OCR coordinates TCRs with the Division of Enforcement, as necessary.	Operated as intended	All control activities were executed.

Source: GAO analysis of SEC information. | GAO-20-115

**Appendix V: GAO Testing Results for Selected  
Securities and Exchange Commission  
Controls, Fiscal Year 2018**

**Table 16: GAO Testing Results for Selected Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE) Internal Supervisory Controls, Fiscal Year 2018**

<b>SEC control description</b>	<b>GAO testing result</b>	<b>GAO findings</b>
Policy proposals/changes are approved via OCIE's governance process. OCIE's Office of Chief Counsel for Compliance guides policy proposals through the process, and the Director approves all changes or new policies and procedures	Partially operated as intended	OCIE provided documentation on the tracking of policy changes and announcements of final policy updates to staff, but it did not provide documentation demonstrating that officials reviewed and approved all policy changes.
National Examination Program managers review and approve examination work at four key points in the examination cycle. (Examination managers or higher may approve pre-field work and post-field work, Assistant Directors or higher must approve disposition letters and examination closing.)	Operated as intended	All control activities were executed.
Management conducts quarterly reviews within 30 days following the close of the calendar quarter of examinations that have been open for 30 or more days. The Assistant Director(s) update the Quarterly Management Review spreadsheets and upload them to the internal examination system.	Operated as intended	All control activities were executed.
Prior to giving final approval of an examination, the assigned supervisor is responsible for ensuring that findings are documented and reconciled to risk and review area documentation and supporting documents are included in the examination tracking system. Assistant Director approval of the examination in the tracking system documents the review.	Partially operated as intended	OCIE provided documentation demonstrating that all examinations were closed and approved by an Assistant Director. However, 20 percent of examinations in our sample were not approved within the 30-day deadline as indicated in the related policy documents for this control. <sup>a</sup>
Training staff track enrollment and completion of new examiner training, and follow up with examiners as necessary by email.	Unable to Assess	OCIE did not provide documentation on the tracking of training for new examiners or that follow-ups occurred when training was not completed. OCIE failed this control's design and operation during its section 961 assessment process for fiscal year 2018. OCIE officials told us they subsequently developed procedures for obtaining information on new employees and ensuring their training was completed.

Source: GAO analysis of SEC information. | GAO-20-115

<sup>a</sup>We reviewed a generalizable sample of cases for this control. This estimate has a 95 percent confidence interval that extends from 11 to 32 percent.

**Appendix V: GAO Testing Results for Selected  
Securities and Exchange Commission  
Controls, Fiscal Year 2018**

**Table 17: GAO Testing Results for Selected Securities and Exchange Commission (SEC) Division of Corporation Finance (Corporation Finance) Internal Supervisory Controls, Fiscal Year 2018**

<b>SEC control description</b>	<b>GAO testing result</b>	<b>GAO findings</b>
Initial screening recommendations are reviewed by a second staff member, unless the initial screener is an Assistant Director, Senior Assistant Chief Accountant, or Branch Chief.	Operated as intended	All control activities were executed.
Filings are reviewed by a second staff member, unless the initial examiner is an Assistant Director, Senior Assistant Chief Accountant, or Branch Chief.	Operated as intended	All control activities were executed.
Assistant Directors monitor compliance with internal policy to issue comments within 30 days of the filing of registration statements.	Unable to assess	Corporation Finance did not provide documentation demonstrating that staff actively monitored compliance with internal policy. Corporation Finance provided emails from staff performing control testing to supervisors asking them to confirm they monitored these activities throughout the year. However, we did not receive documentation indicating that supervisors monitored or tracked staff compliance with internal policy.
Assistant Directors and Office Chiefs monitor compliance with internal policy to process confidential treatment requests within the timing guidelines in the processing guide.	Unable to assess	Corporation Finance did not provide documentation demonstrating that staff actively monitored compliance with internal policy. Corporation Finance provided emails from staff performing control testing to supervisors asking them to confirm they monitored these activities throughout the year. However, we did not receive documentation indicating that supervisors monitored or tracked staff compliance with internal policy.

Source: GAO analysis of SEC information. | GAO-20-115

# Appendix VI: Comments from the Securities and Exchange Commission



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

December 5, 2019

Michael E. Clements  
Director  
Financial Markets and Community Investment  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Clements:

Thank you for your report, *Securities and Exchange Commission: Systematically Assessing Staff Procedures and Enhancing Control Design Would Strengthen Oversight Activities* (GAO-20-115). We appreciate having the benefit of the GAO's review of the Securities and Exchange Commission's (SEC) efforts under Section 961 of the Dodd-Frank Act of 2010 to maintain effective internal supervisory controls and procedures applicable to staff in performing examinations of registered entities, conducting enforcement investigations, and reviewing corporate financial securities filings.

I am pleased that the GAO found that the SEC's control framework reflects federal standards and all evaluated controls were designed consistent with these standards, but I recognize that the evaluation also identified a number of opportunities for improvement. In particular, the report includes five recommendations that the GAO believes would enhance the agency's ability to monitor and evaluate the effectiveness of internal supervisory controls, particularly through improved documentation, policies, and procedures. We concur with, and I have asked the staff to take appropriate management action to address, all five recommendations, which we agree will help to further enhance our oversight over the effectiveness of these critical functions.

Thank you for the consideration that you and your staff have shown our agency. If you have any questions, please don't hesitate to contact me at (202) 551-2100 or the SEC's Chief Operating Officer, Ken Johnson, at (202) 551-2200.

Sincerely,

A handwritten signature in blue ink, appearing to read "JC", is written over the typed name of Jay Clayton.

Jay Clayton  
Chairman

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# Appendix VII: GAO Contact and Staff Acknowledgments

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## GAO Contact

Michael Clements at (202) 512-8678 or [clementsm@gao.gov](mailto:clementsm@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Kevin Averyt (Assistant Director), Christopher Ross (Analyst in Charge), Aaron A. Colsher, Justin Fisher, Efrain Magallan, Marc Molino, Kirsten Noethen, Barbara Roesmann, and Farrah Stone made key contributions to this report.

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